



**4th Annual EuroMed Conference of the  
EuroMed Academy of Business**

**Business Research Challenges  
in a Turbulent Era**

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## **4th Annual EuroMed Conference of the EuroMed Academy of Business**

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### **Business Research Challenges in a Turbulent Era**

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All full papers and abstracts submitted to the EMRBI Conference are subject to an international peer reviewing process, using subject specialists selected because of their expert knowledge in the specific areas.

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## FOREWORD

The Annual Conference of the EuroMed Academy of Business aims to provide a unique international forum to facilitate the exchange of cutting-edge information through multidisciplinary presentations of new challenge in global business with special emphasis on European and Mediterranean countries. This is from an Academic, Research and Professional perspective.

It is acknowledged that the conference has established itself as one of the major conferences of its kind in the EuroMed region, in terms of size, quality of content, and standing of attendees. Many of the papers presented contribute significantly to the business knowledge base.

The conference attracts hundreds of leading scholars from leading universities and principal executives and politicians from all over the world with the participation or intervention of Presidents, Prime Ministers, Ministers, Company CEOs, Presidents of Chambers, and other leading figures.

This year the conference attracted over 200 people from over 45 countries. Academics, practitioners, researchers and Doctoral students throughout the world submitted original papers for conference presentation and for publication in this Book. All papers and abstracts were double blind reviewed. The result of these efforts produced empirical, conceptual and methodological papers and abstracts involving all functional areas of business with a special focus on European and Mediterranean aspects.



## ACKNOWLEDGEMENT

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Special thanks goes to the Conference Chairs (Dr Vagelis Tsoukatos and Professor Fotini Voulgari) and the Faculty of the Agios Nikolaos Campus of TEI of Crete (Dr Christos Floros, Dr Yannis Dimotikalis, Dr Manolis Mavrakis, Dr Stelios Papadakis, Dr Yannis Aikaterinidis, George Arakadakis and Michalis Koutsakis) and the Conference Manager and Master of Ceremony (Dr Manolis Sisamakis) for accomplishing an excellent job. We also express our appreciation and gratitude to Dr Yioula Melanthiou and Yiola Michael (School of Business, University of Nicosia) for their endless support.

It is acknowledged that a successful conference could not be possible without the special co-operation and care of the Track Chairs and Reviewers for reviewing the many papers that were submitted to this conference. Special thanks to the Session Chairs and Paper Discussants for taking the extra time to make this conference a real success.

Further, we would like to thank the local Chamber of Commerce and Industry and the Municipal Community of Elounda, for all their help and support, as well as all our Sponsors and Supporters namely: Agios Nikolaos Campus of TEI of Crete, University of Nicosia in Cyprus, the College of Management Academic Studies in Israel, Les Roches- Gruyere, University of Applied Sciences in Switzerland, the Agricultural Bank of Greece, the National Bank of Greece, MTN, ExpoGlobalOnline.com and Emerald publishing company. Our Sponsors of Communication Mr George Syligardos, Anatoly, Patris and Nea Kriti Newspapers as well as the Creta Channel TV and 104.4 FM are also greatly thanked.

The last but not the least important acknowledgment goes to all those who submitted their work to be considered for presentation at the conference.

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## **A FINANCIAL STUDY OF ENTERPRISES AND COOPERATIVES BELONGING TO THE FRESH FRUIT SECTOR: A TYPOLOGICAL ANALYSIS FOR CENTRAL MACEDONIA**

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### **Abstract**

The fruit and vegetable trade has developed into one of the most dynamic sectors of the international market for agricultural products, due to the globalization of commerce and the changes in the food market all over the world. It is the most important agricultural sector in Greece. The aim of the present paper is to study and evaluate the economic status of the agricultural cooperative organisations (ACO) which are active in the fresh fruit trade sector, and to compare them with relevant private enterprises, which constitute their main competitors. More specifically, the research focuses on two groups of business units, agricultural cooperatives and private enterprises that are involved in the fresh fruit and vegetable sector and are based in Central Macedonia. The results from the presentation and comparison of these two different categories are then used to define the results of the different policies they adopt. Finally, an attempt is made to identify the factors that affect their efficient operation and also the problems they are faced with.

In order to study and evaluate the economic status of the cooperatives in relation to private enterprises, the financial statement analysis method with ratios was used. The results of the comparison between cooperatives and private enterprises can facilitate our understanding of the differing policies applied by each business category; they also provide insight into how the former can best adapt to the new conditions of the market. Based on specific financial parameters, a typological classification -a grouping of the business units in the selected sample- was carried out, which highlighted their level of competitiveness.

**Keywords:** Fresh fruit and vegetable Sector, Financial Study, Financial Ratios Agricultural Cooperative Organizations, Typological Analysis.

### **Introduction**

Fruit and vegetables have internationally evolved into one of the most dynamic sectors of agricultural production (Diop and Jaffee, 2005). Global production amounts to 500 million

tons and its value is estimated at approximately 50 billion euros per year. The greatest importer of fruit in the world is China, followed by India and the European Union (Kalafati, 2007).

In Greece, the fresh fruit and vegetable sector is the most significant agricultural sector nowadays. The Greek fruit production volume amounts to 3.3 million tons and the gross domestic product value is estimated at 1840 million € (NSSG, 2009). The dynamic presence of the sector is also proven by the fact that in recent years, the value of fruit and vegetables has steadily equalled 30% approximately of the gross value of the total agricultural production of Greece; this is a particularly important percentage that can be compared with the percentage share of the whole stockbreeding sector of Greece (NSSG, 2009; ICAP, 2010). In addition, in recent years, the sector has presented the second highest export volume in agricultural products, and a continuous rise in figures. In 2008, the sector's exports amounted to 258 million euros in value, and 387 thousand tons in volume. The main destination countries are Russia, Germany, Romania, Poland, the Czech Republic and Hungary (Exporters' Association, 2008). A decisive role in this development has been played by the significant progress observed in the production methods, post-collection management, and processing of products, along with the growth in logistics technologies – in combination with the increased investments in the sector (Diop and Jaffee, 2005).

The sector in Greece is characterized by the co-existence of a large number of enterprises and cooperatives, which is mainly due to the fragmentation of primary production, and the relatively low level of investment required for a business to enter the sector (Hamourga, 2010). The production facilities of the sector's businesses are located close to the production area of the products intended for trade. Consequently, a high level of concentration is observed in Central Macedonia, which is the Greek region that presents the highest fresh fruit production volume. This region produces approximately 70% of the total Greek fruit and vegetable production. In addition, after the region of Attica (where Athens is located), the largest number of businesses involved in the wholesale trade of fruit and vegetables are located in the region of Central Macedonia. According to Tables 1 and 2, there are 696 businesses in this region, with total sales that exceed 500 million Euros (22% of the total sales in Greece in wholesale trade), and 747 businesses with total sales of approximately 65 million in retail trade (13.8% of the total sales in Greece) (NSSG, 2006).



Table 1. Geographical distribution of businesses active in the wholesale trade of fruit and vegetables (2005)

REGION	No of businesses	Percentage%	Sales in million €	Percentage %
Eastern Macedonia and Thrace	143	4,7	102.219.794,57	4,4
Attica	704	23,2	737.196.919,23	32,0
Northern Aegean	31	1,0	17.898.676,57	0,8
Western Greece	301	9,9	205.522.540,99	8,9
Western Macedonia	38	1,3	15.948.596,40	0,7
Epirus	72	2,4	34.703.941,52	1,5
Thessaly	179	5,9	115.316.800,19	5,0
Ionian islands	61	2,0	22.901.848,59	1,0
Central Macedonia	696	22,9	506.003.514,52	22,0
Crete	250	8,2	170.384.331,13	7,4
Southern Aegean	58	1,9	37.648.614,11	1,6
Peloponnese	387	12,7	265.567.176,10	11,5
Stereia Ellada	118	3,9	72.162.050,45	3,1
TOTAL	3.038	100	2.303.474.804,37	100

Source: NSSG, Business Register 2005

Agricultural cooperatives play a substantial role in the trade of fresh fruit, since they gather and distribute major quantities of the domestic production, primarily on behalf of small-scale producers who are their members (Sergaki and Semos, 2006). The most dynamic cooperatives, by using the necessary technological equipment and modern processing and packaging-standardization methods for their production, in accordance with the specifications of the required quality assurance systems, and through their participation in various promotional activities for their products, have managed to expand their presence both in the domestic and the international market, by responding to its demands in a satisfactory manner, despite their organizational weaknesses and the adverse economic conditions.

Table 2. Geographical distribution of businesses active in the retail trade of fruit and vegetables in specialized stores

REGION	No of businesses	Percentage%	Sales in million €	Percentage%
Eastern Macedonia and Thrace	272	5,8	25.120.145,49	5,4
Attica	1.578	33,8	165.949.117,60	35,6
Northern Aegean	101	2,2	11.471.896,56	2,5
Western Greece	314	6,7	25.982.421,93	5,6
Western Macedonia	131	2,8	8.047.743,73	1,7
Epirus	195	4,2	19.590.298,82	4,2
Thessaly	389	8,3	27.575.826,88	5,9
Ionian islands	123	2,6	14.836.418,82	3,2
Central Macedonia	747	16	64.453.339,57	13,8
Crete	153	3,3	22.789.852,19	4,9
Southern Aegean	140	3	27.570.899,46	5,9
Peloponnese	298	6,4	28.959.324,91	6,2
Stereia Ellada	224	4,8	23.970.094,26	5,1
TOTAL	4.665	100	466.317.380,20	100

Source: NSSG, Business Register 2005

Based on the dynamic growth expected in this sector over the following years, the competition that exists between agricultural cooperatives and private enterprises involved in the wholesale trade of fruit and vegetables in Central Macedonia, and the importance of this sector for this area, it is interesting to compare the economic status of the businesses involved, in order to arrive at useful conclusions regarding the structure of the sector. Consequently, the main objective of this paper is to evaluate the performance and financial status of these two strategic groups: Agricultural Cooperatives and Private Enterprises that specialize in the trade of fresh fruit (kiwis, pears, apricots, plums, cherries, lemons, mandarins, apples, melons, oranges, peaches and nectarines) and vegetables in Northern Greece. Additionally, this comparison is very important as it shows whether agricultural cooperatives or private enterprises are best positioned in the fresh fruit and vegetable market chain and can also firstly point out valuable conclusions about the different marketing policies followed by each group and, secondly, provide information as to how these businesses can best adapt to the new market conditions.

The aim of the present paper is to study and evaluate the economic status of the agricultural cooperative organisations (ACO), which are active in the fresh fruit trade sector, and to compare them with private enterprises which develop similar activities, and are their primary competitors. More specifically, the study focuses on two groups of business units: agricultural cooperatives of various levels and private enterprises of various forms (S.A., sole proprietorship etc.) which are based in Central Macedonia. From an analysis of the financial profile of the business units belonging to the two different categories, an attempt is made to determine the efficiency of their operations and the problems they are faced with. Finally, we proceed with their typological analysis, irrespectively of their initial classification (as private enterprises or agricultural cooperative organisations), in order to determine their level of competitiveness.

## **Materials and Methods**

In order to collect the data for the implementation of the research, case studies were used from selected businesses in this sector. The case study method – using several cases in particular – is constantly gaining ground, since it allows for an analytical, in-depth approach of the research object, and also leads to richer and more detailed data, which cannot easily be collected using other methods (Miles and Huberman, 1994, Yin, 1994). Although case studies cannot lead to generalizations, they were found to be the most suitable method for this particular study, since they provide “first hand” knowledge of the actual operating conditions of the business units active in the fresh fruit trade sector (Siardos, 2005). More specifically, in order to carry out the research, twelve businesses were selected which are active in the sector under study. Six of these are agricultural cooperatives of various levels and the other six are private enterprises, active in the field of standardization-packaging and trading of fresh fruit: they also hold an important position in the market. More specifically, the research included companies in which the related activity accounts for the majority share of sales (over 50%). The selection of agricultural cooperatives of varying levels and organizational structures, and of private enterprises involved in fresh fruit and vegetable trade in the same region, aims at a comparative analysis of the way in which they operate and of the strategies they apply, given the fact that they are in competition with each other.

The necessary financial data in order to study the cooperatives and enterprises in this research were obtained from their financial statements for the period 2003 to 2008. Then, based on the relevant data, a series of financial ratios were estimated. The use of ratios is one of the most widely disseminated and dynamic methods of financial analysis (Niarchos, 2004). In the present study, ratios were calculated pertaining to the Liquidity, Risk and Efficiency of the units' operation, which are considered by many authors to be suitable when aiming to delineate the course and viability of a business (Oustabasidis et al., 2000). The indicators were initially calculated for each business. Then the mean of the ratios was calculated for the group

of agricultural cooperatives and for the group of private enterprises (for the specific time period). Finally, the means of both groups were compared.

The ratios selected to describe the financial profile of the business units are:

1. *Liquidity ratios*. They are used to determine both the short-term position of a business, and its ability to respond to its short-term liabilities (Dickerson et al., 1995; Weston & Brigham, 1997). More specifically, the a) Current liquidity ratio and b) Quick liquidity ratio were selected.

2. *Activity ratios*. They are used to measure how efficient a business is in making use of its assets (Oustabasidis et al., 2000; Downey and Trocke, 1981; Dickerson et al., 1995; Weston & Brigham, 1997). More specifically, the following ratios were used: a) Inventory Turnover Ratio, b) Receivable turnover ratio, c) Asset Turnover Ratio.

3. *Profitability ratios*. These indicators are used to measure the profitability of a business, its dynamic profits and its administrative capacity (Downey & Trocke, 1981). More specifically, the following were selected: a) Gross Profit Margin, b) Net Profit Margin c) Return on total Assets – ROA and d) Return on net worth.

4. *Financial structure and viability ratios*. These indicators estimate the long-term capacity of a business to respond to its liabilities, and the level of protection enjoyed by its creditors (Penson & Lins, 1980; Tew, 1985). From this group, the following ratios were selected: a) Ratio of owner's equity to total, b) Ratio of owner's equity to fixed assets, c) Solvency or Loan Qualifying Ratio.

Next, a blind segmentation of the enterprises and cooperatives in the study was carried out. More specifically, the initial business grouping of the enterprises and cooperatives in the research was considered to be indifferent. The objective of the research is to perform a classification – grouping of the business units in the selected sample, based on specific financial parameters, that will highlight any similarities and differences between them, irrespectively of their initial classification (private enterprises or cooperatives). For this purpose, the mean of the selected parameters was calculated for each of the 12 business units: fixed assets ( $Y_1$ ), current assets ( $Y_2$ ), inventories ( $Y_3$ ), receivables ( $Y_4$ ), total assets ( $Y_5$ ), total net worth ( $Y_6$ ) and sales ( $Y_7$ ), for the relevant periods. At a next stage, Hierarchical Cluster Analysis was applied (Aggelopoulos et al., 2009). The formulation of the clusters was carried out based on the Ward criterion, while the square of the Euclidean distance was used to measure the (dis)similarity of the business units (Hair et al., 1995; Sharma, 1996). The analysis was carried out using the statistical package SPSS ver. 15.0. Before entering the analysis, the variables were transformed into z-scores. The constancy of the results, in relation with the order of entry of the financial parameters into the analysis was checked using the software PermuCLUSTER ver.1.0 (Van der Kloot et al., 2003).

## Results

The Table 3 presents the values of the Current & Quick Liquidity Ratios for this particular period.

*Table 3. Liquidity Ratios*

<i>Current Liquidity Ratio</i>	<i>2003</i>	<i>2004</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>
<i>Cooperatives</i>	<i>1,66</i>	<i>1,89</i>	<i>1,66</i>	<i>2,68</i>	<i>1,38</i>	<i>1,36</i>
<i>Private Enterprises</i>	<i>1,03</i>	<i>1,20</i>	<i>1,23</i>	<i>1,13</i>	<i>1,27</i>	<i>1,20</i>
<i>Quick Liquidity Ratio</i>						
<i>Cooperatives</i>	<i>1,33</i>	<i>1,56</i>	<i>1,22</i>	<i>2,08</i>	<i>1,20</i>	<i>1,20</i>
<i>Private Enterprises</i>	<i>0,81</i>	<i>0,75</i>	<i>0,76</i>	<i>0,69</i>	<i>0,69</i>	<i>0,62</i>

Table 3 shows that both the cooperatives and the private enterprises present a satisfactory liquidity; the cooperatives however present better values with a significant difference, compared to the private enterprises for the whole period under study. The predominance of cooperatives shows that, compared to private enterprises, they can respond more easily to their current liabilities, fixed expenses, claimed interest and dividends, and can also better respond to any current losses. As regards the Quick Liquidity indicator, the ACO also present steadily satisfactory values that are higher than one, in contrast to the private sector enterprises that are lagging far behind, presenting values for this indicator that are lower than one, and a downward trend overall. In general, ACO portray a sound current financial status, since their quick assets more than cover their current liabilities. This is not the case for private sector enterprises, for which the relevant indicator presents values lower than one, which shows that these enterprises depend on their future sales in order to ensure adequate liquidity.

The Table 4 presents the Activity ratios.

Table 4. Activity ratios

<i>Inventory Turnover Ratio</i>	2003	2004	2005	2006	2007	2008
<i>Cooperatives</i>	19,44 (19)	22,66 (16)	26,87 (14)	15,19 (24)	24,22 (15)	26,97 (14)
<i>Private Enterprises</i>	18,16 (20)	16,31 (22)	10,24 (36)	7,50 (49)	7,41 (49)	7,20 (51)
<i>Receivable turnover ratio</i>						
<i>Cooperatives</i>	2,66 (137)	2,70 (135)	2,59 (141)	2,83 (129)	2,80 (130)	2,83 (129)
<i>Private Enterprises</i>	5,03 (73)	11,49 (32)	6,10 (60)	7,18 (51)	7,92 (46)	5,58 (65)
<i>Asset Turnover Ratio</i>						
<i>Cooperatives</i>	0,94	1,11	1,05	1,06	1,20	1,32
<i>Private Enterprises</i>	2,17	2,05	1,94	1,54	1,79	1,70

From an analysis of Table 4, we observe that the inventory turnover ratio presents a continuous rise (with the exception of 2006) for the cooperatives, which may potentially not be related to proportionately high profits, since compression may occur, in their effort to increase the volume of sales. On the contrary, for private enterprises, the inventory turnover ratio presents a continuous decrease, and is shaped at lower values, compared to the cooperatives. The lower turnover for private enterprises is potentially linked to a higher gross profit margin (Niarchos, 2004).

The values of the receivable turnover ratio are much higher for cooperatives compared to private enterprises, thus denoting major differences between the two groups as regards their credit policy: private enterprises are in a better position, since they collect their receivables twice as many times per year on average, compared to agricultural cooperatives. Nevertheless, it should be pointed out that this fact is also related to the commercial policy that each enterprise chooses to adopt; that is why their evaluation must also be accompanied by a study of their credit policy. Although private enterprises present better values for the asset turnover ratio compared to agricultural cooperatives, they also portray a continuous drop, in contrast to cooperatives, for which the indicator presents a continuous rise from 2005 onwards. The lower values of the indicator for cooperatives are an indicator of over-investment of funds in relation to sales, which could be related to their high inventories and generally to their other assets, whose use does not lead to a satisfactory level of sales.

Table 5. Financial Structure and Viability Ratios

<i>Ratio of Owner's Equity to Total</i>	2003	2004	2005	2006	2007	2008
<i>Cooperatives</i>	0,55	0,49	0,46	0,51	0,48	0,47
<i>Private Enterprises</i>	0,24	0,38	0,31	0,30	0,34	0,23
<i>Ratio of Owner's Equity to Fixed Assets</i>						
<i>Cooperatives</i>	1,92	1,40	1,15	1,81	0,99	1,26
<i>Private Enterprises</i>	0,46	0,73	0,66	0,55	0,66	0,31
<i>Solvency Ratio</i>						
<i>Cooperatives</i>	0,45	0,51	0,53	0,51	0,60	0,61
<i>Private Enterprises</i>	0,76	0,67	0,68	0,70	0,66	0,77

Following an analysis of the Financial Structure and Viability Ratios (Table 5), we observe that the owner's equity to total ratio for agricultural cooperatives is steadily at around 50%, while for the enterprises in the private sector it is around 30%, thus denoting that the cooperatives are half funded by equity finance, in contrast to private enterprises, which cover about 70% of funding for their assets using debt finance.

The mean for the Owner's Equity to Fixed Assets Ratio is higher for cooperatives, with values that are fixedly higher than one, as opposed to private enterprises, for which the indicator takes on values from 0.3 to 0.7, thus showing that private enterprises are leveraged and provide limited security to their creditors. Both the private enterprises and agricultural cooperatives in this sector are characterized by a Loan Qualifying Ratio, which takes on values lower than one. For the cooperatives, the indicator ranges on average at 54% in recent years, and for private enterprises at 70%, a fact which denotes greater solvency for agricultural cooperatives.

The analysis of the Profitability Ratios is described in Table 6.

The gross profit margin indicator presents better values for private enterprises in relation to cooperatives for the whole period under study. The net profit margin indicator presents better values for the private enterprises in relation to the cooperatives, where the indicator has a negative sign from 2007 onwards. The return on total assets ratio presents intense fluctuations, taking on positive and negative values for the period under study, for the businesses in both groups. The return on net worth indicator is at a low level, with values around zero for the businesses in both groups, which potentially denotes the existence of weaknesses and problems in their operation.

Table 6. Profitability Ratios

<i>Gross Profit Margin</i>	2003	2004	2005	2006	2007	2008
<i>Cooperatives</i>	0,060	0,125	0,103	0,122	0,024	0,082
<i>Private Enterprises</i>	0,093	0,145	0,163	0,151	0,129	0,134
<i>Net Profit Margin</i>						
<i>Cooperatives</i>	-0,007	0,003	0,003	0,003	-0,028	-0,042
<i>Private Enterprises</i>	0,002	0,013	0,004	0,011	0,005	0,001
<i>Return on total Assets</i>						
<i>Cooperatives</i>	0,011	0,001	0,016	0,016	-0,057	-0,025
<i>Private Enterprises</i>	0,016	-0,005	0,017	0,005	0,036	-0,015
<i>Return on net worth</i>						
<i>Cooperatives</i>	0,014	0,002	0,058	0,062	-0,262	-2,097
<i>Private Enterprises</i>	0,181	0,107	-0,015	0,055	0,001	0,063

Next, after the application of Hierarchical Cluster Analysis on the financial data of the sample, the typology of the business units in the fresh fruit sector is formulated for the region of Central Macedonia. Two clusters of business units emerge for this sector (Table 7). In Table 7, means in columns that are characterized by a different letter in the same column, present a statistically significant difference, at a significance level  $\alpha=0,05$ , according to the results of the relevant Mann-Whitney tests, that were carried out.

The depiction of the financial parameters for clusters C<sub>1</sub> and C<sub>2</sub> is presented in diagram 1.

Table 7. Typology of the business units in the sample

<i>Clusters</i>	<i>Fixed Assets</i>	<i>Current Assets</i>	<i>Inventories</i>	<i>Receivables</i>	<i>Total Assets</i>	<i>Total Net Worth</i>	<i>Sales</i>
	(Y <sub>1</sub> )	(Y <sub>2</sub> )	(Y <sub>3</sub> )	(Y <sub>4</sub> )	(Y <sub>5</sub> )	(Y <sub>6</sub> )	(Y <sub>7</sub> )
C <sub>1</sub>							
<i>Mean</i>	4240291 <sup>a</sup>	5798874 <sup>a</sup>	1743760 <sup>a</sup>	3334801 <sup>a</sup>	10182097 <sup>a</sup>	2876463 <sup>a</sup>	9063737 <sup>a</sup>
<i>Std. Dev/tion</i>	4129678	5927933	1977373.1	3235045.7	9689020	2613061.2	8173408.6
C <sub>2</sub>							
<i>Mean</i>	80913456 <sup>b</sup>	15336434 <sup>b</sup>	18090682 <sup>b</sup>	106403626 <sup>b</sup>	245823062 <sup>b</sup>	113829160 <sup>b</sup>	324031285 <sup>b</sup>
<i>Std. Dev/tion</i>	12771850	47007613	19088060	55557914	45316971	18903746	135374487



The Hierarchical Analysis has indicated two clusters of business units involved in the fruit and vegetable trade; the first includes 9 units (75% of the sample) and the second 3 (25% of the sample). The first cluster (C1) consists of enterprises by 66.7% (6 units) and cooperatives by 33.3% (3 units). The total assets of the business units in the first cluster (C1) equal 4.14% of the assets of the units in the second cluster (C2). The units in cluster C1 present a higher rate of investment in illiquid assets and a lower percentage of liquid assets as opposed to the units in cluster C2. Thus, the fixed assets and liquid assets constitute 42% and 3% of the total assets of the units in (C1), and 33% and 4.7% respectively of the assets of the units in (C2).

For the units in cluster C1, inventories cover 17.4% of the assets, while third-party receivables equal 32.8%. Similarly, for the cooperatives in (C2) the percentage of total assets covered by inventories (7.4%) is lower, due to the short period for which inventories remain at cooperatives; on the other hand, the share of third-party receivables in the assets is higher (43.3%), a fact related to the longer period of credit given to cooperatives. The dependence of business units on foreign funds is higher for the first cluster (C1), since 71.8% of their total liabilities are covered by foreign funds, as opposed to 53.7% for the units in the second cluster (C2).

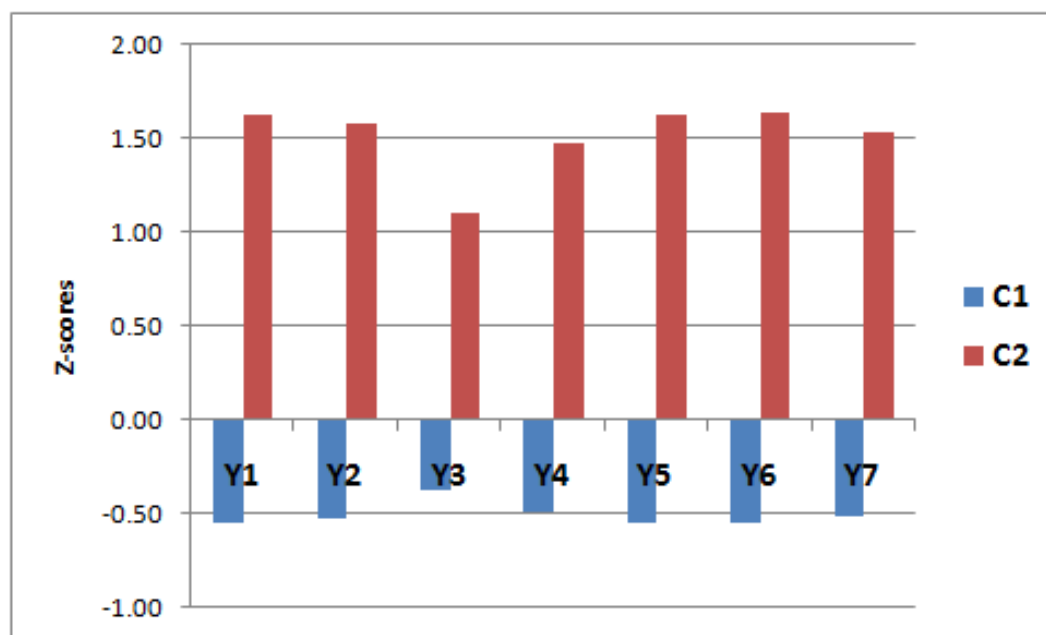


Diagram 1. Projection of financial parameters per cluster in the typology.

## Conclusions & Discussion

The dynamic growth of the fresh fruit and vegetable sector, both in Greece and around the world, imposes the need for business units (private enterprises and agricultural cooperatives) to adapt to the new conditions of the globalized market for agricultural products.

In recent years, agricultural cooperatives have developed as businesses, by making use of modern facilities, and new methods for the processing and packaging-standardization of their production. Through their links with various distribution channels and their participation in promotional and marketing programmes, they have managed to broaden their presence both in the domestic market and abroad. In the same sector, private enterprises of various forms also develop their own economic activities, and therefore constitute the main competitors of cooperatives.

In the analysis that has taken place within the framework of this particular paper, 12 (twelve) case studies were used, involving selected businesses from the sector. More specifically, 6 agricultural cooperatives and 6 private enterprises from the fresh fruit and vegetable sector were examined, which are active in Central Macedonia.

Based on their financial profile, which is depicted according to specific ratios, it is observed that agricultural cooperatives (ACO) present satisfactory liquidity. ACO can very easily respond to the payment of their current liabilities, fixed expenses, claimed interest and dividends, and can also better survive any current losses. They present a high inventory turnover ratio, and a high solvency ratio. Half the financing of their investments is provided by equity finance. The ACO aim to utilize their assets in order to strengthen their sales. However, the indicators that measure the efficiency of asset utilization present an upward trend, which is connected to an increase in sales. In addition, ACO present a significant over-investment of funds in relation to sales which, if not directly addressed through the intensification of the sales sector, will eventually lead them to default.

Private enterprises present limited liquidity, which mainly depends on future sales. As regards the period for collecting receivables, private enterprises are in an advantageous position compared to ACO, since they collect their receivables, on average, twice as many times per year. Private enterprises are leveraged and provide limited security to their creditors. Private enterprises also achieve a higher profitability compared to cooperatives. From the profitability ratios, we can observe that private enterprises are in a better economic situation compared to cooperatives. This is largely due to the different trade policy and promotional sales strategy that each enterprise adopts.

The typological analysis carried out on the sample of enterprises and ACO, highlighted two clusters of business units belonging to the fruit and vegetable trade sector. The first cluster includes private enterprises and ACO. It consists of 9 business units (which constitute 75% of the sample). The business units in this cluster present a significant dependence on foreign funds in order to implement their investment plans. The second cluster (C<sub>2</sub>) consists of 3 business units (which constitute 25% of the sample). It exclusively consists of ACO, which present an intense export capacity. The ACO in this cluster are mainly dependent on equity finance and their inclusion in financing programmes for the implementation of their investments, and only maintain their inventories for a short period. In addition, they present

a higher share of third-party receivables in their assets, a fact linked to the longer credit period than cooperatives present.

The results from the typological analysis confirm the conclusions of the financial analysis that preceded it. They lead to the conclusion that ACO present a satisfactory financial profile, which allows them to compete on an equal standing with the private enterprises in this sector. An analysis of the ACO data, which exclusively comprise the second cluster (C<sub>2</sub>), shows that these are cooperatives with a major export profile, which also carry out significant investments, through their inclusion in operational investment programmes.

This study is a trigger for further research and development of this topic by future researchers, who could examine and define more factors related to the economicity of the businesses in the sector, and conduct a research on a larger sample, so that the resulting data is indicative of the sector for the whole country.

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## CONCEPTUALIZING ENTREPRENEURSHIP AS CREATIVE SPACE

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### Abstract

This paper reviews and challenges received conceptualizations of entrepreneurship. We find entrepreneurship too narrowly defined, the business contexts in which it is customarily applied limiting, and the focus of input measured as forms of capital and output measured as economic gain restrictive. It black-boxes what entrepreneurs really do, reveals little about the process or the phenomenon of entrepreneurship, and its application in contexts other than business unnecessarily imposes business values that are not appropriate in such contexts. We further argue for the use of case studies as a fruitful way of unpacking the entrepreneurial process, and offer an example of such a case study. The analysis of the case results in a conceptualization of entrepreneurship as creative space, with three interrelated and co-dependent process movements: conservation, coordination and creation. We suggest entrepreneurship as creative space as a productive metaphor in studying what entrepreneurs really do, and also recommend a return to the original definition of entrepreneurship as *entreprendre*, that is, to undertake something.

**Keywords:** Entrepreneurship, creativity, space

### Received Conceptions of Entrepreneurship and their Problems

The word entrepreneurship comes from French *entreprendre*, and means, literally, *to undertake* something. It has been used mainly to describe things undertaken in a business context, that is, for profit. Economists have theorized entrepreneurship since the late 1700s (Hébert & Link, 1988), debating whether it is concerned with risk-taking under uncertainty in pursuit of profit, with innovation, with supplying capital for profitable production and trade, or even a function at the heart of the renewal of the economy, as Schumpeter (1934/1983) claimed. Neither people in general nor politicians were much concerned with such musings – businesses were started and closed as a matter of course, and until the 1970s or so an entrepreneur was in many languages just a small business owner, if the word was used at all. A business owner was not in very high regard at that, but seen as a rather selfish and shady figure. Europe was dominated by labor governments who had a social and political agenda focused elsewhere, and which took businesses as suppliers of jobs and tax revenue for granted.

But something changed after the first oil crisis in the 1970s when the world began to understand that the continuous economic growth after the second world war could not be taken for granted anymore. Birch (1979) ignited the interest for entrepreneurship when he convincingly demonstrated the surprising fact that most new jobs were actually created by small businesses, and not by the very large multinational firms that hitherto had completely dominated the debate. The neoliberal political wind, beginning with the Thatcher era in Great Britain but quickly spreading throughout Europe soon caught on, and proclaimed entrepreneurship as the sought-after solution to many problems, the first of which was to refuel economic growth. But also a handy solution to necessary cut downs in public spending with ensuing restructuration, that is, privatization, of the public sector. A long, still on-going campaign followed, with public support for entrepreneurship training programs, entrepreneurship education, entrepreneurship research and support to small businesses, and the explicit stress on entrepreneurship and its latter day cousin innovation in all state and semipublic policy measures undertaken. By the present time, the entrepreneur has come out of the closet and taken center stage as the savior of the economy, an exemplar of morality and a modern day hero. Critics have of course noticed that heroines are largely absent from the debate (Ahl, 2004, 2006). Entrepreneurship as an important phenomenon in the economy and the entrepreneur as its central figure is thus firmly in focus.

The process of entrepreneurship has, however, in most research been black-boxed. Focus has largely been on in-put (money, other material resources, and the human or social capital of the entrepreneur him/herself), or out-put (turnover, profit, growth rate, number of employees). Explanatory studies have focused on the relationships between one or more input factors and one or more output factors, assuming causality. The underlying idea is of course that if one can figure out what makes a successful entrepreneur or a successful business, this knowledge can then be used to stimulate the creation of more of these. But the quest has been rather disappointing. Early research focused largely on the characteristics of the entrepreneur, thinking that entrepreneurs make up a special breed. The focus on profit and growth as a desirable outcome assumes entrepreneurs to be primarily economically motivated, but research on entrepreneurial motivation finds this to be way down the list. The need for independence and to create something ranks higher (e.g. Locke & Baum, 2007).

It has moreover been difficult to find anything that is specific about entrepreneurs as a group, in comparison to people otherwise labeled. Characteristics such as risk-taking propensity, achievement orientation, leadership styles, strategic orientation and so on have been measured, but very little was found to differentiate entrepreneurs from non-entrepreneurs, wherefore the so called trait approach was officially declared dead (Gartner, 1988), but without much success. The idea that the entrepreneur is special keeps coming back. The popular conception at the moment is that entrepreneurship is the recognition of opportunity (Shane & Venkataraman, 2000). Besides assuming the existence of not-yet-recognized opportunities (how research that?), it also claims that some are better at this than

others, which makes it still stuck in the trait approach (Singh, 2001). And it says nothing about what entrepreneurs actually do.

Various other approaches have been used—for example, the stage approach in which different stages are identified from “idea” to “gestation” to “taking action” and so on, but much research so far has basically counted how many people are in each step and what the rate of drop-off is. Then, there are articles on the qualities of the entrepreneurs at the different stages—back to traits, that is. Network research consists mostly of counting types of relationships with types of actors or of identifying “structural holes” in networks (Burt, 1998), but, again, it says nothing about what people actually do in such relationships.

In spite of calls for research on what entrepreneurs do, such studies are still the exception. One reason might be that entrepreneurial action is difficult to study with a survey approach. If entrepreneurship research began to actually study what people do, there would have to be more case studies, with resulting debates about problems of generalizations, which in today’s science landscape is less legitimate. On the other hand, if the field continues on the current road, surface legitimacy may perhaps be had, but little practicality would result. In line with Flyvbjerg (2006, p. 242) we hold that “a discipline without a large number of thoroughly executed case studies is a discipline without systematic production of exemplars, and that a discipline without exemplars is an ineffective one”. Moreover, a case study approach seems necessary in order to open the black box of entrepreneurship. Consequently, we here use a single case study to learn more about what entrepreneurs really do, and as a basis for proposing a theory of entrepreneurship as creative space.

### **The case of the cheese business**

Lena has always been an entrepreneurial person. She is creative, has new ideas and throughout her career, it has become apparent that her ability to find new paths and leverage a business needs space, space as a necessary requirement for creativity.

*I was employed as a middle manager in a chain store, and that was great because as a manager I got to decide what to do. At least so I thought, so it came as a big surprise when I went to my boss and said “this is what I would like to do and I think the launch of this product should be done in this way because no one has done it like that before” – but I hit a dead end. My boss, a really nice person, said that because no one had done it before we couldn’t do it either and that we should do it the usual way. I was so sure that it would work but I hit the entrepreneurial glass ceiling in that business and soon after that, I quit. Later on, the idea became a success and today it’s one of the standard way of presenting products in that line of trade.*

To create the necessary space for the realization of her ideas, Lena took over the family business. Lena’s family had for two generations owned a deli shop specializing in cheese. Her grandfather started the business in 1931, and her father had managed it for many years. Lena and her brother took over the business with the father remaining in the business for three

years before handing over all the shares to his children. The main motive for taking over was to create a space where she could realize her full potential.

*I have always had a strong will and don't want people to tell me what to do and what to think. It has been a valuable lesson to work for other companies. I've learned what not to do and how an organization should NOT work.*

Taking over the family business meant moving into something familiar but already from the beginning, everyday practices were questioned. One of the first things Lena did was to start empowering the personnel. Previously, her father and grandfather had always taken care of the cheese, from the arrival and until it was placed in the store. The personnel knew exactly how it should be done and Lena handed over this task to them. The same thing happened with counting money from the cash register at the end of every workday. Counting money had previously been done by family members only. Delegating tasks provided her with extra time for strategic development of the business. At the same time as she changed certain taken-for-granted ways of working, there were many things that she consciously chose to keep, like the idea to always have an old-fashioned corner store that created a certain traditional atmosphere, and to employ people that were service-minded and polite so that they would treat the customers in the right way.

To avoid confrontation with her father, she implemented her ideas when her father was not in the store. The reason was that he would have opposed the changes, but when he was faced with the positive results of her actions, he let Lena continue with the changes. From her previous work experience she had learned how to import products from other EU countries and she and her brother also started to visit the major food exhibitions in the industry. Their father thought that it was a waste of money to visit these exhibitions but by finding small producers in other countries, the company was able to create a market niche. They could offer a selection that the large food stores did not have. Parallel to this, Lena spent her holidays in Southern Europe, and when she visited food stores and found products she liked, she contacted the producers and if possible, started collaborating with them. This was also the start for moving in to business-to-business sales. Lena has continued to visit other countries and frequently visits food stores to find new products and inspiration.

*In Spain I found some super-nice olive cans, nicely price and I liked the packaging. I thought they would look good in our stores so I bought some and then at home we tried it out and liked it, mailed the producer and now we have them on our shelves. And this curiosity sometimes takes us to a place where we re-think the way we do things, "Oh my God, why don't we do it like this, why didn't we think about this!" We're a bit crazy at times.*

One of those crazy ideas, that later on turned out to be a great success, was to become a wine expert. The idea came when Lena arranged cheese tasting parties, something she did mainly as a marketing event. Around year 2005 people started to ask for cheese and wine combinations, and Lena had the idea to become a sommelier.



*Sure, I had a feeling for what kind of wine you should have with the cheese but then I decided to go to school. I didn't want to take just one of those wine courses but I wanted to aim high and become a trained sommelier. I asked around in the restaurant business and got some suggestions for which company to choose for my education and when I contacted them, it turned out that they were going to give the program in the city where I live so things just fell in place. So we became the first cheese deli shop in Sweden to offer this knowledge to our customers. And a funny thing with this diploma is that the ones that used to say "well, sweetheart, I have also taken a wine course so I know wine too" now come and consult me on which wine to choose.*

Lena has also taken courses in business, created a close network with two other business owners and brought in an external board member to develop the business. The business philosophy is to have fun at work and fun for Lena seems to be to continue developing and learning. The business has expanded by opening Deli Shops in another city, and by growing with business-to-business sales. When they took over ten years ago, they had 6 employees and a turnover of SEK 6 million and today they have 14 employees and a turnover of SEK 25 million. To be able to freely explore ideas and have fun has paid off in the cheese store.

### **Entrepreneurship as creative space**

This case, short as it is, offers some profound insights into the entrepreneurial process. To begin with, it was clear that the main motivation for Lena to choose entrepreneurship was not the opportunity for economic gain, but rather the fact that her job acted as an impediment to creativity. Her previous job as a manager in a large chain store did not give her room to experiment and try out new things. The organization actually acted as a barrier to creativity, demonstrating how managerialism with its focus on control, order and predictability is actually an obstacle for entrepreneurship – which, by the way, conveys an important message for those who desire to stimulate intrapreneurship, or organizational entrepreneurship. Hjorth (2005) actually proposes the redefinition of organizational entrepreneurship as the creation of spaces for play, and effectively demonstrates how this is the complete reverse of standard operating procedures in organizations.

The case does not give any clue as to whether the obstacles Lena met were due to her gender, but she did indeed hit a glass ceiling which is a common experience for women in organizations. Women have been around in organizations for decades now, but management, leadership (as well as entrepreneurship) are still gendered phenomena, and women are called out as the exceptions (Ahl, 2011). Our language demonstrates this point clearly – why would we otherwise talk about women managers, women leaders and women entrepreneurs. Men are customarily given more leadership responsibility and more room for advancement, and men dominate heavily in top management. Gendered norms as well as homosocial reproduction have been put forward as explanations (Ibarra, 1992; Kanter, 1977; West & Zimmerman, 1987).

A further lesson is that of entrepreneurial motivation. Clearly, Lena chose to take over the family business because she needed a venue for developing her ideas, to make “dreams come true” to use a trite, but perhaps still valid language. The case also shows that this desire to create something new seems to be a primary motive – as soon as Lena had installed one change, she continued with another. As soon as he had develop a new facet of the business she went on to develop another. She does not rest on her laurels. Inherent in this development of new ideas and new ventures is learning. Lena is curious to learn new things. She goes on trips, takes management courses, develops networks and even enrolls in a formal training program to become a sommelier. Learning and entrepreneurship thus seem to be intertwined processes.

The main impression, however, is that the business creates room for play and creativity. Hjorth (2005) claims that in an organization one must first “appropriate a place as one’s own” to create space for play and invention. As an employee, Lena did not succeed at this. The organization was not willing to allow her this space. As a business owner, however, she has indeed occupied the whole enterprise as her space for creativity. Interestingly, it turns out that some facets of managerialism, or in our terms *conservation* are necessary as well. In the development of her business, Lena had to strike a fine balance between renewal and preservation. Striking this balance might actually be interpreted as creativity as well. By opening the black box of the entrepreneurial process in this case study we suggest the following tentative model of three interrelated and co-dependent movements:

Table 1: Movements in the entrepreneurial space

<i>Conservation</i>	<i>Coordination</i>	<i>Creation</i>
<i>Old-fashioned atmosphere in the deli shop</i>	<i>Empowering personnel by handing over assignments</i>	<i>Expanding the market by import</i>
<i>Employing service-minded people</i>		<i>Adding business-to-business sales</i>
		<i>Adding new knowledge area by becoming a sommelier</i>

We call the first movement conservation. This entails capitalizing on existing resources and competitive advantages already present in the business. Lena skillfully realized that the location and the service mindedness of her employees were an absolutely necessary ingredient for the success of the business. She understood that this was a core value in the business. Conservation is thus not just about preserving the old, but the ability to discriminate between old as assets and old as liability. Old-fashioned service mindedness and politeness carry a symbolic value that works well in a traditional cheese store, which nowadays are few and far between, and so does the physical layout of the store. Conservation

in this particular case is *also* drawing on contemporary trends, such as in the slow food movement with its interest in genuine, locally produced food.

The second movement in entrepreneurship as creative space is *coordination*. The division of entrepreneurship, management and leadership is actually more of a rhetorical creation than an actual fact, serving symbolic needs as Czarniawska-Joerges & Wolff (1991) explain. Any person taking on the role of running a business must do all three. This is evident in our case in the many routine management issues that Lena carries out on a daily bases, the handing over of diverse assignments to her personnel being a case in point. But as in the previous movement this one does *also* contain elements of creativity and play. Handing over the assignments was a clear brake with old traditions, particularly acute as this was an old family business in which routines and power relations were taken for granted. Breaking with the old meant not just breaking with old business patterns, but also entailed the challenge of breaking with family patterns and challenging her father.

The third movement in our model is *creation*, by which we in this text mean the creation of something entirely new. Lena acts freely within the creative space and based on her innovativeness, this movement opens up entirely new arenas for her business. Adding new knowledge, the wine expertise, created legitimacy not only for her but also for the business as a whole. The diploma on the wall conveyed expertise, and the employees were always able to suggest wine- and cheese combinations based on the expertise of its sommelier. It also created a unique edge at the beginning, a first mover advantage. As there is a discussion and debate in Sweden whether the State should keep its monopoly on the sale of alcohol or not, her move has also a strategic dimension. As a sommelier she would be able to import and sell wine in her cheese store, and she would, in addition, already have a competitive advantage in comparison to other potential outlets for alcohol. Another interesting observation is her import business. It started by chance. She was on holiday trips in southern Europe and when walking through food stores she discovered items that she liked and that were not available in Sweden and simply decided to try them out in the store back home. Having a store provided her the chance to do this. This is another example of how her business provided space for entrepreneurship. Related to this is the business-to-business sales, that grew out of other business owners in Sweden wanting to carry the same items as Lena did. She capitalized on the opportunity, and then she had another business.

In conclusion, this case indicates that using the metaphor “entrepreneurship as creative space” is a useful and productive device for opening up the black box and study what entrepreneurs really do. This metaphor has also enabled us to conceptualize it as consisting of three different but interrelated movements: conservation, coordination and creation. Our model also challenges the idea that managerialism and entrepreneurship should be two essentially different concepts. The entrepreneurial process seems instead to entail a back-and -forth movement between old and new, regulated and innovative, and

between adjustment and rebellion. Going back to the introduction, this conceptualization of entrepreneurship lends itself better than the regular enterprise centered definition to acts of entrepreneurship and creativity in sectors other than businesses, such as the non-profit, voluntary sector or in education. Putting it simply, we are back to the original definition of entrepreneurship as *entreprendre*, i.e., undertaking something. Going back to the original definition is in our opinion productive, as it makes possible the conceptualization of entrepreneurship in a wider context than business.

In many European countries, entrepreneurship is now part of the curriculum not only in upper secondary education but also in primary and secondary school. All universities with self-respect have an entrepreneurship program or at least a course. Activities that were so far regarded as voluntary, non-profit or part of civil society have been relabeled as *social entrepreneurship*, with an accompanying growing body of research on this phenomenon. This might of course be regarded as a creative move of re-branding, as money and attention is available to anything labeled entrepreneurship, but it also invites problems as measures of success for such activities are not necessarily compatible with received notions of success for business activities. And, as we argue in this article, such received notions may not even be compatible with real and experienced success measures for small business owners. In our case, Lena always had the result sheet in the back of her mind, but the joy of creation was the primary motivator. Further, the emphasis on economic growth and profit as a success measure and the idea of these as the primary motivator for entrepreneurship may actually lead astray, and occlude programs and efforts that would indeed create profit and growth, but as a mere side-effect. For future research, we suggest a reconceptualization of entrepreneurship as creative space as a fruitful metaphor for understanding the organic, learning aspects of *entreprendre*.

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## GREEN ACCOUNTING: THE EMISSION TRADING: STOCK, MARKET AND PUBLIC ADMINISTRATION

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### **Abstract**

The primary aim of this research is to offer an overview of the reflections gained from the economic literature on accounting regulation and financial reporting (Jennings, 1973; Thinker, 1984; Laughlin, 1984; Chatterjee, 1996; Bihimani, 1996; Xiang, 1998; Di Pietra, Riccaboni, 2001; Banerje, 2004; Richard, 2005; Allegrini, Quagli, Zattarin, 2006; Maffei, 2007)

In the work, we analyze the relationships of dependence or independence measuring efficiency, productivity of title of electricity on communications to financial markets and the influences on local Public Administration governance (Moe and Gilmour, 1995); in order to check the role and the evolutionary dynamics.

The present research is based on inductive/deductive method that implies a in-depth study of the relevant literature and allows an empirical analysis with regard to planning implementation of TEE., and an adequate dataset, the work aims to point the critical area of the current government system out and it proposes a fair way to improve better the communications to financial markets.

**Keywords:** Public Administration, efficiency, productivity

### **First path of conceptualization**

The primary aim of this research is to offer an overview of the reflections gained from the economic literature on *accounting regulation* and *financial reporting* (Jennings, 1973; Thinker, 1984; Laughlin, 1984; Chatterjee, 1996; Bihimani, 1996; Xiang, 1998; Di Pietra, Riccaboni, 2001; Banerje, 2004; Richard, 2005; Allegrini, Quagli, Zattarin, 2006; Maffei, 2007). In this work, we analyze the relationships of dependence or independence measuring efficiency, productivity of *title of electricity* on communications to financial markets and the influences on local Public Administration governance (Moe and Gilmour, 1995; Borgonovi, 2005, 2006, 2009); in order to check the role and the evolutionary dynamics (Amatucci, 2009). The present research is based on inductive/deductive method that implies a in-depth study of the relevant literature and allows an empirical analysis with regard to planning implementation of *TEE.*, - and an adequate dataset, the work aims to point the critical area of the current government system out and it proposes a fair way to improve better the *communications to financial markets*.

## **Energy costs at the base of the current economic system**

The current trend of consumption growth, the sudden and alarming climate change, instability in the market for energy supply, which is accompanied by an increasingly complex geopolitical landscape, represent some of the key factors that have called on the international debate on all 'unsustainable energy model that characterizes modern society. The choices of energy production and consumption in the past have been driven primarily by quality parameters assessed in terms of portability, availability and convertibility, which led to favor the predominant use of fossil fuels such as primary energy sources. However, what has long been overlooked is the environmental impact, an element difficult to internalize the costs of energy production, having to quantify the intangible nature of damage as the greenhouse effect, pollution, depletion of inventories, the tensions economic policies and instability (Bartolazzi, 2006).

The paradigm of the dominant theories of development has long conceived the environment as an externality, "taken as any other factor of production, and how this transformation from a production system tends toward a virtually unlimited growth" (Conti, 1996, p.480). However, as early as the seventies of last century, the myth of unlimited growth - which placed great confidence in the self-regulating mechanism of the market and technological innovation - has in fact clashed with the objective limits of the environment in terms of scarcity of resources and carrying capacity, limits that have resulted in gradually increasing cost to the economy. The oil shock of 1973, the first sign of real alarm about the sustainability of a development model very 'energy-intensive' and has a strong impact on the environment has awakened the public consciousness and attention of national governments of the industrialized world. Until then, the possibility of obtaining cheap energy has led to neglect the problem of depletion of resources, with "sole objective of the energy system to meet demand" (Bologna, 2000, p.124). In addition to technological innovation, rather than reduce energy consumption by increasing the efficiency of production systems, has in fact encouraged the use of not renewable resources, available at lower costs thanks to lower costs of extraction and distribution.

The distinction between renewable and is not related primarily to an assessment of the time needed to regenerate and make them available again for use. According to this usage are considered all those renewable energy sources other than fossil fuels and nuclear, which are characterized by both regeneration times significantly higher than those of consumption in addition to their exhaustion in terms of stock available on the planet.

This distinction is enshrined in legislation in a European art. 2 of Directive 2001/77/EC, which clarifies that for renewable energy sources are "non-fossil energy sources (wind, solar, geothermal, wave, tidal, hydro, biomass, landfill gas, sewage gas sewage treatment and biogas). The same definition and the entire law was implemented in Italy by Legislative Decree No 387/2003, which art. 17 provides a listing of sources is not counted as renewable:

- Assimilated to renewable sources, as provided by Law No. 10 of 9 January 1991/10 (rules for the implementation of the National Energy Plan in the field of rational energy use, energy conservation and developing renewable sources of energy);

- The goods, products and substances derived from processes whose primary purpose is the production of energy carriers or energy;

- Energy products that do not meet the characteristics defined in the PCM March 8, 2002 about the specifications of the fuels that are relevant for the purposes of air pollution and the technological characteristics of combustion plants.

In this regard, you must specify that the EU and national legislation considers electricity from renewable sources:

- Electricity produced by plants using only renewable energy sources;
- The electricity produced in the hybrid plants 'attributable' to renewable sources (whose production is calculated on the basis of guidelines for in art. 11 of Legislative Decree no. 79/1999;
- Electricity produced from renewable sources and used for filling storage systems (without regard to electricity produced by those systems).

The debate over the use of alternative energy sources has been revived recently by a number of factors and events - from commitments made by international agendas alarms resulting from Global Warming and the 'high oil' recorded in 2008 - have been put in light critical issues related to the potential and re-launch of a new energy paradigm, no longer focused on the use of hydrocarbons. It emerged clearly that the higher costs of energy supply, which is closely related to the heavy dependence on fossil fuels, increasingly put at risk the economic stability of both countries, consumers and the delicate balance of the ecosystem on a global scale. This has made it increasingly attractive market for renewable energy sources, stimulating increased investment aimed at increasing the production of heat and electricity, and fuel by:

- The energy of solar thermal and photovoltaic (resulting from the flows of solar radiation),
- Wind power (which uses wind energy to generate electricity);
- Geothermal energy, thermal gradients and movements of the sea .

### **Renewable energy: opportunities and critical**

In accordance with the administrative decentralization process started in Italy, the Legislative Decree 112/98 - which confers on the Regions and Local Authorities administrative functions and duties in the implementation of Chapter I of Law 59/97 - transferred to the Regions and local authorities powers in energy matters, reserving to the State the definition of the general policy and the adoption of measures of national energy



policy and coordination in programming for regional energy . Regions Compete instead the function of control over some incentive mechanisms, and coordination of local authorities in terms of energy savings. Finally, it functions to local authorities to carry out programs for the promotion of renewable sources and energy conservation, monitoring of return on the thermal, authorizing the installation and operation of plants for energy production.

In particular, at the central level, the role of public administration is embodied in the provision of incentives for economic and financial equilibrium in the production of renewable energy and funding for the construction of production facilities, compared to production costs and levels of productivity still comparable with those of energy from fossil fuels.

In compliance with Directive 2001/77, which establishes the obligation for Member States to set national indicative targets for consumption of electricity produced from renewable energy sources consistent with the commitments under the Kyoto Protocol, Italy adopted the d. Decree of 29 December 2003 No 387, which sets national targets for using renewable energy sources, both as regards the production and consumption of electricity, as well as the incentive mechanisms. With regard to the latter, the decree introduces a new element from the past: moving from CIP-6 incentive system to one based on Green Certificates (GC).

Other important changes to the regulatory framework have been made with the financial 2008 (Act No. 244/2007) by introducing tax benefits, simplified bureaucratic obligations installation supplied by renewable sources (Falcione, 2008), including a diversification source of money as an incentive and mandatory quota, the introduction of all-inclusive rate, as a mechanism alternative to the Green Certificate, which is activated on demand producer for power plants not exceeding 1 MW and variable depending on the source (Article 2 , paragraph 145).

In particular, the legislature has provided:

- A new scheme for green certificates;
- The tariff for the micro distributed generation (called feed-in tariff);

The incentive mechanism of green certificates (introduced by Legislative Decree no. 77/99) was amended by providing that, for the period 2007-2012, the fixed fees that the Italian electricity producers and importers are obliged to enter the network, or either to satisfy through the purchase of Green Certificates, increase of 0.75% per annum (previously 0.35%), and, the duration of Green Certificates "sold" by a system of renewable energy is extended to 15 years (previously 12 years).

It was also recognized the feed-in tariff for renewable power plants for distributed micro, with an annual average nominal power less than one MW. Specifically, the system of tariffs that provides the system operator pays the customer for kilowatt hour of electricity generated by solar systems at a guaranteed price, the incentive, then, is commensurate with the energy and the construction of the as is implied by the program 'Photovoltaic Roofs'.

At the regional level it is rather the provision of a regulation that will facilitate the implementation of renewable energy installations. Following the legislative decree 112/98, Chapter V, the regions have enacted laws on energy, defining the areas of regional competence in relation to the guidelines of the State and the mechanisms of regulation of the electricity market and gas.

Currently, almost all regions have made efforts in defining and drafting energy plans and, more recently, the Regional Environmental Energy Plans (PEAR) - provided by art. 5 of Law 10/91 "rules for the implementation of the National Energy Plan in the field of rational use of energy, energy conservation and developing renewable sources of energy" - which, together with the Strategic Environmental Assessment (SEA), are valid and effective tools for a comprehensive analysis of energy policies and future land, especially in light of the provisions of Legislative Decree no. 112/98.

A decisive role in the development of renewable energy is conducted primarily at the local level: municipalities, in fact, lies in the actual development of the local area, according to the guidelines of energy policy drawn at the regional level. The increased attention from municipalities to the energy question is found primarily in the preparation of building regulations aimed at stimulating the reduction of heat loss and self-power generation, for example by introducing new design criteria and the requirement for energy certification of new buildings. In particular, Article 5 of Law 10/91, paragraph 5, states that land-use plan of the municipalities with a population of more than fifty thousand inhabitants must provide for the Municipal Energy Plan (PEC), an instrument operating at the municipal level relating to ' use of renewable sources of energy.

In general, it appears that an important first task is assigned to local public bodies in terms of saving energy, operating according to a new approach aimed at minimizing waste and a more rational use of energy. This is possible using methods appropriate and adequate to reduce energy consumption within acceptable limits, dictated solely by the criterion of the true and fair requirement, as required by the abovementioned Law 10/91. To set a good example, in recent years, it is the local government with the launch of several initiatives aimed to modernize the network of public lighting and heating / cooling of public buildings, thereby reducing costs load of the PA and, therefore, the nationality, due to improved plant performance and quality standards of the same.

In this regard, it is noted that in recent years has witnessed a profound change in the logic of the local development policies, favoring a bottom-up approach that places value on collective synergy of local actors, starting just a growing community involvement in political life and opportunities for indigenous development of the territory.

## The economic and financial feasibility of the implementation of renewable energy installations

From the analysis conducted, it's possible to define and to identify the economic and financial feasibility of a renewable energy system in order to provide useful guidance to local authorities interested in making an initiative of project financing. The financial sustainability of renewable energy plants is linked to forms of energy production incentives, which vary for different types of systems. In relation to the survey carried out in the preceding pages, we analyze two particular types of plants:

- a) solar photovoltaic;
- b) wind turbines.

As seen above, in Italy, from September 2005, is on the incentive mechanism "Energy Bill" to promote the production of electricity from photovoltaic systems. The term "Energy Bill" is given an incentive mechanism based on tariffs, which ensure fair remuneration of capital and operating costs for the production of energy by photovoltaic conversion of solar energy in the internal market of electricity.

The mechanism in "energy bill" provides for the provision of a commensurate incentive to electricity produced by the plants. In particular, this incentive applies to photovoltaic power at least 1 kW, connected to the mains, which came into operation after 30.09.2005 as a result of new construction, expansion or renovation total. The tariffs, which have a maturity of 20 years, revenues are added to the grid supply in the event of sale or the savings on the bill in case of consumption (the possibility of "net metering" for a lift up 200 kW).

Incentive recognized energy produced Rates (€ / kWh) for plants in operation as of 1 January 2009 \*

Type of photovoltaic system

Rated power (kW) Non-integrated Integrated Partly integrated

A)  $1 \leq P \leq 3$  0.392 0.431 0.48

B)  $3 < P \leq 20$  0.372 0.412 0.451

C)  $P > 20$  0.353 0.392 0.431

\* The values were reduced by 2% compared to the rates identified in DM 02/19/2007. further reduction of that percentage is expected for 2010.

Source: GSE

The higher rates are approved for the small household systems of up to 3 kW, which are

architecturally integrated. Rates are provided for a period of 20 years from the date of entry into the facility, and remain constant (not subject to updates ISTAT) for the entire period. For plants that will come into operation from 1 January 2010-31 December 2010, the values in the table above will be reduced by 2% (more than 2% already planned for 2009) and stayed constant for the period of twenty years of disbursement of the incentive. For plants that begin operation in the years after 2010 the fees will be redefined. In addition to the incentive, the person responsible for the system relies on an additional economic advantage, using the energy produced by:

a) the supply network, provides for the sale of energy produced and used immediately. In this case we have:

- income from a dall'incentivo total energy produced, determined by the type of plant;
- a savings equal to the value of the electricity consumed in cars;
- an income from the sale of electricity produced and not self consumed.

For installations up to 200 kW that use the exchange service in place, art. 7 of Ministerial Decree February 19, 2007 provides that the photovoltaic systems that access tariffs, operating under the net metering and intended for food, utilities or partially located within or otherwise coupled to housing units or buildings can be eligible for an additional premium if they are energy efficiency measures made on the building. The prize consists of an increase in the price, half the percentage reduction in energy demand achieved and certified, but may not exceed 30% of the incentive rate.

Particularly interesting is the incentive mechanism for public administrations. It is envisaged that the base rate can be increased by 5% in the following cases:

- For installations where the person responsible is a public school / peer or a public health facility;
- For installations where responsible parties are local authorities with population less than 5,000 inhabitants, as shown by the census ISTAT.

Still, according to innovations introduced by the Finance Act of 2008, photovoltaic systems, whose subjects are responsible for local authorities, fall under the type of integrated system, regardless of the actual architectural features of the installation.

### **Architectural integration**

The DM 19 February 2007 provides for three types of applications, depending on the degree of integration and functional architecture, in buildings or street furniture.

Therefore, the photovoltaic system can be:

- Integrated is the photovoltaic modules which are integrated into street furniture and street, the outer surfaces of the shell of buildings, building structures, whatever their function and destination. The photovoltaic modules replace material coating of buildings, taking on the functions. The modules are in fact installed in place of tiles, glass facades, balustrades elements, sound-absorbing panels in acoustic barriers, etc.
- Partially integrated: it is the system whose modules are placed on elements of urban and street furniture, exterior surfaces of the shell of buildings, building structures, whatever their function and destination. The modules are installed on roofs or facades of buildings so flush with the surface without replacing the materials coating the surface of walls or roofs. Also part of these installations on the roofs, floors and terraces of buildings and buildings and installations in the presence of perimeter balustrade, provided that the maximum share, related to the median axis of photovoltaic modules, showing the minimum height of not more than the same balustrade.
- Not integrated: it is the system with modules located on the ground, or with modules located in different ways from the above, the elements of urban and street furniture, on the outer surfaces of the shell of buildings, buildings and building structures of any feature and destination.
- The energy bill is the main source of revenue for the entity in charge of the PV system, since it involves the provision of an incentive proportional to the generation of electricity. An additional source of income is the value of electricity produced by the plant, which can also be consumed (even with the exchange system in place) or sold to the market.
- The consumption of energy produced is a source of income implicit in that is a savings (reduced electricity bills) because you can not buy electricity from the grid in proportion to the energy consumed in cars. The sale of electricity produced and consumed is a source of revenue rather explicit.

#### Administrative procedures for access to incentives

The Leg. N 387, 29/12/2003, art. 12, states that the construction and operation of plants using renewable sources are subject to a single authorization to the competent State or delegated to the provinces according to the specific procedures to be issued following a case of a maximum of 180 days, subject to the environmental standards, protection of landscape and historical and artistic heritage. The Legislative Decree no. 387/03 also provided that a Joint Conference, proposed by the Minister of Productive Activities (now the Economic Development) in consultation with the Minister for the Environment, Land and Sea and the Minister for Arts and Cultural Affairs, had approved the guidelines for the conduct of

proceedings only on the authorization. To date, this conference has not yet been convened and thus each region has adopted its deliberations to determine the procedures to be performed.

No authorization is required if the system is installed at sites without constraints of landscape, environmental and others. In any case, industrial plants for the production of energy, before submitting the request for authorization to build and operate a plant shall be subjected to the preliminary procedure for the verification of the need for Environmental Impact Assessment (EIA) procedure is not necessary for plants that produce energy from renewable sources if they consume at least 70% of energy produced. Next, will be submitted to the competent municipality Login Declaration (DIA). For plants that do not require any authorization is sufficient declaration of the start activity (DIA), and finally, for the systems to be implemented in areas classified as agricultural, it is not necessary the change of use of sites.

### **The economic and financial feasibility**

The economic and financial feasibility of the operation and return on invested capital, both for photovoltaic systems is, as we shall see, for wind power plants, depends heavily on investment costs, because the maintenance costs are limited. The main elements of assessment refer to:

#### **Costs**

The installation of a photovoltaic system requires above all a high initial investment, while operating costs are very low: the "fuel" (solar radiation) is free and maintenance costs are limited because the system, in most cases, has no moving parts.

Currently in Italy the cost of a plant varies between 4,500 and € 6,500 per kilowatt of installed capacity. The lowest values are for large systems (photovoltaic power plants), for which you can qualify for discounts related to higher order of importance, both for the purchase of components for installation.

In any case, the supply module is the most significant cost item and is generally about often exceed 60% of the cost of the plant.

The annual operating and maintenance costs are usually estimated at about 1-1.5% of the cost of the system. The useful life of the system is calculated in at least 20 years and, starting from the tenth year, there should be major repairs for the replacement of certain electrical components, especially the inverter. It may also be useful to enter into insurance contracts to ensure the plant in the face of events "extraordinary" as the theft or damage due to extreme weather events. In the case of transactions with government, including the costs for the manager also knows the value of annual royalties payable to the City, established in the race, compared to the high return on the transaction.

**Revenues**

As seen above, revenues for the entity in charge is obtained from:

a) the tariffs approved in all the electricity produced by PV, the tariffs are differentiated according to the size, type of architectural integration and the opportunity to enjoy additional "bonuses" for additional energy savings or other certain conditions;

b) the value from the electricity produced by the plant, which can then be consumed (even with the exchange system in place) or sold to the market.

Consequently, revenues of the person responsible are diverse and vary as a function of several factors depending on the technical characteristics of the photovoltaic system, the type of service performed (on-site exchange or sale of electricity sold to the electricity grid) as well as the ability to take advantage of the additional prizes.

**Economic and financial balance**

In light of the foregoing, it follows that each individual action, especially if made with commercial purposes, contains unique characteristics that can be properly assessed only through a specific and careful financial analysis that takes into account the investment to be made to achieve the 'PV, anticipated revenues, operating costs and maintenance and insurance system, finance charges and the system of taxation applicable.

With reference to facilities established by local authorities, medium sized, you can have the following assumptions :

**Hypothesis of a photovoltaic system**

1 MW installed capacity

Annual production 1,300,000

Investment cost

Design € 150,000

Infrastructure installation and € 4,835,000

Bureaucracy € 15,000

Total investment of € 5,000,000

Operating Costs

Routine maintenance € 50,000

Other costs € 20,000

Source: author

As seen above, the facilities established by local authorities have more incentives. By making an approximation of average energy produced and the type of system, we arrive at the following estimates for the basic parameters of the model:

**Time of return on invested capital**

- Northern Italy: 10-12 years
- central Italy: 8-10 years
- Southern Italy: 6-8 years

The system also allows you to define, roughly, a fair royalty for the City grantor:

- Northern Italy: 5-6% of annual turnover
- Central Italy: 7-8% of annual turnover
- Southern Italy: 9-10% of annual turnover

b) The other types of renewable energy installations. The green certificate system and the all-inclusive price.

A second instrument to promote electricity production from renewable sources has been defined by decree. March 16, 1999, No 79 (so-called Bersani decree) issued in accordance with



Directive 92/97/EEC, which was launched a major restructuring of the electricity sector. The decree has introduced a policy to support renewable sources, based on market mechanisms: in fact, it creates an obligation, since 2002, for those manufacturers or importers of non-renewable electricity, to enter into a national network proportion of energy generated from plants using renewable sources, the requirement may be fulfilled by acquiring third-party energy from renewable sources or its securities (Green Certificates). The status of RES (renewable sources) and is certified by GRTN case of plants came into operation after April 1, 1999.

Initially, the share of energy was set at 2% and thereafter, the Legislative Decree no. 387/2003 has increased by 0.35% per annum and, finally, the Budget Law for 2008 provides for an increase of 0.75% per year for the period 2007-2012. For subsequent years, additional increases will be determined by subsequent ministerial decrees .

### **GC characteristics**

The GCs are securities that evidence of the origin of electricity produced from renewable sources and which may be sold separately from the energy that is natural. Their size, initially set at 100 MWh, the legislation has been progressively lowered: first to 50 MWh from L. 23/08/2004 No 239 and finally to 1 MWh by the Finance Act 2008. From 1 January 2009, therefore, possession of a green certificate attests to the production of 1 MWh.

The period has been increased recognition of CV to:

- twelve years for plants fueled by renewable sources entered service between 1/4/1999 and 31/12/2007;
- fifteen years for plants fueled by renewable sources entered in operation at a later date to 31/12/2007.

The sale price of the CV and energy input are regulated by market mechanisms. Transactions can take place through bilateral contracts or through a trading platform set up at the GME, which is organized through the market. The offer price of such certificates by the GSE, which markets them exclusively via the platform of the GME, is called the reference price. Since 2008, the reference price is equal to the difference between a reference value of 180 € / MWh and the average price of electricity supply for the previous year, defined by 31 January each year by the Authority. The price of HP, so decided in 2008 was € 112.88 per MWh in 2007 was € 137.49 per MWh, in 2006, however, € 125.28 per MWh.

### **The sources and technologies allowed to resume**

Over the years have changed the systems ("RES") who are eligible to receive CVs from the GSE at the request of the producers, after their "status". According to the original definition of Leg. March 16, 1999 No 79, were considered renewable and therefore enjoyed the green certificates, "the sun, wind, water, geothermal resources, tides, waves and converting it into electricity plant products or organic and inorganic waste ". Subsequently, the Legislative

Decree no. December 29, 2003 No 387, adopting the definition of art. 2 of Directive 2001/77/EC excludes from renewable sources "inorganic waste and the Finance Act 2008, excluding non-biodegradable waste from the benefit of private incentives for renewable sources.

### **The all-inclusive price system**

In order to achieve the objectives defined in the Kyoto Protocol, Italy has transposed the European Directive 2001/77 on the subject of promoting the production of electricity from renewable sources, the 2008 Budget Law and the Law November 29, 2007 has introduced, alongside the mechanism to share the system with all-inclusive rate.

These include tariffs, differentiated by source, the incentive is that the revenue from energy sales and is applicable, upon request, to plants using renewable sources, subject to authorization in the case of biomass from short chain, came into operation at a later date to December 31, 2007, are rated for an annual average of no more than 1 MW of electrical power and no more than 0.2 MW wind turbines.

The incentive is granted for fifteen years, while tariffs may be updated every three years by ministerial decree by the Minister of Economic Development.

These costs are highly variable depending on the characteristics of varying complexity of the chosen site, morphology and soil type affect the costs of foundation, the conduit and roads, accessibility impacts on transport costs and the organization of the yard , while the distance from existing transmission system determines the cost of grid connection.

It should be stressed that the infrastructure related to accessibility and connection to the network have a capacity to use more durable than as a reference to amortize a single plant, so they can allocate their profits even further initiatives, if you want to continue using the wind resource.

In economic evaluations, it usually takes into account the costs relating to operation and maintenance of facilities in the two following ways:

- a total annual value, expressed as a percentage of the investment in wind turbines; directly as an estimate of cost per unit of energy (€ / kWh).

Concession fee to the local in relation to this heading, there are a lot of data available. Estimates ENEA data collected by business interests include a percentage that varies from 1, 5% to 3.5% of annual revenues from energy sales. This value, however, depends also on the profitability of the work.

At the end of its useful life, normally due in 20 years, the plant must be dismantled, though this should be deemed to have abandoned the area concerned.

On the contrary, it is reasonable to think that a site with good wind resources and, most importantly, data from long-established operation of the wind itself, can continue to be used by replacing the machines installed with the most technologically advanced wind turbines.

In this scenario, the municipalities will open vast opportunities to exploit the potential in different territories (natural biomass and hydro, solar photovoltaic, wind). The prospect is considered successful only if it is able to combine with speed, courage and sense of responsibility, with the specific energy goals and potential in the different geographical areas. The municipalities are responsible therefore the challenge of creating an innovative energy model, some of which directly uses the electricity generated, in part gives the network.

Of course, for local governments, the challenge is to operate according to a new culture, which combines economic growth, local development and attention to the ecosystem. This translates into policies for the development of alternative sources and energy conservation, integrated by adopting different measures:

- increasing the representation of solar thermal in building municipal facilities (schools, hospitals, offices, libraries)
- endorse or promote building codes that encourage the use of renewable energy, energy efficiency and green building;
- carry out ongoing advocacy to citizens through environmental education policies, aimed at developing a greater sense of personal responsibility that can help promote positive changes in daily behavior of the community;
- provide for appropriation of funds to promote the use of sources;
- set up information points for citizens and businesses;
- directly promote renewable energy plants (solar, photovoltaic, wind).

Especially in this last area, the municipalities can carry out public-private partnerships (project finance transactions, establishment of joint ventures), which, thanks to incentives provided, are very profitable in terms of economic and financial. If realized through appropriate public procurement procedures, aimed at stimulating competition among manufacturers, these operations provide financial income in fact relevant to the coffers of the institution, through royalties (license fees) is also significant (in some cases the concession fees to favor of the municipality reached percentages of 9 and 10% of the turnover produced by the plant).

Of course, in summary, an innovative energy policy requires at least two conditions: firstly, it is essential that this perspective will pass through a full involvement of the regions, which must assume responsibility in pursuing the objectives of disseminating renewable, and second, the government efforts aimed at pulling the market development of renewable

energy need to be matched by private traders, able to invest boldly in sustainable development.

### **Green Certificates**

Green certificates have been introduced by Legislative Decree 79/99 and the Ministerial Decree of 11 November. Based on this legislation, the manufacturers and importers of electricity generated from renewable sources should not be placed on the network electricity produced from renewable sources at a level equal to a percentage share of electricity produced from renewable sources and high-efficiency cogeneration. The requirement can also be achieved by market purchase and subsequent return to the GSE (Energy Services Manager) to set aside a corresponding proportion of green certificates, such certificates are granted to producers of electricity based on electricity production from renewable sources.

As provided by Law December 24, 2007, No 244, the production of electricity from renewable sources or re-powered plants came into operation with effect from 1 April 1999 until December 31, 2007, is entitled to certification of production from renewable sources (green certificates) for the first twelve years of exercise, the production of electricity from renewable sources or re-powered plants started from 1 January 2008, however, entitled to the certification of renewable generation for the first fifteen years of operation. This fee was originally equal to 2% of the electricity produced in or imported from non-renewable source in the previous year, exceeding 100 GWh / year from 2004 to 2006 was increased by 0.35% per annum and the period 2007-2012 has increased by 0.75% per year. the 2% share in 2001 has thus reached 5.3% in 2009 and 6.80% in 2011; in 2012 should amount to 7.55% but subsequent ministerial decrees may provide additional increases in subsequent years to 2012. The producers of energy from renewable sources, owners of qualified plants RES, may apply to the issuance of GSE Green Certificates (GC).

### **GCs can be obtained from:**

- a balance sheet, according to the energy actually produced from the net than in the previous issue;
- estimate, based on the expected net energy capability of the system.

The GSE downstream of verifying the reliability of information from producers, whose plants have been qualified to issue a report, within thirty days of receipt of the request, green certificates earned by rounding the net production of energy in MWh, with trade policy. As the green certificates that are then interpreted as incentives / penalties introduced by the legislature to allow production from renewable sources, hitting the same production / import of energy from renewable sources. Green certificates are framed in different ways depending on the different subjects involved:

- For producers of electricity from renewable sources represent a kind of contribution that can be monetized through the sale to the power exchange.

- For producers from non-renewable and thus subject to the obligation to purchase an additional cost to produce electricity.

The maturation of green certificates is when energy is produced and fed into the grid. Green certificates have a value equal to the fair value determined as the average value deduced from changes in the value of the power exchange. The certificates will therefore be recorded in the balance sheet loans to other working capital with the offsetting other income to the income statement. Then when these certificates are completed and delivered to the producer, receiving the title will be accounted for by a decrease in other receivables and an increase in other securities of financial assets that are not permanent. While those who are obliged to buy green certificates is not to have met the minimum production / import of energy from renewable sources. Once you define the amount of certificates to be purchased, the cost will be accounted for in the budget for the certificates and other charges in the voice production costs and its debt. At the time then when the green certificate is purchased, the output will be accounted for by reduction of its bank debt.

#### **White certificates**

More properly defined energy efficiency certificates (TEE) are incentives likely to reduce the energy consumption of electricity, natural gas and other fuels, in relation to well distributed. The Tee's are issued by the Electricity Market Operator - GME for distributors, subsidiaries, distributors, companies operating in the energy services (ESCO or Energy Service Company) and, since 2008, although companies with energy managers in the face the completion of projects for increasing energy efficiency. White certificates, which came into force in January 2005, consist of securities purchased and then resold thereafter, the value of which was originally fixed, but is likely to vary in response to market trends.

White certificates allow you to achieve savings targets able to contain the rate of growth in energy demand with the same energy services enjoyed by consumers, while also contributing to the achievement of targets for reducing greenhouse gas emissions under the Protocol for Italy Kyoto. The Leg 08/02/2007 introduced the possibility for co-generation high-performance, energy-efficient to obtain licenses.

At this point, forced the company to achieve the targets set will carry out measures to improve energy efficiency, earning certificates or white can buy them from other companies. The sale of white certificates is appropriate in a market established by the Manager of the electricity market and introduces a further element of efficiency in the system. On the one hand, therefore there is an obligation established annually by a third Authority, on the other hand, a market where white certificates assume an economic value on the basis of market demand. The mechanism set to prove effective, as it poses several possibilities to achieve the savings targets and energy efficiency.

The certificate market is structured in such a way that:

- The purchase of securities by dealers who, through their projects, receive lower savings compared to its annual target and, therefore, need to buy the securities market deficiencies;
- The sale of securities in case of an annual savings exceeding the target set (so dynamic that generates profits for distributors);
- The sale of shares obtained from independent projects by energy service companies, which, not having to comply with any obligation, the opportunity to make trading.

White certificates have been established in Italy with the DM July 20, 2004 and subsequently modified and integrated with the DM 21 December 2007 determining the national quantitative targets to increase energy efficiency and the Decree. February 8, 2007 has introduced the possibility to obtain energy efficiency certificates for high-efficiency cogeneration. distributors virtuous in terms of energy efficiency achieved a contribution to projects that involve a reduction in final consumption of electricity and natural gas resources needed to finance the subsidies granted are collected through special tariff components. The achievement of the objectives is through energy saving measures assessed by the Authority for Electricity and Gas Authority (Authority) which, in the case of positive evaluation of GME requires the issue to the project implementing body of the Energy Efficiency Certificates corresponding to savings certificates (in number and type).

#### **The price of white certificates is determined annually**

The energy efficiency certificates are different depending on the type of intervention which they relate and, consequently, the negotiation is different depending on the different types of securities.

Specifically, the energy efficiency certificates have a market value equal to one tonne of oil equivalent (TOE) and are divided into three types:

- Type I - can testify to the achievement of the primary energy savings through measures to reduce consumption of electricity;
- Type II - can testify to the achievement of the primary energy savings through measures to reduce consumption of natural gas
- Type III - demonstrating the achievement of the primary energy savings through measures other than those quoted above (savings of other fuels).

The system of white certificates, as noted by the Chairperson of the Energy and Gas, Alessandro Ortis, has also produced benefits for consumers in terms of lower costs in the bill. It should be noted, in fact, that the authority shall determine each year a contribution to be paid to distributors for meeting their obligations. This contribution is funded through a levy on distribution tariffs of electricity and gas, for which we, in a nutshell. Faced with this increase in costs (a total of 317 million euro between 2005 and 2009) estimated a total economic return from 6 to 15 times the cost of these incentives for each unit of energy saved. In addition, each certificate issued and every toe white spared our country allows a cost

savings between 118 and 587 €, in relation to the achievement of national obligations under the European Climate Package.

There is no specific accounting principle for white certificates and therefore it would seem appropriate to refer to IAS rules also in the preparation of financial statements under Italian GAAP.

In a budget-oriented ITA GAAP historical cost, setting the fair value is not applicable and it seems feasible based solely on the expected cost-settlement approach.

According to this approach:

- The rights purchased must be accounted for using the purchase price.
- The liability shall be recognized with the maturation of the obligation and on the basis of market value.

In this circumstance, depending on the value of purchase and subsequent resale to the GME, the company will realize a gain or sustain a charge related to the price differential between buying and selling third party title to GME. All this mechanism can then lead operators to realize capital gains or losses on disposal.

Then applying the cost approach-expected settlement, you must make an estimate of the liabilities payable by the company since it is an obligation to relate to increased revenues from customers. Therefore the company should then provide the stationing of a fund equal to the difference between purchase price and the sales value of the GME. For the determination of the purchase price of white certificates to be taken as the basis for the determination of the fund seems reasonable to take account of developments in the market price in the period between the date of the budget and its preparation, if this trend contributes to determine a realistic market value.

### **Accounting for environmental certificates**

Although the substance has been widely covered in the national legal framework, it should be noted that for accounting purposes there is now formally recognized as a reference (in accounting policy, guidelines, explanatory circular, etc..) Framing the problem and evaluating the environmental certificates therefore, it regulates its impact on the balance sheet. Currently, the Italian Accounting (OIC) is working to formulate an accounting standard on specific national environmental certificates (whose publication is expected in the second half of 2011), to apply only to companies that do not adopt the model of balance-IAS IFRS.

In our country, as mentioned above, have not been developed accounting standards or guidelines on the subject, the two most critical issues were identified, on the one hand, the prohibition to capitalize intangible asset acquired at no cost (set forth in Principle OIC 24) and, second, in the historical cost instead of fair value.

In the discussion on the issue at national level should be reported the following documents:

- Working group Confindustria, "accounting and tax aspects of the application in Italy of the European Directive on the trading of greenhouse gas emissions", March 2006;

- National Council of Chartered Accountants (CNDC) - Committee on Economic and Environmental Accounting "-" Rights of greenhouse gas emissions (GHG) - accounting and budgetary aspects ", in April 2007.

The two documents, while addressing both in a critical method of accounting for environmental certificates proposed by the IASB and its representation in the budget come to different solutions.

The working group Confindustria, sharing fully in the intangible nature of environmental certification and also picking out the fungible nature of fertility in simple, which, as such would not be subject to any process of technical and amortization should find entry in a special account that does not reflect the current assets of a financial asset such as a title. From the accounting point of view, compared to free allocation of an activity, is the proposed mechanism of deferred income, then in the income statement opposing the allocations for each year to those making up the cost of operating the same according to the survey of actual consumption.

This approach obviously does not preclude the possibility of including any provisions for risks and charges into a fund for future payments, where the final balance of the beneficiary were to return to the manager a larger number of certificates.

The document prepared by the Commission for Economic and Environmental Accounting "CNDC moves the setting of accounting at the time provided by IFRIC on an international level, and then distinguish between two methods of detection:

1. A method of accounting for "gross" - applicable to those companies that adopt International Accounting Standards with reference to IAS 38 and 20 - which includes, first, accounting for emission rights the same way as intangible assets (to be entered between the intangible assets in a specific Sub CO2 emissions rights ") and, secondly, the inclusion of public assistance to be reported on an accrual basis according to the mechanism of deferred income;

2. A method of counting "net" - applicable to those companies that adopt International Accounting Standards by following the approach of IAS 37 - which only requires entry of an expense in the year of allocation of rights, cost of emissions related productive activity for the year resulting in excess of quotas assigned and proceed aside the value (the higher cost) should be presumed to support the following year than assigned in terms of value. This method, however, may also be made for those companies that are not required to apply International Accounting Standards by law and that, as a result of Accounting Standard 24 OIC can not capitalize on intangible assets acquired free of charge, as in the case . In this second collection methodology, it is also provision for the registration of emission rights



between the current work, we welcome the provision in the income statement only to a specific fund charges and future risks, to cover the deficit of emission allowances excess CO<sub>2</sub> in terms of value as assigned.

### **Impact and influences in the budget**

In the notes, but also as part of the annual report, in light of the provisions of the new wording of art. 2428, co. 2, Civil Code, which provides for the inclusion of "indicators of financial results and, where appropriate, non-financial matters relevant to the specific activity of the company, including information relating to environmental and personal" should be highlighted the following considerations:

1 In accounting terms, the environmental certificates, while presenting legally valid multi (different type of certificate), do not constitute intangible assets - the thesis, the latter also supported by the fact that some of them would be acquired free of charge and not would be subject to any procedure depreciation technical and / or financially - but account for emission rights (in the case of "gray certificates") or atypical securities (in the case of green certificates and white certificates ") having an Substitutability;

2 The cost should be the most technically correct specific cost, which requires the identification and allocation of emission allowances to the individual or the individual certificates, costs incurred specifically for the award of the same. As a fungible assets, instead of the specific cost method, you may refer to the configuration methods of the estimated cost for the 13 OIC fungible, which means the weighted average, FIFO and LIFO (as commodities).The creation of trading activity by the beneficiary, rather than a producer of CO<sub>2</sub> emissions or energy from renewable sources, or even energy efficiency, should not affect in any way the nature of those assets that represent rights / fungible and that as such would not be subject to a different accounting treatment depending on its economic use;

3 Under the principle of substance over form, it would be preferable for the accounting of environmental certificates to happen through a method of counting "net" that provides for its inclusion in the budget deficit arising from the negative difference between the emission allowances ( in the case of "gray certificates") or securities issued (in the case of the "green and white certificates") and allowances / securities to be returned (because it accrued, and therefore subject to cancellation by law). It follows that if the date of preparation of the budget deficit were to emerge, certain in amount and in its enforcement notice, it would be possible, on the one hand, the accounts of a debt to be included in a separate entry called "Asset Certificates environment "and, second, all'appostazione a negative component of income. In the event that the date of the financial statements, it proves the uncertain quantity of shares / securities to be repaid, the firm may enter the amount of assumed debt in a specific account of the "Provisions for future risks and charges" against the related provision in the income statement.

4 In the presence of a surplus, ie a positive difference between allowances / securities issued and completed, the difference could be registration, however, the date of preparation of the budget and only where there is reasonable certainty that the related realized capital gains, in 'current assets, as financial assets which are not permanent, under a special item called "environmental certificates" in the income statement would be entered on the positive component of income, you could explain in notes to the effect of the method of accounting "to Gross, explaining to the amount of bonds allocated and corresponding price and the number of shares / securities issued, and the impact their contribution to income of the public;

5 Finally, note that, following the transposition of Directive 2003/51/EC (Directive accounting modernization or Accounts Modernization Directive), national regulatory plant (through the Legislative Decree no. February 2, 2007, n. 32), would be advisable, as part of the annual report, the undertakings specified in the special section "Required information on the environment" or "Voluntary information on the environment" (as appropriate) details of the emissions and other pollutants environmental certificates awarded. The analysis applies with respect to the functioning of emission trading system as regulated at European and national level until December 31, 2012. As for the period 2013-2020, the operational mechanisms of the system (and with them, probably, the nature or interpretation of accounting examined) could change substantially, because of the transposition of Directive 2009/29/EC. This Directive, in order to improve and extend the Community scheme for trading greenhouse gas emissions, significantly alter the Directive 2003/87/EC, in particular with regard to the objectives of reducing pollution, the sectors concerned, to the total quantity of emission permits and, above all, the rules for the allocation of emission allowances (critical dynamics, the latter accounting for the detection of environmental certification).

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## FINANCIAL DYNAMICS OF PUBLIC-PRIVATE PARTNERSHIPS IN THE DESIGN OF WELFARE SYSTEM

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### **Abstract**

The primary aim of this research is to offer an overview of the reflections gained from the economic literature on business ethics issues (Freeman, 1994; Phillips, Perrini, 2001; Freeman and Wicks 2003), on corporate social responsibility (Ricci, 2004, 2007; Gallino, 2005; Helen, Rusconi, Heros, 2010) and on ethical probity in a narrow managerialist focus (Onida, 1964; Masini, 1979; Kettle, 1993; Moe, 1994; Borgonovi, 1994; Wilson, 1994; Frederickson, 1996; Peters and Savoie, 1996) underlining the role and evolutionary dynamics of public private partnership in the design of social benefits (social card, social housing, social income, social bonds).

The present research is based on inductive/deductive method that implies a in-depth study of the relevant literature concerning the application of different models of corporate social responsibility of public and private partnership (PPP) (Amatucci, 2006) and allows an empirical analysis with regard to planning implementation and welfare systems (Musella, 1998; 2006) in the social policies (Fiorentini, 2006) of Public Administrations in order to improve efficiency measures, social accountability (Ricci, 2007), transparency and ethic culture. Through a case study (social housing, social card, social income) and an adequate dataset, the work aims to point the critical area of the current government system out and it proposes a fair way to implement a participative corporate social responsibility model.

Generally we noticed a loss of government capability and a lack of control by public institutions, with a resulting weakening of administrative structures and responsibilities. This entails in turn a progressive worsening of the image and legitimacy of institutions, and at the same time a credibility gap regarding wealth control and wealth redistribution activities in welfare system (Esposito)

### **Introduction: the relevance of research topic**

The primary aim of this research is to offer an overview of the reflections gained from the economic literature on business ethics issues (Freeman, 1994; Phillips, Perrini, 2001; Freeman and Wicks 2003), on corporate social responsibility (Gallino, 2005; Helen, Rusconi, Heros, 2010) and on ethical probity in a narrow managerialist focus (Onida, 1964; Masini, 1979; Kettle, 1993; Moe, 1994; Wilson, 1994; Frederickson, 1996; Peters and Savoie, 1996). In the work, we analyze the relationships of dependence or independence measuring efficiency,

productivity, social accountability and the ethics infrastructure (Borgonovi and Giavazzi; 1994; Kidder, 1995, Molteni, 2004; Cavalieri, 2008; Ricci, 2009; Rusconi, 2010) of public private partnership (Amatucci, 2005, 2006) in local Public Administration governance (Moe and Gilmour, 1995); in order to check the role and the evolutionary dynamics of public-private partnership in the design of social benefits (Borgonovi, Fattore, Longo, 2009; Meneguzzo, 2005; Fiorentini, 2003, 2004, 2006; Musella, 1998, 2005, 2006, 2008;), reinventing government movement (Kamensky, 1996; Hood, 1990, 1991) to investigate asocial budgets, social imbalances (Boeri, 2000) to stem the liquefaction PA's (Esposito, 2010). The present research is based on inductive/deductive method that implies a in-depth study of the relevant literature concerning the application of different models of corporate social responsibility of public and private partnership (PPP) and allows an empirical analysis with regard to planning implementation and welfare systems in the social policies of Public Administrations in order to improve efficiency measures, social accountability, transparency and ethic culture. Through a case study (social housing, social card, social income) and an adequate dataset, the work aims to point the critical area of the current government system out and it proposes a fair way to implement a participative corporate social responsibility model. Generally we noticed a loss of government capability and a lack of control by public institutions, with a resulting weakening of administrative structures and responsibilities. This entails in turn a progressive worsening of the image and legitimacy of institutions, and at the same time a credibility gap regarding wealth control and wealth redistribution activities in welfare system. The consequences of these conducts and behaviours advantaged individual interests penalizing the economic integrity of institutions and enterprises from which job and wellbeing of thousands people depend. This research attends to highlighting gaps between rules and conducts and then between elements of delegitimation and contradiction in the social policies of public administrations of Southern Italy; the aim is to prevent and control "welfare distortions " attempts toward the common estate -also characterized by capital rationing- penalizing the present-day community and of the future generations' one. The origin of this research path - which considers social responsibility as a management attribute - can be found - according to Chirieleison (2004) - in Akerman and Bauer (1976), and Frederick's works (1994). The first ones develop an approach to strategic business management designed to anticipate and respond to social demands of the external environment; the second one supports the need to integrate the concept of social responsibility with that of social responsiveness, intended primarily as capacity to respond to social pressures. In this context the environment is no longer the competitive and/or normative system expressed in terms of constraints and incentives, or otherwise of collective goals, but a network of interrelationships, economic, socio-political and institutional factors that interact in turn with the several business functions in contexts defined by its behavior and strategic orientation. From this perspective, companies should consider more deeply the impact of activities they undertake in the reference environment, and since the environment is in constant change, in constant change will also be the constraints and limits set by the social

contract of business and society. In the contribute we analyze the relationships of dependence or independence measuring efficiency, productivity, social accountability and the ethics infrastructure of public private partnership; in order to check the role and the evolutionary dynamics of public-private partnership in the design of social benefits reinventing government movement to investigate asocial budgets, social imbalances to stem the liquefaction PA's .

Analysing the current social distortions in the local Italian Public Administration the contribute demonstrates the existence of a model of PPP corporate social responsibility that allows to achieve political goals and to improve political consensus highlighting the role of the state anti-social replacement by social enterprises, just organizing the consensus on shared awareness of the results, accountability, transparency and ethic culture and on a better quality of citizens' life.

### **Asocial State and social Enterprise: the role and evolutionary dynamics of public-private partnerships in the design of social benefits.**

"This paper is an excerpt from a larger contribution in which they analyzed a variety of social benefits such as social housing and social income. The analysis offered in this paper focuses in particular on social and family card and bonus effects / impact on people in various Italian regions".

The increased role of private social organizations in defining and delivering of welfare services, coupled with increasing number of institutions and companies working in the field social services and health education, contributed on the one hand to reinforce the value has led many scholars and other social economy to deal with these particular organizational forms: a dynamic world, and complex evolving a number of agents which aims to promote social welfare, aims to strengthen and expand the system of welfare rights, with a strong ethical push in support of the people who they live in conditions of social distress and risk of exclusion and at the same time produces more or less stable employment, even in the modern sense of self employment, through the use of their tools of business economics.

The definition of social enterprise contained in the enabling act in reality leaves many points open to define and deepen, especially in light of the decree of the Government Delegate, D. Legislative Decree No. 155/06, which outlined the hallmarks of the business, reducing considerably for the truth, the pressure towards unification in a single container law in all its forms entrepreneurship, social value, but merely, it seems to describe a further subjects of attorney with entrepreneurial characteristics within the social services sector.

The law on social enterprise, then, appears as an additional measure which adds other laws that already regulate the industry and the people who work there, creating confusion and thereby losing the opportunity to simplify and clarify roles and profiles of the different actors in the social economy, marking the difference with clarity exists between the private

company that focuses on the profit and the company that has a function of social utility. The definition of social enterprise in the Legislative Decree has large pores and opens the door to any company that operates or will operate, so prevalent and not exclusive, in areas where the exchange of goods and services is considered of social utility.

In this perspective the firm is confronted with typical tools of business economics adapting and shaped by their specific social connotations: manufacturing processes, organization of work flow management and processing staff, management of imbalances financial and access to credit. These are just some of the items with which you must compare the strategic planning process of a social enterprise. The cooperation combines the needs and not capital, it maximizes the social expectations of people of the partners in terms of recognition and guarantee of employment opportunities, but also in terms of experimenting with concrete forms of self-government and therefore of democracy and this is especially true when it comes to social cooperation, promotion of job opportunities, combines the maximization of the needs of recipients to whom the subject of intervention become and must become subjects of law with which to build trails emancipation in a process that aims specifically to rethink the social and work processes and services. The economic literature on nonprofit organizations (Fiorentini) has four main interpretations of their existence:

a) identifies the most common interpretation in the bond distribution of useful way to overcome the failures of the contract determined by the existence of information asymmetries between producer and consumer that prevent them to monitor ex post the quality of our product ex-ante. Linking them to not distribute profits, the organization informs the consumer that is not interested parties to make ex-post such asymmetries, reducing the quality of the product in order to maximize profits (Hansmann, 1980).

b) the interpretation that identifies the nonprofit response to the difficulties of the government to tear down a sod-heterogeneous demand for public goods (Weisbrod 1975, 1988);

c) the interpretation that explains how nonprofit institutions that allow consumers control to maximize the output in order to overcome information asymmetries between producers and consumers (Van Hoomissen, 1991);

d) the arguments that explain the nonprofit as the result of particular types of entrepreneur (Young, 1980, 1997, Rose-Ackerman, 1996), groups, religious or not, willing to expand its influence (James, 1989), also funded by the income of non-pooled and redistributed proselytizing activities (Rose-Ackerman, 1987);

A definition focusing only on the prohibition of profit distribution are opposed definitions that restrict and specify the meaning and role.

## **Italian law enforcement policies in the European context**

The distributional effects of the major reforms of the tax-benefit system in the first year of the XVI Italian legislature. During the first year of the term, the Government has introduced changes to the tax-benefit system that will impact on income distribution and poverty. Here we focus on the impact on family incomes of four interventions: the buyer's card, the family bonus, the abolition of the ICI tax on first homes and electricity bonus. Of these facilities, assess the effects on the prevalence and intensity of economic poverty (both relative and absolute), the main beneficiaries and the impact on income distribution. Each measure was first considered and discussed separately. In the final section presents an analysis of the overall effect of the four interventions.

### **The data**

We simulate the revenue and distributional effects of reforms on the standard EU-SILC 2006 for Italy, made up of 21,499 households and 54,512 individuals. For the purposes of the simulations, all monetary values are updated to 2009 prices. This database will be calculated for each individual, the major institutions of our system of tax-benefits. To impute to the families perception of means-tested benefits was necessary to reconstruct the information on the total income, ie before deduction of personal income tax. The EU-SILC survey for Italy, in fact, currently only contains data on income net of direct taxes. Starting from the value of the declared net income, an algorithm produces a rough estimate of gross income. An iterative procedure then simulates the personal income tax and net income. If it differs by more than 20 € from declared net, the value of gross income is modified and subject to a recalculation IRPEF. The process continues until the defendant produces a gross estimate of the net, which differs by less than 20 € from the "true" net income. The unit of analysis chosen for the measurement of indicators of inequality and poverty is represented by the family. The standard of living of each person is measured by the equivalent disposable income received by the family unit. Disposable income is the sum of all forms of family income, net of direct taxes. In what follows we consider the income gross of imputed rents on real estate property. To achieve comparability between the incomes of families of different Numerically, the available family income is divided by the equivalence scale "modified OECD", which assigns a weight to adult weight 0.5 to all other members with at least 14 years and coefficient 0.3 for children under 13 years.

### **The purchase card**

Card purchases (commonly known as social card) was introduced by Decree-Law 112, June 25, 2008, converted by Law No 133 of August 6, 2008 (Article 81, paragraph 32). It is a credit card magnetic, funded by public funds and private donations and distributed by the Italian Post, which gives poor people the right to make purchases at points of acceptance or pay the bills for public services. In building simulation programs related to social card we have also taken account of the Decree of the Ministry of Economy and Ministry of Labour on 27



February 2009, which supplements Article 81 of Law 113 in part by changing some rules for access to benefit. Card purchases, which will be entitled to a monthly charge of 40 €, it is for people with at least 65 years and children under 3 years, living in households with disposable income and Isee very low. The elderly in particular should benefit from pensions of less than EUR 6,000 (8,000 if aged 70 or more years), have a value of less than 6,000 € ISEE, not to own more than one property and have a heritage securities not exceeding € 15,000. Children apply similar selection criteria. From the chart does not include foreign nationals, even if legally resident. Applying the standard Eu-Silc these selection criteria, and the results reported to the universe of Italian families, our simulations show that a regime should benefit from the social card about 815,000 people, 1, 36% of the Italian population (Table 1). This estimate of the potential number of beneficiaries is based on two key assumptions: first, the full representation of the sample used, the second a full take-up, or that all those who have the requirements to obtain the benefit really require it. The total annual expenditure for the card purchases amount to around 390 to 400 million euro.

Table 1. Beneficiaries of social card by region

	% individual beneficiaries	Individuals domiciled total sharing	Sharing individual beneficiaries	Number individuals beneficiaries	Number of beneficiary families
<i>Piemonte</i>	0.67%	7.36%	3.6%	29.512	28.368
<i>V. Aosta</i>	0.51%	0.21%	0.1%	644	633
<i>Lombardia</i>	0.86%	16.26%	10.3%	83.694	73.543
<i>Bolzano</i>	0.99%	0.82%	0.6%	4.848	4.790
<i>Trento</i>	0.97%	0.86%	0.6%	4.999	3.654
<i>Veneto</i>	0.86%	8.03%	5.1%	41.441	36.103
<i>Friuli</i>	0.93%	2.04%	1.4%	11.408	10.826
<i>Liguria</i>	1.59%	2.66%	3.1%	25.305	24.116
<i>Emilia</i>	0.66%	7.13%	3.4%	28.034	23.510
<i>Toscana</i>	0.63%	6.14%	2.8%	23.230	22.867
<i>Umbria</i>	0.59%	1.48%	0.6%	5.196	4.827
<i>Marche</i>	0.96%	2.6%	1.8%	14.962	13.045
<i>Lazio</i>	1.26%	8.99%	8.4%	68.176	53.202
<i>Abruzzo</i>	1.48%	2.22%	2.4%	19.650	17.262
<i>Molise</i>	1.72%	0.55%	0.7%	5.680	4.575
<i>Campania</i>	2.45%	9.9%	17.8%	145.437	127.799
<i>Puglia</i>	2.03%	6.93%	10.3%	84.217	78.916
<i>Basilicata</i>	1.62%	1.01%	1.2%	9.837	8.795
<i>Calabria</i>	2.55%	3.43%	6.4%	52.398	46.617
<i>Sicilia</i>	2.87%	8.57%	18.1%	147.539	131.313
<i>Sardegna</i>	0.55%	2.82%	1.1%	9.233	7.857
<i>Total</i>	1.36%	100%	100%	815.440	722.618

(Ceis Report, 2009)

Table 2. Share of beneficiary households by deciles of equivalent disposable income and poverty

	<b>% Beneficiary families</b>	<b>Number of families benefiting</b>	<b>Combined share of total expenditure</b>
1	17.8%	428.350	57%
2	7.5%	180.981	84%
3	2.8%	66.024	93%
4	1.2%	28.847	98%
5	0.3%	7.315	98%
6	0.1%	2.146	99%
7	0.2%	4.445	99%
8	0.1%	2.800	100%
9	0.1%	1.616	100%
10	0.0%	0	100%
<b>TOTAL</b>	<b>3.0%</b>	<b>722.524</b>	<b>100%</b>
<i>Families who could receive the paper</i>			
<i>Absolute poor</i>	17.2%		
<i>Poor relation</i>	13.6%		

Table 3. Share of beneficiary families and their distribution

	Share of beneficiary families	Beneficiary families sharing		Share of beneficiary families	Beneficiary families sharing
Geographical area			Age of reference person		
North West	1.8%	17.5%	<=30	4.5%	7.4%
North East	1.7%	10.9%	31-40	4.0%	22.2%
<b>Center</b>	2.0%	13.0%	41-50	1.1%	6.7%
<b>South</b>	5.5%	39.3%	51-65	0.1%	0.6%
<b>Islands</b>	5.4%	19.3%	>65	5.4%	63.2%
<b>Total</b>	3.0%	100%	<b>Total</b>	3.0%	100%
Number of components			Condition of reference person		
1	3.0%	28.9%	Worker	3.2%	24.1%
2	3.3%	29.5%	Employed	0.5%	3.3%
3	2.5%	17.0%	Manager	0.5%	0.3%
4	2.8%	17.3%	Parasubordinate employment	2.6%	0.5%
5	3.7%	5.1%	Entrepreneur	0.7%	0.3%
>=6	6.0%	2.2%	Independent professional	0.9%	0.8%
<b>Total</b>	3.0%	100%	Independent	1.8%	4.7%
			Partner	3.7%	0.8%
			Retired	3.6%	41.2%
			Unemployed	8.6%	7.3%
			Disabile	8.9%	3.6%
			Housewife	7.0%	13.2%
			Student	0.9%	0.1%
			<b>Total</b>	3.0%	100%

(Ceis Report, 2009)

Table 4. Breakdown beneficiary families by area and number of components

Number of components	North West	North East	Center	South	Islands	Total
<b>1</b>	45	41	32	23	18	29
<b>2</b>	30	35	34	26	31	30
<b>3</b>	6	13	17	18	26	17
<b>4</b>	15	11	14	21	18	17
<b>5</b>	4	0	1	8	6	5
<b>&gt;=6</b>	0	1	2	4	1	2
<b>Total</b>	100	100	100	100	100	100

(Ceis Report, 2009)

Table 5. Mean values and impact of the amount received by card purchases, by deciles of equivalent income

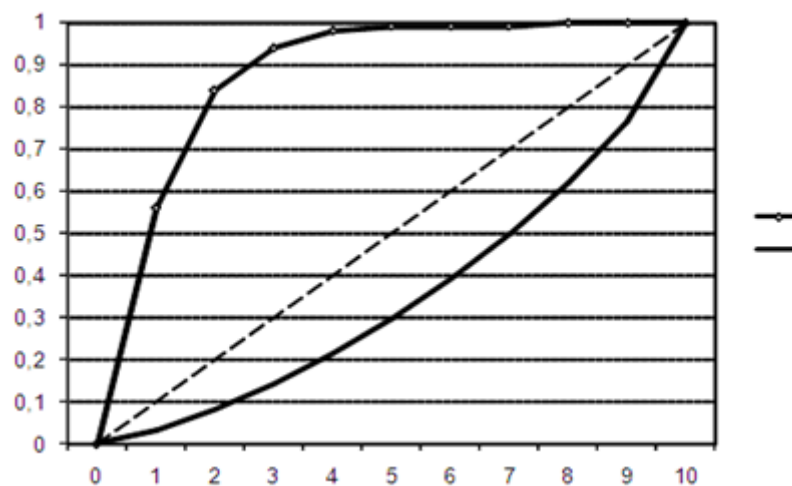
Decyl	All the families			Only beneficiary families			
	Equivalent amount of Card	Equivalent disposable income	Incidence of Card on income	Equivalent amount of Card	Equivalent disposable income	Incidence of Card on income	Not of the same average amount of Card
1	62	6.716	0.9170%	345	6.832	5.1%	527
2	29	11.159	0.2641%	391	10.966	3.6%	560
3	11	13.799	0.0766%	384	13.740	2.8%	531
4	5	16.226	0.0296%	399	15.811	2.5%	485
5	1	18.588	0.0049%	297	18.046	1.6%	480
6	0	21.105	0.0014%	342	21.379	1.6%	480
7	1	23.947	0.0022%	285	23.090	1.2%	480
8	1	27.487	0.0020%	480	26.308	1.8%	480
9	0	32.932	0.0008%	369	34.427	1.1%	480
10	0	52.926	0.0000%				
Total	11	22.487	0.0485%	362	9.250	3.9%	533

(Ceis Report, 2009)

Table 1 shows, for each region, the estimated share of individuals who receive the paper, the distribution among regions of the recipients and a comparison with the breakdown of total residents. Finally, it shows the number of subjects who receive a card in each region and that of the corresponding families. The regions with the highest proportion of the total beneficiaries are residents of the Calabria (where 2.55% of residents receiving the paper) and Sicily (2.87% of residents). More than 50% of card purchases should be concentrated in four southern regions (Campania, Puglia, Calabria and Sicily). According to official data available at the website of the Government, to May 20, 2009 567,120 cards had been activated, and 60% of them were attributed to residents in these four regions. Italian families are categorized into ten groups of equal number (deciles), each containing 10% of households, ordered on the basis of equivalent disposable income in the first of them (the poorest) 17.8% of households receiving the paper purchases, compared with 8, 7% in the second. Overall, the social card affects 3% of Italian households. More than half of the beneficiary households belong to the poorest 10% of the population. About 57% of total expenditure goes to households located in the first decile. The bottom of the table shows the proportion of poor families, according to two alternative definitions of poverty, receiving the card. Poverty is measured here both in relative and absolute. In terms relative, is considered poor with a family income equivalent to less than 60% of the national median equivalent income. The only consideration of relative poverty is not enough to test the effects of social card, since it was conceived as an intervention for families in conditions of extreme need. E 'therefore essential to complement the impact of poverty on social card also that the absolute poverty. To this end, we exploited the recent work by Istat (2009) estimated that absolute poverty lines for different household

types (defined on age and number of components), area (North, Central and South) and amplitude of the municipality of residence. To calculate the characteristics of distribution and absolute poverty, Istat has applied this extensive battery of lines to the distribution of consumption. EU-SILC survey, however, does not have information on the overall level of consumption expenditure of households. Then we define as poor in an absolute sense a family that receives a disposable income below the appropriate threshold. It is assumed therefore that the disposable income coincides with consumption, a reasonable assumption in the case of low-income families. We obtain in this way, the EU-SILC survey data on income, an estimate of the prevalence of absolute poverty which is very close to that calculated by Istat survey on micro consumption: according to Istat fact the percentage of households poor in absolute terms in 2007 stands at 4.1%, which corresponds to 4.2% calculated in our sample. Our simulation of the social card shows that only 17% of very poor families, fewer than one in five, should be at least card purchases. This very limited penetration of the social card among poor families in an absolute sense depends primarily on personal selection criteria, which exclude those who have more than three years or less than 65. Are outside its scope, for example, families with small children not in age, between which it is known that the economic malaise is, in Italy, particularly common, or the families of non-elderly adults. The probability of receiving the social card is much higher for the southern regions, as already noted (see table below): it is about three times that on the central and northern regions. To these should be 28% of the total number of cards, 13% in the Centre, South and Islands 59%. 63% of the cards is given to households with reference person aged. The probability of receiving the paper is well above the average for families with small children and families with elderly members, while almost nothing to the families of the fifties. Despite the probability of obtaining the social card is much higher than average only for large families, the vast majority of papers focuses on families for up to three components, being aimed at households with elderly. The figure shows the Lorenz curve of the equivalent disposable income and the concentration curve of the amount transferred with card purchases. On the horizontal axis are the cumulative percentile of households, ordered by the poorest to the richest on the basis of equivalent disposable income before social card. The vertical axis represents the combined quota of social card and equivalent disposable income. The transfer is very pro-poor, since it is highly concentrated at the lower section of the distribution. Being an instrument defined in terms of all relevant, the concentration curve does not tell us anything about the impact of social card on disposable income.

Figure 1 Concentration curve of the social card and equivalent disposable income, by deciles of the latter



(Ceis Report, 2009)

### The Family Bonus

The "special bonus for families, workers, retirees and dependents" was required by law November 29, 2008, No 185, with the aim of supporting the income of households made up of employees and retirees at a time of severe economic crisis. In line with this objective, those who request it must hold income from employment or pension (or similar), while income from self-employment by the person seeking the benefit will be excluded. Otherwise, the spouse and other family members may engage in self-employment, as long as this occasionally. The revenues from funds not be denied access, but only if present in conjunction with other income and total less than 2,500 €. The bonus will be entitled to a one-off amount for 2009 alone, which varies depending on the size of the household and the total income of its members (see table below), referring to the year 2007 or into 2008. In the simulation assumes that the applicant always refers to the former. The sum may be paid to a single household member and is exempt for tax purposes. The family of relevance to access to benefits is made by the applicant, the spouse, even if not charged, and other dependents. It is important to note that this definition of family differs from the family as a group of people normally resident in the house. In practice, the family relevant to the bonus rule is people living together, but not linked by ties of kinship or marriage, the family is not dependent. The main consequence is that a family can enjoy the corresponding benefit to a family structure other than the real one. In the simulation, in order to locate the family has had to simplify, built around the reference person or his spouse. However, it is possible that a family, as a set of people who cohabit, correspond in fact more relevant to the private benefit. In this simulation, we chose to exclude this possibility, for reasons of consistency with the module that simulates the personal income tax in our model, also built around the person of reference. As for the analysis of the redistributive effects, as we continue to refer to the following family as a group of people who cohabit, except in the following table (distribution of beneficiaries by type of household). If the group is composed of a single component, will

benefit from the bonus only if the recipient of retirement income. The limit of total income is instead increased to € 35,000, regardless of the number of components, if one is disabled dependents. To think about the components disabled, was used as a proxy for the perception of social assistance or other benefits for disability, which is available in EU-SILC. The requirement in the family bonus instead, ask the certification of disability under the law 104/1992, which is issued by the same committees that evaluate the legal minors, supplemented by other operators and specialists. Nevertheless, no statistical information available on the number of disabled people so identified. Putting these assumptions, the estimated proportion of families receiving equal to 25.75%, for an annual average of 80.7 €. The total number of beneficiary families is thus about 6.18 million, for a total expenditure of approximately 1 billion and 936 million euro, which was less than 2 billion and 400 million expected.

*Table 6 Distribution of households benefiting from the family bonus for each type of family nucleus*

<i>Type of household</i>	<i>Bonus amount</i>	<i>Share of total beneficiaries</i>	<i>Access threshold (total household income)</i>	<i>Threshold with respect to such a "pensioner member"</i>
<i>A pensioner member</i>	200	47.5%	15.000	1
<i>Two components</i>	300	28.9%	17.000	1.13
<i>Three components</i>	450	9.8%	17.000	1.13
<i>Four components</i>	500	8.4%	20.000	1.33
<i>Five components</i>	600	2.2%	20.000	1.33
<i>Six or more components</i>	1000	0.6%	22.000	1.47
<i>With disabled component</i>	1000	2.7%	35.000	2.33
<i>Total</i>	-	100%	-	-

*(Ceis Report, 2009)*

Only the distribution of beneficiaries by the amount of bonus is observed that most of the recipients (about 48%) consists of families consisting of one senior member. Since the definition of household is material to the benefit not coincide with that of family as the nucleus of cohabitation, it is in every way possible that families with higher abundance receive an amount equal to 200 €. This is the case, 0 for example, a retiree who lives with her unmarried partner, or with a child not dependent. In view of this clarification, the families formed by one or two elements represent more than 50% of beneficiary families and their is little more than half of the expenditure. The proportion of households eligible for each class size is decreasing up to four components, and then grow by number higher. This trend reversed bell is partly a consequence of the equivalence scale implicit in the definition of the thresholds for access to the benefit (see tab. later), which differs significantly from the commonly used scales and provides the same limits for families with two or three components and those with four or five components. It should, however, be careful in comparing the distribution of number of family members with the criteria for the thresholds

(see table below) and because the presence of a disabled member revised the criteria regardless of abundance, or because, for the reasons already discussed, the family size does not necessarily coincide with that of the core material.

Table 7 Share of family beneficiary the bonus and the breakdown of family

	Share of beneficiary families	Beneficiary families sharing		Share of beneficiary families	Beneficiary families sharing
Geographical area			Age of reference person		
North West	20.4%	22.6%	<=30	10.4%	2.0%
North East	21.2%	16.2%	31-40	12.3%	8.0%
<b>Center</b>	21.7%	16.5%	41-50	10.2%	7.6%
<b>South</b>	35.2%	29.2%	51-65	16.6%	16.7%
<b>Islands</b>	36.2%	15.5%	>65	50.5%	65.8%
<b>Total</b>	25.8%	100%	<b>Total</b>	25.8%	100%

	Number of components		Condition of reference person		
1	34.1%	38.0%	Worker	27.7%	24.3%
2	28.1%	29.6%	Employed	5.3%	3.8%
3	19.9%	15.8%	Manager	4.1%	0.2%
4	16.0%	11.5%	Parasubordinate employment	12.2%	0.3%
5	21.4%	3.5%	Entrepreneur	0.0%	0.0%
>=6	38.9%	1.6%	Independent professional	0.0%	0.0%
<b>Total</b>	25.8%	100%	Independent	1.9%	0.6%
			Partner	10.7%	0.3%
			Retired	40.2%	53.7%
			Unemployed	23.9%	2.4%
			Disabile	53.2%	2.5%
			Housewife	54.2%	11.9%
			Student	3.1%	0.1%
			<b>Total</b>	25.8%	100%

(Ceis Report, 2009)

As for other family characteristics, the reference person is retired for more than 50% of beneficiary families, while only 28.6% of cases it is an employee. However, it is almost nothing the percentage of households benefiting from those in which the reference person is self-employed, a predictable result given the stringent constraints in this regard. In the few cases in which these families receive the benefit, the reference person carries out occasional self-employment and the applicant is the spouse, an employee or retiree. On a regional basis, 38.8% of beneficiary families residing in the North, while 44.7% are resident in southern Italy. In terms of the number of beneficiaries, therefore, there seems to be a significant difference between the two areas. The average amounts, however, are higher in southern Italy and the Islands, due to greater diffusion of households applicants other than the type "senior only".



From other calculations it is a bonus only for the average beneficiary families of 360 € and 339 € in the South Island, compared with about € 273 in the northwest, the 276 in the Northeast and 298 in the Centre. The main effect is the breakdown of expenditure that goes to 50.4% in the South, to 34.0% in the North and the remaining 15.7% in the Centre. The effect takes maximum value equivalent to the families belonging to the first two deciles, then decreased, but remained positive for higher deciles of equivalent disposable income. It is noted, in fact, a percentage of beneficiaries other than zero for the families that lived in the last decile. The bonus will then show a degree of inefficiency in directing spending to support families in terms of only 22 low-income families, a feature that we are primarily due to two factors. The first is the definition of the threshold for access to the benefits in terms of total income, the value of one part excludes certain categories of income, including financial income subject to substitute tax, while the other underestimates labor income in because of tax evasion. The second factor that explains this inefficiency is once again the difference between the definition of household in the determination of bonuses and that of family as a group of people who dwell in the house. In particular, there may be people living with incomes that high, but whose total income is irrelevant to the benefit because they do not care and other than the spouse of the applicant. The most typical example is that of unrelated persons living together by kinship, adoption or affinity, or the case of two parents whose son lives in the house, but it is not against them.

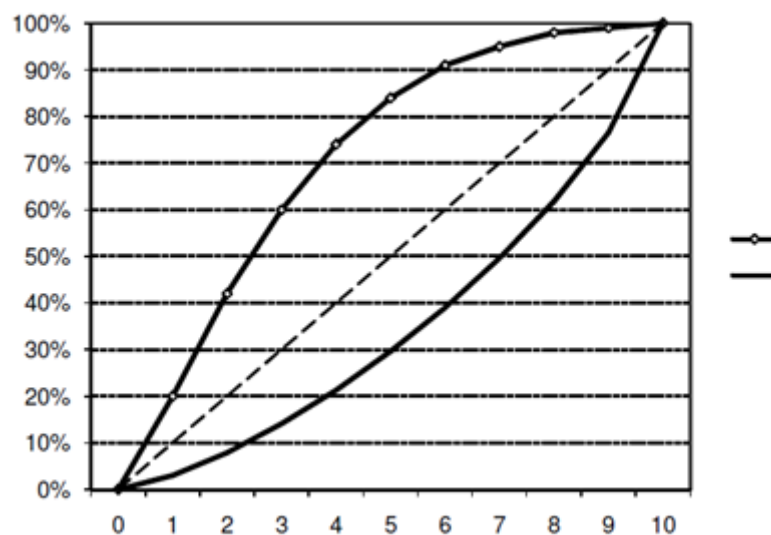
*Table 8 Average values bonus amount received by the family and income, by deciles of income equivalent diponibile*

<b>Decyl</b>	<i>Share of family beneficiary</i>	<i>All the families</i>			<i>Only beneficiary families</i>			
		<i>Equivalent amount of bonus</i>	<i>Equivalent disposable income</i>	<i>Incidence of bonus on income</i>	<i>Equivalent amount of bonus</i>	<i>Equivalent disposable income</i>	<i>Incidence of bonus on income</i>	<i>Not of the same average amount of bonus</i>
<b>1</b>	48.6%	104	6.716	1.55%	215	7.484	2.87%	406
<b>2</b>	55.6%	115	11.159	1.03%	207	11.101	1.86%	320
<b>3</b>	46.5%	95	13.799	0.68%	203	13.789	1.47%	288
<b>4</b>	36.2%	72	16.226	0.44%	198	16.189	1.22%	273
<b>5</b>	26.5%	52	18.588	0.28%	198	18.544	1.07%	280
<b>6</b>	17.2%	36	21.105	0.17%	207	21.023	0.99%	302
<b>7</b>	12.0%	23	23.947	0.10%	191	23.871	0.80%	278
<b>8</b>	7.9%	14	27.487	0.05%	172	27.116	0.63%	268
<b>9</b>	5.1%	8	32.932	0.02%	161	31.801	0.51%	251
<b>10</b>	1.8%	3	52.926	0.01%	177	46.735	0.38%	245
<b>Total</b>	25.7%	52	22.487	0.23%	203	14.796	1.37%	313

*(Ceis Report, 2009)*

The bonus-family, so the social card is pro-poor, in other words to the families belonging to the lowest deciles of income it is a more than proportional share of total spending. You can observe this by noting that in the chart above, the concentration curve dominates the bisector of the bonus equivalent. Unlike card purchases, however, the family has a bonus less concentrated on very low income families, as can be seen in Table 9, noting that the share of beneficiaries and the average amount of equivalent benefit for the second decile are greater than the first. Applicants must in fact be the recipients of an income from employment or retirement to qualify for the bonus, a requirement that it effectively excludes the self-employed poor and families in particularly difficult economic conditions. The requirements also exclude persons with sun-free pensions, such as invalids who receive disability pensions only.

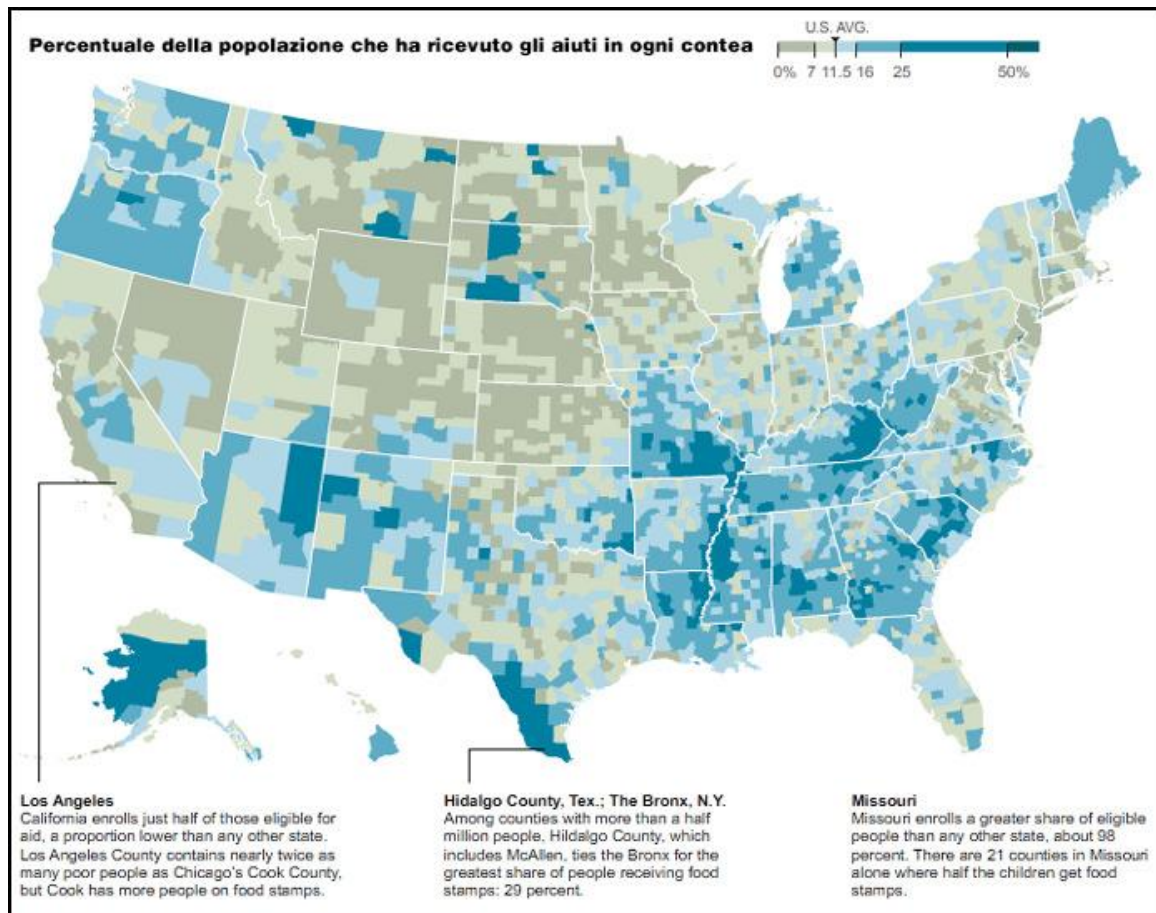
Figure 2. Lorenz curve and equivalent disposable income concentration curve of equivalent benefit



(Ceis Report, 2009)

## The Food Stamps

Born around 1940 to help poor families, the Food Stamp resemble our social card. They are used to buy food and may require low-income families, unemployed and single mothers. Given a stamp of poverty, something to be ashamed of, so far not been widely used. The breakthrough came in October 2008 when the state aid program has changed the name and, in part, the purpose. Today part of a Food Stamp assistance program (SNAP) who wants to help Americans to better feed their children. Credit cards are like in Italy, but only for use in grocery stores. Depending on the components of the family and the income may be increased to \$ 500 per month. In 2009 they have asked for 36 million Americans, that is 12% of the population, in practice, one in four children is nourished by the aid. It is a huge number, but another 15 million Americans who would be entitled not ask for them. At times, recognize their poverty is a psychological threshold crossed.



Although the Food Stamp Act is broadly bipartisan - has been renewed by George Bush - no lack of criticism. The Republicans want to restrict access to aid, encourage guilty of the laziness of the unemployed. But the most interesting discussion is another. Even eating healthy, or more expensive, is a right of the poor? In America, eating organic is considered a luxury reserved for the upper class, especially the rich Democrats sensitive to environmental issues. For the uninformed, there is the junk-food at a good price, see hamburgers sold at a dollar in many fast-food restaurants. If vegetables, pasta, and remember everything the Mediterranean diet is rich stuff, it is also because the meat is cheaper than the Americans. Consequently, the crucial question, one that contains within itself all the contradictions of American becomes this. If the poor can eat (junk food) with little, why force them to spend more on eating healthy? The paradox today is that the father of a family in need to spend money to help other people, or worse, to fight them. America is a nation that has 12 trillion in debt, but continues to behave as if sailing gold.

### The International Comparison

The Italian social card comes in the wake of the experiences undertaken abroad. For example, the first U.S. Foods Stamps Program has been operating from 1939 to 1943, only to be restarted in 1961. Currently 99.8% of the grants is provided through electronic system. From 1 October 2008, the program is called Snap (Supplemental Nutrition Assistance

Program). With an electronic card with people with no income or low income level can buy food with nutritional value. For the purpose of issuing the card has the income and resources available, housing is not included. The amount is defined by the number of persons who constitute the household. The card is accepted in most shops that sell food. Here is an overview of the social card use abroad. The card in the aftermath of Katrina, the Disaster Relief Assistance, funded mainly by private donations, was introduced in 2003 by the American Red Cross. This is a prepaid card that has played a key role in the distribution of relief after Hurricane Katrina. To give a figure, before Katrina, the Red Cross ran a stock of 70 thousand cards, after it reached a share of a million cards. The paper, which can not be used for discretionary purchases, but only for necessary goods and services, has proved fast and effective way to help victims of natural disasters. In Georgia, card supports childhood. In the State of Georgia, the government has used an electronic card to manage more efficiently the program of support to children. The initiative has allowed the families without bank accounts to eliminate tariffs collection of checks, to avoid delays in recovery or loss of checks, reducing the time of payment. In 2005 it distributed 596 million dollars. In England a card for teens based on sports and culture. In England the Government has launched a pilot project grants provided through the electronic card. The first author who took part in the project is the Cambridgeshire Country Council, which has a prepaid card distributed to children aged 13 to 17 years of low-income families. A card for a period of 12 months, charged at a rate of € 40 per month be spent only for cultural or sporting activities. In the Netherlands assistance to people in need. In Holland you use a prepaid card in different programs for the provision of subsidies by local governments that use the same platform. You can make emergency payments in special circumstances, assistance to people facing difficult financial conditions. But are also used for the payment of benefits by social security and social assistance to the unemployed. In Poland social benefits via card. In Poland, the prepaid card is used to distribute pensions and social benefits through the municipal offices in over 26 cities. It is recharged by monthly transfers from the municipal authorities and can be used without restrictions for all purchases in the exercises of the Maestro. 7. The Italian Case Poor but excluded from the social card. The poorest of the poor homeless, the poor immigrants because they do not Italian citizens, the new poor, young and insecure. Poor. The social card was the only measure of poverty created by the government but failed the target. He brought a benefit to no more than 3-4 per cent of households, leaving out the vast majority of those who would need. The amendment included in the so-called Milleproroghe, omnibus decree that raised the social card also as a private student with the entry in the field of institutions "charities involved in voluntary work, is the implicit confirmation. We have eight million people in relative poverty and more than three million in absolute poverty. In all, nearly four million poor families. In just over two years were 750 000 people who have used the card purchases. More to the south and the north. But the Ministry of Finance in that number there are those who bought with the card once. So there are less people using it constantly, 400-500 thousand. Why did you change just one of the requirements (age, for example) to not have

more right. Yet the government estimated that 1.3 million potential beneficiaries of the prepaid card. Why did this happen? Why you chose the card instead of a social instrument for direct income support as in Europe? Because the poor are left out? Why, now, it opens the entrance of the private? And as individuals? The social card was not designed for everyone. Meanwhile, cut off aliens as residents and, in many cases, poor. The social card is only for the Italians, while the share of foreigners who have lost their jobs because of the long global crisis is constantly growing. The tables say the latest "Report on the policies against poverty and social exclusion" delivered to the government before the summer in 2007 were foreigners without jobs, 9.3 percent of the total, rose to 13.5 percent in 2008 and 16.6 per cent in 2009. In Turin every hundred new members in mobility lists 37 are foreigners. But they are out of the social card. Out as young people with unstable work and no children under three years. Because apart from the requirements of income (including no more than 6,300 per annum or € 8,300 if age and many other constraints) for the social card you must be 65 or over or under 3. Italy, in fact, not a country for young people. They, however, are getting poorer: those under 34 were 4.6 per cent of the total, now rose to 4.8 percent, and the age group between 35 and 44 years increased from 5 to 5.6 per cent. It is a social metamorphosis, accelerated by the recession, the government appears not to have seen

### **The Cooperative Puzzle**

The social card is the brainchild of a cooperative Matera, whose trademark was patented in Matera in August 2008. In fact the name "Social Card" has been duly registered with the Italian Patent and Trademark Office of the Ministry of Economic Development to work in a cooperative Matera relating to the consortium "The city is essential." The label "Social Card" has been submitted to the Chamber of Commerce of Matera August 20, 2008 by Cooperativa Sociale "The Puzzle" therefore "in very difficult times " since the beginning of the Italian government.

According to state law, the name "Social Card" trademark, can not be used by anyone, including the Italian, to mark a service or object. So much so that.

Officially, the government had to call the card for pensioners' Paper purchases "can not use the words" Social card "which had been publicized in recent months by all the media. "The social card-states the report tabled by the Cooperative Puzzle Patent Office of the Ministry, is a charter of social services for citizens and communities more generally, to improve the quality of life of individu meeting social need, acting through the provision of support services in social life, from early childhood services for the elderly, disabled and better services for family life. " "The brand that we have seen, says the president of the consortium Joseph Bruno, is part of a larger project put together by the Cooperative Matera for the assistance and services to families. The project 'Die Serenity' The Puzzle of the cooperative aims to assist the entire family in everyday life by taking advantage of services and assistance, including through the use of "Social card" that allows you to book shopping at the

nursery, ask the baby sitter at home in case of illness of children and many other services". The Cooperative's Puzzle Matera is therefore the sole proprietor of the "Social Card" while the card issued by the Italian government is called "Purchase Card" even if all continues to improperly call "social card". The Puzzle The cooperative was founded in 1999, thanks to the will of people who believed from the outset in the development of human resources of the territory, the creation of a widespread culture of solidarity, in the implementation of educational services at the same time innovative and high quality. The decision to invest resources to enhance the local professionals, to promote family values, promote integration and social inclusion, to develop the principle of subsidiarity, to promote the practice of active citizenship, promote solidarity and social potential of local communities, has found its right size and has strengthened the motives of the establishment of a social cooperative that aims to pursue the general interest of the community to promote human and social integration of citizens (Article 1, L.381 / 91) and bases its tenets on the principles of mutuality, solidarity and democracy. The persons, cooperative members have begun the path to business / social experiences and activities dedicated to the band pre-adolescent, in fact, the cooperative is inspired and supported by the Blue Tree from which the center is named after childhood and adolescence same name, which houses a kindergarten, nursery school and Matching Game Room in structured environments and distinct.

Puzzle City now operates in Matera and in countries of the Province with the management of kindergartens, nursery schools equal, daycare centers for children, community housing for children, home support thirteen countries in the province. The cooperative also promotes actions of local promotion, awareness and prevention through planning initiatives in certain time in close collaboration with schools and local institutions. The service also provides a path in their supply chain to support the reconciliation of family / work called "The chain of serenity." A wide range of network services based on the concept of the chain, the tool to access services is the "Social Card" (registered trademark), through which, for example, you can access a bank of time baby sitter, or use service "spending ready."

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## TOURISM SEGMENTATION BASED ON SPIRITUALITY

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### Abstract

The island of São Miguel, in the Azores (Portugal), is characterized in terms of religious belief by the expressions of faith of its people. No doubt the best known one in the Azores is the Ecce Homo Festivities - Senhor Santo Cristo dos Milagres, which take place in the fifth week after Easter and culminates with the procession on the Sunday before the Ascension.

This paper aims at understanding the tourist movements in the Azores based on religious motivation, as well as the potential and the best strategies for developing religious tourism.

The analysis that follows aims at drawing the profile of tourists who attended the event in 2010, regarding, in particular, the several variables that allowed segmenting them in three different groups named as "Spiritual", "Religious" and "Moderately Religious".

The paper is structured in two main parts: the first explains the methodology generally used in this type of studies, presenting the data collection method that was adopted and the structure of the questionnaire; in the second part, we present the data analysis for each of the three referred segments. Finally, we will present the main conclusions, in which some problems relating to the influence of spirituality in the tourists coming for the Ecce Homo Festivities will be approached.

**Keywords:** Tourism Segments; Spirituality; Ecce Homo Feast.

### Methodology

According to Finn and Elliott-White (2000), there are three research methods for leisure and tourism: the inquiry, the experimental and the ethnographic method. The inquiry method requires a sample that will fulfil the questions previously established as essential for the research development.

Through this method, it is possible to compare individual elements from the same sample by resorting to the same questions. According to Gunn (1994), the inquiry method allows to collect a significant amount of data in a short period of time.

Apart from the advantages and disadvantages of each method, the inquiry is the one method where data dispersion is less significant. Therefore, this method adjusts best to a



quantitative analysis; in this case, one whose goal is to know and draw the profile of the tourists taking part in the Ecce Homo Festivities (EHF).

Following the aim of this research, which is to analyse the spirituality of the tourist visiting São Miguel Island during the EHF, this survey was carried out during the festivities period. The sample is composed of tourists staying at hotels in the city of Ponta Delgada, right before and after the Ecce Homo procession.

The data collection method was the direct and personal interview, since the reply rate is higher and also the interviewers may enlighten the tourists whenever necessary.

The interviews were held by fifteen (15) interviewers; three of them were responsible for the project, therefore they followed and guided the other interviewers throughout the whole training process regarding the application of the inquiry and the data collection.

The data collection was held from May 4<sup>th</sup> to May 12<sup>th</sup> in some hotels in Ponta Delgada, São Miguel Island: seven (7) 4-star hotels, two (2) 4-star apartment hotels and seven (7) 3-star hotels.

### **Inquiry Structure and Methods of Statistical Analysis**

The difficult task of drawing an inquiry sometimes leads to a certain kind of question formulating that tempts the interviewed to answer in a particular way, possibly biasing the research result. Hague and Jackson (1990) name these questions as “biased and discriminatory questions”.

In a survey on consumer buying behaviour, the author divides the questions into three categories: (1) questions about behaviour; (2) questions about attitudes and (3) classification questions. The questions about behaviour indicate the “product’s” current position, as well as its possible future position. On the other hand, the perspectives, dimensions and the image the interviewed tourists have about a certain matter are part of the questions about attitudes. The classification questions consist of “cataloguing” the interviewed, being quite important both for the qualitative analysis and the quantitative analysis. Also, there are two types of questions: open and closed – for this last type of questions the answer is previously defined. In this particular case, questions are mostly closed ones. They are organised by scales used in data analysis, namely the Likert scale (for this survey there were five options ranging from “not important/much worse than expected” to “very important/much better than expected”). In fact, this scale is a common denominator to almost every survey on consumer buying behaviour, since it is very efficient on measuring attitudes, on classifying them and easily managed (Yuksel, 2001). Finally, it should be stated that the inquiries carried out in Portuguese were translated into English and German.

The questionnaire’s structure used in this project aimed at knowing and understanding the impact and the importance of religious tourism from the perspective of the tourist that takes part in religious demonstrations in the Azores, especially the Ecce Homo Festivities.

The most delicate questions, such as those related to social and demographic features, were the last ones to be made, in order to win the trust of the interviewed throughout the inquiry.

The questionnaire also took into consideration the literature revision, based both on religious tourism and references to spirituality, allowing the creation of a set of questions on how the tourist outlooks and assesses the event.

The first part of the inquiry aimed at characterising the trip/destination as to realise what motivations are behind it, as well as the means of transportation used, the accommodation, the activities carried out during the stay and also at understanding if these tourists travel in groups.

Through this analysis it was also possible to draw some of the booking characteristics, namely how much time in advance did the tourists buy the tourism services, as well as the information sources they used to buy and organised their trip to the Azores.

The second part of the inquiry focused on psychographic features, as to understand which the religion of the interviewed is, to get to know her/his religious habits and previous trips with religious motivations. This part of the inquiry takes in two of the survey's main goals: to analyse the relation of the interviewed with religion, through variables related to spirituality, and also to understand in which way the interviewed evaluates the Ecce Homo Festivities when comparing them to other religious events and places, as to be aware of the position of this religious event among the religious tourism competitiveness.

The third part of the inquiry aimed at defining the intentions and the degree of knowledge about the EHF, as well as the main motivations that moved the tourists to take part in them.

On the fourth part, there were some questions about expectations and the level of satisfaction regarding not only the EHF, but also the São Miguel Island destination. These aspects were assessed by a 5-point scale (from "Much worse than expected" to "Much better than expected").

Finally, the fifth part included social and demographic variables, such as the tourists' nationality, their relation with emigration, age, etc.

The data collected for the inquiry was analysed and treated through the SPSS statistical software (*Statistical Package for the Social Science*), as it enables a descriptive and diversified statistical analysis and consequently the gauging of the significance level of each variable.

## **Cluster Analysis**

The groups were segmented through hierarchical and non-hierarchical clustering methods (k-means) and then confirmed by discriminant analysis. Segmentation was based on homogeneity (within the groups) and heterogeneity (from group to group).

Literature on segmentation uses mainly hierarchical and non-hierarchical methods. Hierarchical methods are mostly used for small samples. Hair, Anderson, Tatham and Back

(1998) showed that the hierarchical process is not feasible for samples with more than 200 or 300 remarks. The advantage of this method is that is not necessary to previously establish the number of segments, even if the conclusion on the number of groups results both from the dendrogram's interpretation and the researcher's knowledge of the market.

Non-hierarchical methods require the researcher to previously determine the number of groups to be created based on similarity and distance. This process is more feasible for large samples. Hair et.al (1998) concluded that the non-hierarchical method is more useful for large samples when the purpose is to gather remarks in homogeneous groups, admitting there should always be a maximum inter-group variance and a minimum intra-group variance.

Resorting to this method, it was possible to group the interviewed tourists into three clusters: "Spiritual" tourists, "Religious" tourists and "Moderately Religious" tourists.

## Result Analysis

From the 420 undertaken inquiries, 409 were considered valid. These 409 inquiries correspond to the designation "Total", thus referring to the total number of tourists interviewed for this analysis, i. e., regarding the EHF, in the Azores.

Concerning structure, the presentation of the results follows the underlying statistical analysis, which respects the purposes outlined in this survey. In that sense, point number one starts by identifying homogeneous groups of tourists (this is the main focus of this paper). The identified segments are then characterised according to the following features: social and demographical – who are these tourists (point number two); psychographic – what are their religious practices? (point three); tripographic – how do they travel? (point four); their relation with the destination (point five); characteristics of their travel bookings (point six); specificities related to their participation in the EHF (point seven); their level of satisfaction regarding the destination and the EHF (point eight); their opinion on the EHF in comparison to other religious events/places (point nine).

**Tourist Segments of the EHF by Religious Attitudes/Beliefs** – in order to segment the EHF tourists a Principal Component Analysis (PCA) was firstly undertaken, so to reduce the number of variables to be analysed. From there, and resorting to a Cluster Analysis, several segments were defined according to their degree of concordance to different statements of the interviewed on religious attitudes/beliefs.

By resorting to the PCA method, it was possible to reduce the 35 relative variables to the religious attitudes/beliefs and to extract 14 dimensions to the 35 initially taken into consideration. The extracted variables were grouped into three sets, namely: spirituality, religiousness and paranormal beliefs, as showed on table number 2. The elements, described below, stand for 65,8% of the total variance, with a 0,871 KMO and a significant Bartlett's test ( $p = 0,000$ ).

The designation found for the three groups of factors is supported by literature and it is especially concurring with the *ESI - Expressions of Spirituality Inventory*, MacDonald (2000).

According to this author, spirituality is expressed by five distinct dimensions, labelled as follows: 1) “cognitive orientation towards spirituality”, which includes beliefs, attitudes and perceptions related to the nature and the meaning of spirituality; 2) “experiential/phenomenological dimension of spirituality”, related to the meaning and the true value of life; 3) “existential well-being”, associated to the way individuals outlook the meaning and the purpose of their own individual existence; 4) “paranormal beliefs”, standing for the belief in supernatural phenomena, and 5) “religiousness”, i. e., religious behaviour and practices.

Table 1 shows the dimensions of spirituality defined by MacDonald (2000) adopted by and adapted to this survey.

Table 1 – Dimensions of Spirituality

Dimension	Correspondent Variable
Cognitive orientation towards spirituality	<ul style="list-style-type: none"> <li>- I believe that God is present in everything that I do</li> <li>- Religious beliefs mean nothing to me</li> <li>- Spirituality is an essential part of human life</li> <li>- I believe there is a higher, divine power influencing my life</li> <li>- Whenever I have to make a decision I take the spiritual consequences into account</li> </ul>
Experiential or phenomenological dimension of spirituality	<ul style="list-style-type: none"> <li>- Spiritual orientation is essential for a serene life</li> <li>- Spirituality has no true value in life</li> <li>- Material prosperity is more important than spiritual growth</li> <li>- Spirituality is not relevant for quality of life</li> <li>- I believe there are many rewards to a spiritual way of life</li> <li>- I trust my life to God</li> </ul>
Existential well-being	<ul style="list-style-type: none"> <li>- I am happy</li> <li>- Spirituality has a positive influence on my energy level and on my physical health</li> <li>- Spirituality helps to improve my professional performance</li> <li>- I usually feel stressed out</li> <li>- I constantly feel that I'm doing everything wrong</li> <li>- I consider myself a spiritual being</li> <li>- I do not understand how people are able to have a close relationship with God</li> <li>- Spirituality helps me to deal with difficult social situations</li> </ul>
Paranormal beliefs	<ul style="list-style-type: none"> <li>- I believe in life after death</li> <li>- I have experienced situations in which I felt like transcending time and space</li> <li>- It is possible to communicate with dead people</li> <li>- I believe in ghosts and apparitions</li> <li>- I have experienced situations that I cannot explain</li> </ul>
Religiousness	<ul style="list-style-type: none"> <li>- I pray on a regular basis</li> <li>- I believe that taking part in religious events is important</li> <li>- Whenever I have a problem I ask God for help</li> <li>- Whenever I have a problem I ask the Virgin Mary for help</li> <li>- Whenever I have a problem I ask the saints for help</li> <li>- I go to religious events on a regular basis</li> <li>- I feel close to God on a regular basis</li> <li>- Thanking God implies physical sacrifices</li> <li>- In order to show my gratefulness to God it is enough to keep my promises</li> <li>- A promise always implies body sacrifices</li> <li>- God forgiveness is not achieved by body sacrifices, but by our own conduct</li> </ul>

Source: Adapted from MacDonald (2000)

Therefore, the factors associated to “Spirituality”, which is the first group of variables, are related to attitudes and perceptions regarding the nature and the meaning of spirituality, as well as its importance in intrapersonal terms. This group of factors is the one that best explains total variance (33,0%), while the variables “Spirituality is an essential part of human life” (4,32/5) and “I believe that God is present in everything that I do” (4,29/5) stand out in terms of univariate analysis.

Table 2 – The tourists' attitudes and beliefs

SPIRITUALITY	
- I believe that God is present in everything that I do (4,29/5)	
- Spirituality is an essential part of human life (4,32/5)	
- I believe there is a higher, divine power influencing my life (4,21/5)	
- Whenever I have to make a decision I take the spiritual consequences into account (3,56/5)	
- Spiritual orientation is essential for a serene life (4,02/5)	
- I believe there are many rewards to a spiritual way of life (3,91/5)	
- I trust my life to God (4,23/5)	
RELIGIOUSNESS	
- Thanking God implies physical sacrifices (2,28/5)	
- In order to show my gratefulness to God it is enough to keep my promises (2,20/5)	
- A promise always implies body sacrifices (2,12/5)	
PARANORMAL BELIEFS	
- I have experienced situations in which I felt like transcending time and space (2,25/5)	
- It is possible to communicate with dead people (2,18/5)	
- I believe in ghosts and apparitions (2,56/5)	
- I have experienced situations that I cannot explain (2,93/5)	

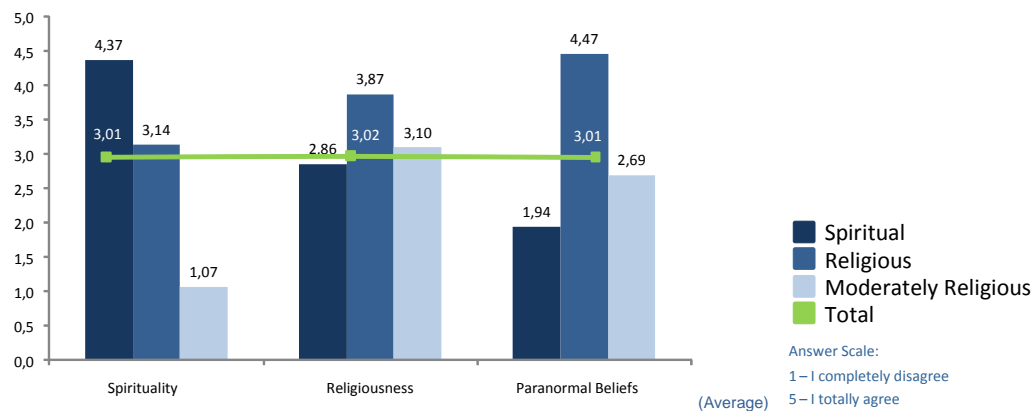
The second group of factors, labelled as “Religiousness”, stands for 17,1% of the total variance. These dimensions regard religious behaviours and practices. However, the interviewed tourists disagree with the questions about religious sacrifices.

The third group, associated to “Paranormal beliefs”, stands for 15,7% of the total variance. In this case, the variable “I have experienced situations that I cannot explain” stands out (2,93/5).

The Cluster Analysis, which was based on hierarchical and non-hierarchical criteria, points out the existence of three groups of tourists from those visiting the EHF. From the 409 cases studied, the Cluster Analysis enabled the grouping of 322 remarks. From all the cases, 97,5% were classified within the correct groups.

The analysis of image number 1 reveals significant differences between the several segments. This allows the designation of each group after their spiritual beliefs.

Image 1 - The average level of concordance between the tourist segments and the defined Attitude/Belief Groups



In general, the tourists who visited São Miguel Island during the EHF do not have a high religiousness level, while in terms of segments their attitudes vary considerably. The average level of concordance with each of the three groups of factors identified by the PCA became the base to designate each segment. Therefore, the first group was labelled "Spiritual", the second "Religious" and the third group of individuals is referred to as "Moderately Religious" (Image 2). The distinction between "spiritual" and "religious" tourists is settled on the notion that religion is not only related to individual aspects, but mainly to institutional ones and also to formal expressions of religious institutions, such as the Catholic Church, while spirituality is associated to the personal and individual side of the religious experience.

Image 2 – Tourist Segments

Spiritual (N = 143)	Religious (N = 118)	Moderately Religious (N = 61)
Spirituality (4,37)	Spirituality (3,14)	Spirituality (1,07)
Religiousness (2,86)	Religiousness (3,87)	Religiousness (3,10)
Paranormal Beliefs (1,94)	Paranormal Beliefs (4,47)	Paranormal Beliefs (2,69)

Most tourists (44,4%) follow under the "Spiritual" category. They are labelled as "Spiritual" because their level of concordance with the group of factors associated to "Spirituality" stands out (4,37/5 average). On the opposite side, these individuals are sceptical about the most enigmatic aspects of faith - "Paranormal Beliefs" (1,94/5 average).

The second group of tourists, "Religious", is the one in which individuals agree the most, in average, with the "Religiousness" aspects (3,87/5 average) and the "Paranormal Beliefs" as well (4,47/5 average). These tourists live their faith more intensely, as it goes beyond their personal issues, associated to "Spirituality", and they abide both by the institutional values of church ("Religiousness") and supernatural elements ("Paranormal Beliefs").

The last segment of tourists, being the smallest one (18,9%), is designated "Moderately Religious", since their average numbers do not overpass 3,10/5 ("I do not agree nor disagree"). This means that these individuals do not value spiritual or religious aspects in their lives.

**Social and demographic features** - the average age of "Spiritual" and "Religious" tourists is over 55 years old. For the second segment, "Moderately Religious", the average age is 45. In the first two groups there are more women than men (55,9% and 55,2% respectively), while on the other one the opposite situation occurs (39,3%). This shows that women have a larger tendency for religious practices.

Concerning nationality, the "Moderately Religious" group is the only one with a substantial number of different nationalities (44,3%), besides Portuguese and North-American (many of these tourists come from a second generation of emigrants). In the "Spiritual" and "Religious" groups, the percentage of nationalities is reduced to 4,9% and 3,4% respectively.

Most of the tourists staying in Ponta Delgada during the 2010 EHF were married - over 70% in the first two groups and 60% in the "Moderately Religious" group. Furthermore, over half of the tourists in this group have attended higher education studies (60,7%), while in the "Spiritual" tourist group the percentage is 25,2%. Also in the "Moderately Religious" group the largest number of employed people (75,4%) is registered, opposing to the 44,8% of the "Spiritual" group and to the 53,6% of the "Religious" group. This is a tendency also in what regards wages over 2.000,00 € per month: 72,2% for "Moderately Religious", 62,9% for "Spiritual" and 59,3% for "Religious". In general terms, the "Spiritual" and "Religious" groups represent the typical tourist visiting the Azores: older individuals with family bonds to the archipelago, still working or already retired, living in Portugal or in the countries where the Azoreans emigrated to - USA and Canada. Given the age of these individuals, their level of education is not very high and consequently their income pattern is quite varied. The third segment ("Moderately Religious") represents a new "kind" of tourist, one that might come from many countries (but especially from Scandinavia), who is younger, more educated, employed, who has more purchasing power and who is not so connected to spirituality and religiousness.

**Psychographic Features (religious practices)** - the variables that characterise the religious habits of the tourists that visit São Miguel Island during the EHF include her/his religion, the saints she/he worships, participating in the Sunday mass and her/his action in the parish.

It should be restated that "Spiritual" tourists are the most representative ones (44%), followed by "Religious" (36,7%) and, finally, by "Moderately Religious" (18,9%). In the two first groups, over 90% of the individuals are Catholics, while in the last one Catholics are even under 50%. In general terms, the interviewed tourists are mainly Christians: 83,1% are Catholics and 9,5% are Protestants. Apart from these, 1,2% belong to other religions and 6,2% are agnostic or do not believe in God's existence.



Within Catholics who worship saints and/or the Virgin Mary, Saint Anthony is the most referred to, followed by Our Lady of Fátima and Ecce Homo.

Most of the Catholic tourists are religiously active: 52,7% go to church every Sunday and 14,7% go at least once or twice a month. These percentages are higher for "Spiritual" tourists (57,8% and 18,5%) and "Religious" ones (57,4% and 11,3%), whilst for "Moderately Religious" tourists the percentages are 11,5% and 15,4%.

"Spiritual" and "Religious" tourists admit having an active role in their parishes. "Spiritual" tourists live their religious experiences very intensely, by taking active part in their church as catechists (27,5%) or Eucharist helpers, namely as acolytes or readers. The "Religious" tourists are essentially volunteers (27,7%) or take part in religious associations, such as Scouts, among others (24,1%).

**Tripographic Features (how do they travel)** - Concerning trip characteristics, tourists travel to the Azores during the EHF for two main reasons: for holidays (42,5%) or to participate in the EHF (39,4%). The "Moderately Religious" tourists are the ones who contribute the most for the "holidays" ratio (62,3%); the "Spiritual" and "Religious" tourists stand out for visiting the Azores with the purpose of participating in the religious festivities (51% and 52,6% respectively). "Spiritual" tourists travel in groups/tours (39,9%) and "Religious" ones travel as a couple (41,6%).

When booking accommodation, all the segments favour 4-star hotels, starting with the "Moderately Religious" (68,9%), the "Religious" (65,3%) and the "Spirituals" (56,6%).

**Relation with the destination** – as regards the tourism experience in relation to the destination, there is a clear distinction among the segments: the "Moderately Religious" tourists are usually visiting the Azores for the first time (72,1%), as opposed to "Spirituals" and "Religious" (58,7% and 55,1% respectively). From these, the "Spirituals" are the ones with a stronger connection to the destination: on average, they visit the Azores five times (excluding the current visit). This is the group with the highest percentage of emigrants (42,0%).

Most tourists coming to the Azores during the EHF visit only São Miguel Island (80,4%); only 19,6% of the tourists go to other Azorean islands. This conclusion is common to all the tourist segments, even if "Spiritual" tourists are those who usually visit other islands besides São Miguel (22,4%).

**Booking features** - Most tourists visiting the Azores during the EHF booked their trips approximately one to three months in advance (66,0%). They booked through travel agencies (36,9%), the Internet (21,6%) and by telephone (25,4%).

"Moderately Religious" tourists booked their trip later: one month (34,4%) or even one week before travelling (8,2%). On the opposite side, "Spirituals" were the ones to book earlier: 45,5% booked one to three months in advance and 23,8% booked until six months before travelling.

This is related to the fact that these tourists usually travel in groups/tours and, therefore, resort to travel agencies to book their trips.

However, as regards travel planning, many EHF tourists chose to do it themselves (35,9%). When so, the privileged information source was, apart from travel agencies (3,7/5), friends and family opinions and recommendations (3,7/5). The internet was not so used by "Spiritual" (2,5/5) and "Religious" tourists (2,7/5), but on the other hand, it was one of the "Moderately Religious" tourists' favourite sources (3,3/5).

Regarding the purchase of a tourist package, most tourists (54,3%) did buy one to travel to the Azores. This was more common near "Spiritual" tourists (55,9%) and less common for "Religious" ones (48,3%). Most tourists purchasing a tourist package chose a full package, including flight, accommodation, transfers, meals and, in some cases, tours. For "Moderately Religious" tourists the packages normally included less tourist services, covering only the flight and the accommodation.

In terms of expenses, "Spiritual" tourists spent more with their trips. Those who bought a tourist package spent on average 1600 Euros, while those who did not purchase it spent around 1300 Euros. On the other hand, "Moderately Religious" tourists spent the least in the Azores, as their trip normally did not reach 800 Euros (with or without tourist package).

**Taking part in the EHF** - Regardless the reason for their trips to São Miguel Island, the respondent tourists unanimously stated they were willing to take part in the EHF: 88.3% were assuredly willing to take part in the festivities.

The "Religious" tourist segment is the most likely to take part in the festivities. In fact, 95.8% intended to take part or actually took part in the festivities. By contrast, "Moderately Religious" tourists had the highest rate of unwillingness to participating in the EHF (27.9%).

There are several underlying reasons to taking part in the EHF: both the "Spiritual" and the "Religious" tourists participate in the festivities due to their religious devotion (67.9% and 61.9% respectively); on the other hand, "Moderately Religious" tourists take part in the festivities mostly out of curiosity (62.2%).

"Religious" tourists are those who take part in the festivities more often, having an average attendance rate of seven times. "Religious" and "Spiritual" tourists consider the EHF to be a cultural reference, and claim to have always known these religious manifestations (40.7% and 46.9% respectively), or through family and friends (22% and 18.2% respectively). By contrast, "Moderately Religious" tourists are those who are less connected to the EHF: only 11.5% think of the festivities as a cultural reference and many of them (18%) only know about this event when they are already on São Miguel Island; most times they are aware of it at the hotel.

Most "Spiritual" and Religious" tourists believe the EHF gives them spiritual comfort/inner peace (4.05/5 and 3.90/5 respectively); a feeling of renewed energy (4.01/5 and 3.92/5 respectively) or an occasion for adoring Christ (3.96/5 and 3.71/5 respectively). However,

none of the items were over 1,95/5 for “Moderately Religious”, showing the little importance they give to the religious and spiritual elements of the EHF.

**Satisfaction regarding the chosen destination and the EHF** - Tourist satisfaction can be assessed by taking into account two parameters: the first one is related to the chosen destination (São Miguel) in general and the second one is related to several aspects, namely the benefits of taking part in the EHF.

As regards the first parameter, we should bear in mind that both the landscape (4.25/5) and the accommodation (4.05/5) are the two main aspects behind a positive assessment of this tourist destination in particular, since these two features have an average rate by a consensus as “better than expected”. In fact, this is the overall review to the destination (4.02/5). By tourist segments, the “Moderately Religious” tourists are the least happily surprised ones (3.56/5); they even consider some aspects, such as the climate (2.82/5) and the flight connections (2.77/5), to be slightly “worse than expected”. In fact, climate is the less favoured aspect by all the segments (3.25/5), which can be related to the weather conditions during the EHF in 2010.

According to the assessment of tourists taking part in the EHF, we can conclude that the festivities represent a moment for “Spiritual” and “Religious” tourists to reaffirm their values and their faith in Christ. More than physical or psychological renewal, the EHF represent an opportunity for them to get closer to God (4.60/5 and 4.58/5 respectively), to adore him (4.58/5 and 4.56/5 respectively) and to obtain spiritual comfort by doing so (4.59/5 and 4.52/5, respectively). As regards “Moderately Religious” tourists, none of the above mentioned aspects surpass 3.50/5.

**The EHF and other religious destinations/events** – At this point, we compare the EHF to other religious places/events mentioned by the tourists. The choice to make open questions allowed the interviewed tourists to freely identify the most impressive religious places/events they have visited. Fátima stands out as the most recognised and impressive sacred place for all the EHF tourists, gathering 53,8% of the answers. Apart from the Portuguese sanctuary, also Santiago de Compostela (11,8%), Lourdes (11,8%), Rome/Vatican (6,6%) and the Holy Land (5,9%) are part of the most remarkable places.

The Fátima sanctuary is the most visited one but, when compared to the EHF, its assessment is quite neutral (3,4/5) for the average of the three segments. In fact, Rome/Vatican and the Holy Land bear a more positive assessment by the “Spirituals” (3,7/5 and 3,6/5 respectively), as well as Lourdes for the “Religious” tourists (3,7/5).

However, the Fátima sanctuary stands out again for representing the place the EHF tourists are willing to visit in a three to five year-period: 31,7% (average of the three segments) state their wish to return to Fátima or to visit it for the first time. Rome/Vatican comes second both

for the “Spiritual” tourists (17,9%) and the “Religious” ones (27,5%), followed by Santiago de Compostela for the “Moderately Religious” (25,2%).

Therefore, we come to the conclusion that, on a competitive level, the EHF are in a very favourable position comparing to other events/regions, even if it still exists a tendency to choose destinations with stronger religious features.

### **Final Considerations**

It is possible to identify spirituality as a variable, even if a complex one, as it enables the segmentation of people travelling to a certain destination to attend a particular event.

It is now clear that these tourists have different purposes, other than Religious Tourism, as well as different perspectives to life, which, in turn, lead to distinct interests and behaviours.

In the particular case of the Ecce Home Festivities, which take place in the Azores, Portugal, and taking the proposed segmentation as a base – “Spiritual”, “Religious” and “Moderately Religious” tourists – our advice to the Azorean tourism promoters is to continue resorting to this event, on the short and medium-term, to advertise the region.

Nevertheless, the “Moderately Religious” tourists are expected to take over, throughout the years, the “Spiritual” and the “Religious” tourists. To become more aware of these changes, it is necessary to carry out this survey on a regular basis, as to follow their development and to be able to act accordingly.

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## DYNAMIC STATISTICAL MODELS FOR BANKRUPTCY PREDICTION OF ITALIAN FIRMS

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### Abstract

Different models have been proposed in corporate finance literature for predicting the risk of firm bankruptcy and insolvency. In spite of the large amount of empirical findings, significant issues are still unsolved. In this paper we developed dynamic statistical models for bankruptcy prediction of Italian firms in the industrial sector using financial indicators. The model specification has been obtained via different variable selection techniques and the predictive accuracy of the proposed default risk models has been evaluated at various horizons by means of different accuracy measures. The reached results give evidence that dynamical models have a better performance in any of the scenarios considered.

**Keywords:** Default risk; Financial ratios; Variable selection; Logistic regression; Hazard model.

### Introduction

Business failure is widely studied within corporate finance and different models have been proposed in literature to predict the risk of firms bankruptcy and insolvency. Since the seminal works of Beaver (1966) and Altman (1968), bankruptcy prediction is attracting the attention of both academics and practitioners. Lately, academic researchers have looked for the best corporate failure prediction model (recent reviews are Falkenstein et al., 2000; Altman and Hotchkiss, 2005; Balcaen and Ooghe, 2006; Ravi Kumar and Ravi, 2007). The exponential growth of financial and micro-data availability and the development of computer intensive techniques have recently attracted new attention on the topic, leading to further investigations on some unsolved issues, such as the selection of optimal predictors and the estimate of the dynamical evolution (Sexton et al., 2003; Brabazon and Keenan, 2004; Härdle et al., 2009).

Some authors have studied the role of variables (Keasey and Watson, 1987; Mossman et al., 1998; Amendola et al., 2010) to assess whether some predictors are better than others. Others have compared the performance of static and dynamic models, in order to evaluate the impact and the effect of the time dynamics on both parameters' estimates and model performance (Shumway, 2001; Balcaen and Ooghe, 2004; Chava and Jarrow, 2004; Hillegeist et al., 2004; Dakovic et al., 2007). Few authors have attempted to assess the contribution of variable selection techniques to the performance of a model (Back et al., 1994; Brabazon and Keenan, 2004; Sexton et al., 2003; du Jardin, 2010; Amendola et al., 2011).

The aim of the present paper is to investigate the determinants of corporate failure in the Italian industry sector. In particular we focus on the role of the explanatory variables in static and dynamic approaches. The main purpose in failure risk studies is, in general, to find out the best bankruptcy prediction model, by classifying companies according to their financial variables and ratios. However, the problem which still deserve further investigation is how to choose the best predictors, among the large number of financial indicators, suitable for predicting the bankruptcy and insolvency. For this purpose, following Amendola et al. 2011, we use modern selection techniques in order to define the optimal predictor set and compare the model performance both in static and dynamic framework.

The analysis, carried out on a sample of healthy and failed industrial firms throughout Italy, aims at evaluating the model capability of improving the forecasting performance over different time windows.

The paper is structured as follows. The next section introduces the sample characteristics and the predictors dataset. Section three briefly illustrates the proposed approach. The results of the empirical analysis are reported in Section 4. The final section will give some concluding remarks.

### The data base

The sample consists of 1048 limited liability companies, operating in the industrial building sector in Italy, between 2006 and 2009. The information on the legal status and the financial information used for the analysis were collected from the AMADEUS database of Bureau Van Dijk (BVD). In particular, the disease sample is composed of those industrial firms that had entered the juridical procedure of bankruptcy in Italy between 2006 and 2009 for a total of 218 failed firms (Table 2.1). The healthy sample was randomly selected among the Italian industrial firms according to the following criteria: were still active at time  $t=2009$ ; have not incurred in any kind of bankruptcy procedures in the period from 2006 to 2009; had provided full information between 2006 and 2009. For each company, all financial statement information available in the database has been collected.

Table 2.1: Sample of Firms.

	%
<i>Healthy Firms</i>	79.20
<i>Failed Firms</i>	20.80

The sample is divided into two parts: in-sample set, used for estimating the forecasting models; and out-sample set, used for evaluating the predictive power of models. The predictors database for the years of interest (2006-2009) was elaborated starting from the financial statements of each firm included in the sample for a total of 6965 balance sheets. We computed  $p=27$  indicators selected as potential bankruptcy predictors among the most relevant in literature (Altman, 2000; Dimitras et al., 1996). They have been chosen on the basis of different criteria: have a relevant financial meaning in a failure context, have been commonly used in failure predictions literature, and finally, the information needed to calculate these ratios is available. The selected indicators reflect different aspects of the

firms' structure: Probability Area (p=12); Operational Area (p=7); Structure Area (p=5); Non-Financial Area (p=3). In this last area, the legal form, the company category and the shareholders' number are included.

A pre-processing procedure was performed on the original data set. In particular we applied a modified logarithmic transformation which is still defined for non-positive argument and mitigated the effects of outliers by “winsorizing” all observations less than 0.01 percentile and greater than 0.99 percentile (Perederiy, 2009). In other words, for each continuous covariate, the values below 1% quantile and above 99% quantile were calculated and firms with financial values outside this range were excluded from further consideration.

## The methodology

One of the main problems in risk failure prediction is how to select the optimal predictors subset, and how to single out the best model in terms of prediction accuracy. Selection of the prediction can be based on personal judgment and theoretical evidence or computed through automatic selection techniques. A classical approach in variable selection is the subset regression, which aims to select the set of the most important regressors by removing the noise regressors from the model. Within this class there are different methods: best-subset; backward selection; forward selection; stepwise selection.

Despite the large diffusion in empirical applications, these techniques have some limits and drawbacks. In particular, small changes in the data can lead to very different solutions; they do not work well in presence of multicollinearity; since predictors are included one by one, significant combinations and iterations of variables could be easily missed.

To overcome these limits, shrinkage methods can be applied. They try to find a stable model that fits the data via constrained least squares optimization. This class includes the Ridge Regression and some more recent proposal such as the Lasso, the Least Angle Regression and the Elastic Net (Hastie *et al.*, 2009).

Suppose we have  $n$  independent observations  $(\underline{x}, \underline{y}) = (x_{i1}, x_{i2}, \dots, x_{ip}; y_i)$  with  $i = 1, \dots, n$  from a multiple linear regression model:

$$y_i = \underline{x}_i' \beta + \varepsilon_i, \quad \forall i$$

with  $\underline{x}_i$  the  $p$ -dimensional vector of covariates and  $y_i$  the response variable for the  $i$ -th individual,  $\beta = (\beta_1, \dots, \beta_p)$  the vector of regression coefficients and the error term  $\varepsilon_i$  assumed to be i.i.d. with  $E(\varepsilon_i) = 0$  and  $Var(\varepsilon_i) = \sigma^2 > 0$ .

The Least Absolute Shrinkage and Selection Operator, LASSO (Tibshirani, 1996), minimizes the penalized residual sum of squares:

$$\hat{\beta}_{lasso} = \arg \min_{\beta} \sum_{i=1}^n \left( y_i - \beta_0 - \sum_{j=1}^p x_{ij} \beta_j \right)^2$$

$$\text{subject to } \sum_{j=1}^p |\beta_j| \leq \delta$$

with  $\delta$  a tuning parameter. This is equivalent to:

$$\hat{\beta}_{lasso} = \arg \min_{\beta} \left\{ \sum_{i=1}^n \left( y_i - \beta_0 - \sum_{j=1}^p x_{ij} \beta_j \right)^2 + \lambda \sum_{j=1}^p |\beta_j| \right\}$$

with  $\lambda > 0$  the parameter that controls the amount of shrinkage. A small value of the threshold  $\delta$  or a large value of the penalty term  $\lambda$  will set some coefficients to be zero. Correlated variables have chance to be selected.

A more recent proposal by Efron *et al.* (2004) is the *Last Angle Regression*, LAR. The LAR procedure can be easily modified to efficiently compute the LASSO solutions (LARS algorithm) (Friedman *et al.*, 2009), enlarging the gain in application context. The Lasso linear regression can be generalized to other models, such as GLM, hazards model, etc. (Park and Hastie, 2007; Friedman *et al.*, 2010).

In particular, the Logistic Regression equation,

$$\ln \left( \frac{p(y)}{1-p(y)} \right) \equiv \text{logit}(p(y)) = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \dots + \beta_p x_p$$

with

$$\hat{\beta} = \arg \min_{\beta} \sum_{i=1}^n \{ y_i \ln p(y_i) + (1 - y_i) \ln(1 - p(y_i)) \}$$

is modified adding a  $L_1$  norm penalty term in the Regularized Logistic Regression,

$$\hat{\beta}_{lasso} = \arg \min_{\beta} \sum_{i=1}^n \left\{ y_i \ln p(y_i) + (1 - y_i) \ln(1 - p(y_i)) - \lambda \sum_{j=1}^p |\beta_j| \right\}$$

The Logit model is a static model (also called *single-period model*), it uses a single observation per company, ignoring the dynamics of failure process. In fact, static models don't consider that the characteristics of most firms change from year to year. Moreover, they assume a steady state progression of financial distress; they omit the time of failure as an integral factor in corporate distress analysis, and finally they do not allow estimation of survival probabilities or the time of corporate failure.

Recently, in some studies (Shumway, 2001; Chava and Jarrow, 2004; Hillegeist *et al.*, 2004; Dakovic *et al.*, 2007) dynamic models have been developed in order to overcome the limits of static approach, by accounting for the time dimension of company bankruptcy, and by assuming that the failure process



is not constant over time. Moreover, Shumway (2001) says that by ignoring that firms structure change through time, static models produce biased and inconsistent bankruptcy probabilities. These models are shown to be outperformed by dynamical hazard models (Hosmer and Lemeshow, 1999), which explicitly account for time and use all available information of each firm at each time-point.

Let  $T$  be the time to failure of a firm. Let  $\underline{x}$  be a  $p$ -dimensional vector of covariates. The conditional hazard function given by:

$$\lambda(t | \underline{x}) = \lim_{\Delta t \rightarrow 0} \frac{P(t \leq T \leq t + \Delta t | T \geq t, X_o = \underline{x})}{\Delta t}$$

defines the instantaneous risk of an event occurring at time  $t$ , given the firm survives to time  $t$ .

A hazard model suitable for the analysis of failure risk analysis is the Cox Proportional Hazards Model (Lane *et al.*, 1986; Whalen, 1991; Wheelock and Wilson, 2000), where the conditional hazard rate is of the form:

$$\lambda(t | \underline{x}) = \lambda_0(t) \exp\{\beta' \underline{x}\} \quad (3.1)$$

where  $\lambda_0$  is the baseline hazard rate, that measures the effect of time on the hazard rate for an individual whose variables all have values of zero;  $\underline{x}$  is the vector of those variables that influence the hazard;  $\beta$  is the vector of their coefficients.

Shumway (2001) shows that the hazard model can be reduced to a multi-period logit model, including each firm year as a separate observation. In fact, the multi-period default probability is conditional probability, given by:

$$P(T \leq t | X = \underline{x}) \quad (3.2)$$

can be estimated by:

$$P(T \leq t | X = \underline{x}) = 1 - S(t, \underline{x}) = 1 - \exp\left\{-\int_0^t \lambda(\tau | \underline{x}) d\tau\right\} \quad (3.3)$$

where  $S(t, \underline{x})$  is the survival function.

In order to estimate the coefficients  $\beta$ , Cox (1975) proposed a partial likelihood function based on a conditional probability of failure by assuming that there are non tied values in the survival times, without any specification on  $\lambda_0(t)$ . The partial likelihood is given by:

$$\ln(\beta) = \ln \left[ \prod_{r \in D} \frac{\exp\{\beta' x_{jr}\}}{\sum_{j \in R_j} \exp\{\beta' x_j\}} \right] \quad (3.4)$$

where  $D$  is the set of indices of the failures,  $R_r$  is the set of indices of the firms at risk at time  $t_r - 0$ , and  $j_r$  is the index of the failure at time  $t_r$ . Tibshirani (1997), using the results showed in a previous paper (Tibshirani, 1995), propose to estimate  $\beta$  via the criterion:

$$\hat{\beta} = \arg \min \ln(\beta), \quad \text{subject to } \sum_j |\beta_j| \leq s \quad (3.5)$$

where  $s \geq 0$  is a user-specified parameter.

Suppose  $\hat{\beta}_j^0$  is the maximizers of the partial likelihood (3.4). Then, if  $s \geq \sum_j |\hat{\beta}_j^0|$ , the solutions to (3.5) are the partial likelihood estimates. If  $s < \sum_j |\hat{\beta}_j^0|$ , then the solutions to (3.5) are shrunk towards zero.

## The empirical results

Our main interest is in investigating the performance of static and dynamic models, focusing both on the role of the explanatory variables for predicting the bankruptcy risk and on the capability of these models of evaluating the discriminant power of the variables selected as potential predictors. In particular, we selected the optimal set of predictors by means of classical and modern approaches, and we compared them by evaluating their performance in terms of predicting the risk for an industrial enterprise of incurring in legal bankruptcy, at different rolling time windows. Therefore, four models are estimated. The Static Single-period Logistic Regression and the Dynamic Multi-period Logit model, (respectively, *Model 1* and *Model 2*), where the potential predictor have been selected by stepwise variable selection. The Lasso selection have been implemented for the regularized Static Logistic Regression and the regularized dynamic Multi-Logit Regression, (respectively, *Model 3* and *Model 4*). Three time windows (2006-2009; 2006-2008; 2006-2007) have been considered, for estimating and validating the models, and for predicting the failure risk one, two and three years ahead.

The predictive performance of the estimated models has been evaluated by means of appropriate accuracy measures, widely used in bankruptcy prediction study (Engelmann, 2003; Fawcett, 2006), on in-sample and out-of-sample sets. In particular, starting from the classification results summarized in the Confusion matrix (Table 4.1), we computed the Type I error rate (a failing firm is misclassified as a non-failing firm) and the Type II error rate (a non-failing firm is wrongly assigned to the failing group), assuming equal costs of the two errors. These rates are associated with the Receiver Operating Characteristics (ROC) analysis that shows the ability of the classifier to rank the positive instances relative to the negative instances. The classification ability is computed by the Area under the ROC curve (AUC), which is defined as the probability that the classifier will rank a randomly chosen failed firm higher than a randomly chosen solvent company. The area is 0.5 for a random model without discriminative power and it is 1.0 for a perfect model. The last measure calculated is the Correct Classification Rate (CCR), i.e. correct classified instances over total instances.

Table 4.1: Confusion Matrix.

		Predicted Class	
		Failed	Healthy
Actual Class	Failed	True Positive	False Negative
	Healthy	False Positive	True Negative

The Tables 4.2 – 4.3 show the results of the models' performance, displaying the accuracy measures computed for the in-sample and out-of-sample sets, at different time windows.

The performance of the four models for the time window 2006-2009 is summarized in the first block of Tables 4.2 – 4.3. By comparing the results of static and dynamic models (neglecting the variable selection technique considered), we noticed how the CCR and the AUC have different behavior. In fact, while the CCR in static model is higher than in dynamic one, the AUC has opposite direction. In fact, it is higher in dynamic set up. Now, looking at the variable selection methods, there is any significant difference between the lasso technique and the classic stepwise selection, both in static and dynamic frameworks. These considerations are true for all prediction time windows, i.e. when the bankruptcy is predicted one, two and three years ahead. However, it can be noted that the forecasting accuracy in terms of correct classification rate declines when we increase the number of forthcoming years for prediction, while the values of AUC increase. The performance of the models can be considered as stable even when predicting bankruptcies several years into the future. Similar considerations are done for the other two time windows (2006-2008 and 2006-2007).

The results show a better performance of forecasting models based on dynamic models, confirming that the time evolution has to be taken into account for predicting the bankruptcy. Then, there is not a significant difference in the prediction accuracy by using a traditional variable selection procedure and a shrinkage selection method. The overall models' performance, in terms of AUC, increases as the number of forthcoming years for prediction increases.

After analyzing the accuracy and the classification performance of the four models, we investigated the variables selected as predictors and the sign of coefficients' estimates, in order to give an economic interpretation and to check whether some variables appear to be equally selected among the models, according to the forecasting time windows. Table 4 shows the number of times in which every variable has been selected for the different time windows.

It can be noted that some predictors, such as Company Category, Legal Form and ROE, have been selected as predictors in the four models and for all the time windows. Comparing the variables according to the rank of appearance in the four models<sup>[1]</sup>, we noticed that Company Category and Legal Form have always been selected respectively as the first and the second predictors in all four models and for all time horizons, following by Solvency Ratio, ROE and ROCE.

Finally, the sign and the value of coefficients' estimates<sup>[2]</sup> change in different years before failure, confirmed the results by Zavgren (1985) and Laitinen and Luoma (1991).

Table 4.2: Accuracy measures for in-sample.

	Single-period Logit	Multi-period Logit	Single-period Lasso	Multi-period Lasso
<i>Sample: 2006-2009</i>				
<i>1-year ahead (2006-2007-2008)</i>				
Correct Class Rate	0.89991	0.94452	0.90340	0.94452
Type I Error	0.55474	0.81148	0.53285	0.95808
Type II Error	0.03247	0.00863	0.03082	0.00000
AUC	0.91813	0.90313	0.92200	0.89955
<i>2-year ahead (2006-2007)</i>				
Correct Class Rate	0.88183	0.93443	0.88525	0.93648
Type I Error	0.40234	0.79048	0.39063	0.76190
Type II Error	0.05795	0.00957	0.05629	0.00957
AUC	0.92283	0.88549	0.92507	0.88437
<i>3-year ahead (2006)</i>				
Correct Class Rate	0.88079	0.94305	0.87947	0.95327
Type I Error	0.33750	0.85106	0.35625	0.72340
Type II Error	0.06050	0.00424	0.05714	0.00142
AUC	0.92054	0.87378	0.92270	0.87108
<i>Sample: 2006-2008</i>				
<i>1-year ahead (2006-2007)</i>				
Correct Class Rate	0.87773	0.93443	0.88525	0.93648
Type I Error	0.42188	0.79048	0.39063	0.76190
Type II Error	0.05877	0.00957	0.05629	0.00957
AUC	0.92283	0.88549	0.92427	0.88437
<i>2-year ahead (2006)</i>				
Correct Class Rate	0.87285	0.94305	0.88079	0.94702
Type I Error	0.33750	0.85106	0.35000	0.72340
Type II Error	0.07059	0.00424	0.05714	0.00847
AUC	0.91894	0.87378	0.92459	0.87901
<i>Sample: 2006-2007</i>				
<i>1-year ahead (2006)</i>				
Correct Class Rate	0.88079	0.94305	0.87682	0.94437
Type I Error	0.33750	0.85106	0.35625	0.57447
Type II Error	0.06050	0.00424	0.06050	0.02119
AUC	0.92054	0.87378	0.92270	0.87547

Table 4.3: Accuracy measures for out-of-sample.

	Single-period Logit	Multi-period Logit	Single-period Lasso	Multi-period Lasso
<i>Sample: 2006-2009</i>				
<i>1-year ahead (2009)</i>				
Correct Class Rate	0.98742	0.99371	0.98428	0.99371
Type I Error	1.00000	1.00000	1.00000	1.00000
Type II Error	0.00633	0.00000	0.00949	0.00000
AUC	0.77690	0.62975	0.79430	0.64873
<i>2-year ahead (2008-2009)</i>				
Correct Class Rate	0.96402	0.97884	0.94180	0.97778
Type I Error	0.65000	1.00000	0.55000	0.94737
Type II Error	0.02270	0.00108	0.04757	0.00324
AUC	0.89065	0.88542	0.89157	0.88189
<i>3-year ahead (2007-2008-2009)</i>				
Correct Class Rate	0.92624	0.95405	0.91173	0.95405
Type I Error	0.48276	0.98701	0.41379	0.93506
Type II Error	0.04291	0.00000	0.06372	0.00254
AUC	0.91510	0.88534	0.91163	0.90459
<i>Sample: 2006-2008</i>				
<i>1-year ahead (2008)</i>				
Correct Class Rate	0.95534	0.97129	0.93461	0.97129
Type I Error	0.55556	1.00000	0.50000	0.94118
Type II Error	0.02956	0.00164	0.05255	0.00328
AUC	0.89015	0.91495	0.89965	0.90338
<i>2-year ahead (2007-2008)</i>				
Correct Class Rate	0.91542	0.94461	0.90120	0.94311
Type I Error	0.43860	0.98667	0.42982	0.97333
Type II Error	0.05155	0.00000	0.06792	0.00238
AUC	0.91728	0.88947	0.90758	0.89849
<i>Sample: 2006-2007</i>				
<i>1-year ahead (2007)</i>				
Correct Class Rate	0.89986	0.91961	0.88999	0.92243
Type I Error	0.45833	0.98276	0.37500	0.84483
Type II Error	0.04405	0.00000	0.06852	0.00922
AUC	0.91268	0.88230	0.91918	0.89359

<sup>[1]</sup> The ranking tables are available upon requests from the authors.

<sup>[2]</sup> The tables on coefficients' sign are available upon requests from the authors.

Table 4.4: Rank of selected variables.

ID	Variable	Area	2006-2009			2006-2008		2006-2007
			1 Year ahead	2 Years ahead	3 Years ahead	1 Year ahead	2 Years ahead	1 Year ahead
Q1	Legal Form	Non-Financial ratios	4	4	4	4	4	4
Q2	Number of shareholders	Non-Financial ratios	2	1	2	2	1	1
Q3	Company Category	Non-Financial ratios	4	4	4	4	4	4
V1	Return on shareholder funds	Profitability ratios	1	2	2	3	2	3
V2	Return on capital employed	Profitability ratios	1	2	1	0	1	0
V3	Return on total assets	Profitability ratios	3	2	3	2	2	2
V4	Profit margin	Profitability ratios	1	2	2	3	2	2
V5	EBITDA	Profitability ratios	1	1	0	1	1	0
V6	EBIT	Profitability ratios	1	1	2	2	1	3
V7	Cash flow/Operating revenue	Profitability ratios	2	2	2	2	2	2
V8	ROE	Profitability ratios	3	4	3	4	3	3
V9	ROA	Profitability ratios	2	2	4	3	3	4
V10	ROCE	Profitability ratios	3	2	2	3	2	3
V11	Net assets turnover	Operational ratios	3	3	3	3	3	3
V12	Interest cover	Operational ratios	1	1	2	2	2	2
V13	Stock turnover	Operational ratios	1	2	0	2	1	1
V14	Collection period	Operational ratios	1	1	0	2	1	0
V15	Credit period	Operational ratios	1	1	1	2	1	1
V16	Current ratio	Structure ratios	2	1	1	1	2	2
V17	Liquidity ratio	Structure ratios	1	1	1	2	1	1
V18	Shareholders liquidity ratio	Structure ratios	2	3	2	3	2	2
V19	Solvency ratio	Structure ratios	4	3	3	2	3	2
V20	Gearing	Structure ratios	0	1	1	2	0	2

## Conclusion

Dynamic models for corporate failure in the Italian industry sector have been estimated based on different variable selection procedures. The importance of time dimension in the model has been investigated, assessing the usefulness of a dynamic approach, in order to better estimate the risk of bankruptcy. Then, the capability of each model, at different time horizons and for different variable selection procedures, has been evaluated by means of some accuracy measures. Finally, the determinants of failure are further explored via some empirical findings such as the number of variables that appear to be repeated among the models, the frequency of appearance and the sign of coefficients.

From the results obtained it can be noticed that, the lasso procedure and the stepwise method perform equally well, in terms of correct classification rate and AUC, at least when the number of candidate predictors is not so high. Then, the forecasting accuracy of the dynamic approach is greater than the corresponding accuracy of static approach, in any of the considered scenarios. The multi-period model can be a good alternative over logistic regression, generating additional findings even in terms of number of predictors included in the model. In other words, the overall performance depends on the time dynamics. Furthermore, focusing on the selected variables in each model, there are some predictors that appear significant in all four models and for the different time horizons playing an important role in failure risk evaluation.

Therefore, further investigation is needed for taking into account the time dynamics and the evolutionary behavior of the financial variables in order to develop an appropriate multi-state model.

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## AN ANALYSIS OF E-LEARNING PRACTICES WITHIN CYPRUS UNIVERSITIES

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### Abstract

This paper presents an extensive research study and results on the use of existing open-source Learning Management Systems, or LMS within the public and private universities of Cyprus. The most significant objective of this research is the identification of the different types of E-Learning, i.e. Computer-Based Training (CBT), Technology-Based Learning (TBL), and Web-Based Training (WBT) within Cyprus universities. The paper identifies the benefits and limitations of the main learning approaches used in higher educational institutions, i.e. synchronous and asynchronous learning, investigates the open-source LMS used in the Cypriot universities and compares their features with regards to students' preferences for a collaborative E-Learning environment. The required data for this research study were collected from undergraduate and graduate students, alumni, faculty members, and IT professionals who currently work and/or study at the public and private universities of Cyprus.

The most noteworthy recommendation of this study is the clear indication that most of the undergraduate students that extensively use the specific E-Learning platform of their university do not have a clear picture of the differences between an LMS and a VLE. This gap has to be gradually diminished in order to make optimum use of the different features offered by the specific E-Learning platform.

**Keywords:** E-Learning, Learning Management Systems (LMS), Virtual Learning Environment (VLE), Open-Source LMS, Cyprus Universities

### Introduction

Over the past 15 years, knowledge and information about the utilization of various E-Learning services in Cyprus higher educational institutions is incomplete and limited mainly because there is still insufficient information on the key players offering E-Learning services in Cyprus (Stylianou and Kokkinaki, 2006). Moreover, the E-Learning services which are currently offered have to be systematically categorized and any future potentials of using other open-source learning management systems need to be identified. Therefore, the importance of this research becomes more evident by taking into consideration the fact that there is still very limited and in some cases no relevant information about the perceptions of Cypriots towards the use of E-Learning services within the public and private universities of the island. This research intends to add more information about the learning management systems and E-Learning within Cyprus universities.

## **Literature Review**

E-Learning is defined as encompassing both learning through the use of ICT (Information and Communication Technology) and learning the necessary competences to make use of ICT in the knowledge society (Christodoulou, Germanakos, and Samaras, 2008). E-Learning can be classified into three main categories which are Computer-Based Training (CBT), Technology-Based Learning (TBL), and Web-Based Training (WBT). CBT is a form of education in which the students learn by executing specific training programs on their computers. TBL constitutes learning via electronic technology including the Internet, intranets, audio/video conferencing, satellite broadcasts, chat rooms, and webcasts (Koller, 2001). On the other hand, WBT uses streaming media to create a dynamic learning environment via the Internet. It is an optimal way to deliver E-Learning content to a large group of people scattered around the world provided that there are high-speed Internet connections.

## **Synchronous and Asynchronous E-Learning**

Synchronous E-Learning has the potential to support E-Learners in the development of learning communities as it is commonly supported by media such as audio/video conferencing, Instant Messaging (IM), and chat. On the other hand, asynchronous E-Learning supports work relations among learners and teachers even when the participants cannot be online simultaneously. In simpler terms, asynchronous E-Learning enables the learners to log on to an E-Learning environment at any time in order to download documents, upload projects and assignments, or send messages to teachers and/or peer students. Asynchronous E-Learning is supported by media such as E-mail, blogs, and discussion boards (Hrastinski, 2008). Synchronous E-Learning makes the learners to become more committed and motivated because a quick response from the teacher and/or other peers is expected. It is mainly used for discussing less complicated issues and task-planning communications. Moreover, Kock's media naturalness hypothesis predicts that synchronous communication increases psychological arousal (Kock, 2005).

## **Learning Management System Fundamentals**

A Learning Management System or LMS is a web-based software application that is used to centralize and automate the administration of the E-Learning activities such as managing, tracking, and reporting on training events (Ellis, 2009). The types of learning delivered could be online, traditional with ICT elements, and hybrid (a combination of traditional and online learning). It also helps to deliver the learning contents rapidly, configure and personalize learning contents, and enable knowledge re-use. The main functional characteristics of a learning management system include administration tools, content accessibility, content development, content integration, skills management, assessment capabilities, reporting,

standards adherence, and security (Ellis, 2009). Figure 1 illustrates the learning management system with its typical functionalities.



Figure 1: A Typical LMS and its Functional Elements

An effective LMS should enable administrators to manage user registrations and profiles, set curricula, define roles, manage content, author courses, and administer the user payments. Content accessibility involves the medium in which the content is delivered, i.e. online or in-class as well as the methods and languages of the delivered content. The delivery methods can either be instructor-led, self-paced, or blended (a combination of instructor-led and self-paced methods). Content development includes authoring, maintaining, and storing the learning content (Trakakis, 2011). Content integration provides native support to a wide range of external systems such as Content Management Systems (CMS), portals, and registration modules. Skills management revolves around assessing the competency skills of the E-Learners using peer reviews and other feedback tools. Assessment capabilities are based on the evaluation and testing of the delivered learning content to the E-Learners. In simpler terms, a learning management system collects, tracks, and stores the assessment data since it has the capability of assessment creation. One of the most significant functions of a learning management system is the strong and flexible reporting structure which quantifies and evaluates the performance of the specific LMS. In other words, the embedded reporting structure consolidates and tracks all the learning and training efforts within the LMS and creates customized reports based on the courses offered, course completion/incompletion status, etc. Moreover, a learning management system should attempt in supporting standards such as SCORM. SCORM or Shareable Content Object Reference Model is a set of specifications applied to the course contents in order to produce small and re-usable learning objects. It implies that the LMS can import and manage courseware that complies with standards irrespective of the authoring system that has produced the content. In other words, SCORM-compliant course elements can easily be integrated with other compatible elements

which result in having a highly modular E-Learning repository. Finally, a priority in any data system containing personal user information and proprietary content is security in terms of user authorization, authentication, and data protection. Passwords and encryption methods are typical security features of an effective LMS (Ellis, 2009).

### **Learning Management Systems in Cyprus Universities**

The universities in Cyprus can be placed in two categories of public and private. The public universities of Cyprus are the University of Cyprus (UCY), Cyprus University of Technology (CUT), and the Open University of Cyprus (OUC). The private universities of Cyprus are the University of Nicosia (UNic), European University of Cyprus (EUC), the Frederick University, and the Neapolis University of Paphos (NUP). All of the mentioned universities make use of the E-Learning platforms on the basis of their students' and faculty members' essential learning needs. For instance, Moodle is one of the major open-source learning management systems that increase its share in the educational market. It is widely used within Cyprus universities particularly in the UCY, EUC, the Frederick University, and the NUP. On the other hand, UNic makes use of the Learning Activity Management System (LAMS) which is a new tool for designing, managing, and delivering collaborative E-Learning activities. The CUT and the OUC make significant use of the customized open-source LMS called eCourse and eClass, respectively which are both based on the Moodle infrastructure.

### **Virtual Learning Environment Fundamentals**

A Virtual Learning Environment or VLE is a set of teaching and learning tools specifically designed to enhance students' learning experience by incorporating computers as well as the Internet in the learning process (Jeba Kumar and Govindaraju, 2009). Ideally, a VLE should have a collection of learning tools for synchronous/asynchronous communication, assessment, student progress monitoring and reporting, collaboration, conferencing, content authoring, as well as personal productivity tools in order to completely satisfy the E-Learners' educational needs. Nowadays the VLEs are mainly used to complement the traditional learning and traditional learning with ICT elements, commonly known as hybrid (blended) learning. A typical VLE consists of these elements: administrative information, course syllabus and details, notice board, student registration, teaching material, reading material and links to digital libraries across the Internet, self-assessment quizzes and tests, communication and collaboration, and simplified content authoring tools.

Over the past 10 years universities and higher academic institutions including the universities in Cyprus have rapidly adopted VLEs due to the several benefits that they offer such as cutting down the time spent for training the users especially if they belong to the administration or research departments. Moreover, VLEs simplify the integration of traditional and distance learning because most of them are SCORM-compliant and the process of uploading, launching, and monitoring courses is standardized. The VLEs currently

available in the E-Learning industry are either commercial or open-source. The open-source VLE enables the users to have free access to their desired virtual learning software such as Atutor, Chamilo, Claroline, Docebo, Dokeos, ILIAS, Moodle and OLAT. It should be taken into consideration that some of the free open-source VLEs are also viewed as a learning management system (LMS) such as Moodle, Claroline, and Dokeos. On the other hand, there are some other learning platforms which are considered as an LMS only such as LAMS. Similarly, there are learning platforms which are solely considered as a VLE such as Blackboard which is a family of virtual learning software, WebCT which is a subset of Blackboard and it is used to enhance teaching/learning activities within a VLE. Table 1 summarizes the supported features and/or services of the most well-known VLEs available in the E-Learning market.

Table 1: Top Virtual Learning Environments

	<i>Atutor</i>	<i>Chamilo</i>	<i>Claroline</i>	<i>Docebo</i>	<i>Dokeos</i>	<i>ILIAS</i>	<i>Moodle</i>	<i>OLAT</i>
<i>Version</i>	2.0.2	1.8.7.1&2.0	1.10.4	4.0.4	2.0 Pro	4.1.6	2.0.3 & 1.9.12	7.0
<i>Origin Country</i>	<i>Canada</i>	<i>France</i>	<i>Belgium</i>	<i>Italy</i>	<i>France</i>	<i>Germany</i>	<i>Australia</i>	<i>Switzerland</i>
<i>SCORM /AICC Compliance</i>	√	√	√	√	√	√	√	√
<i>Accessibility</i>	√	√						
<i>Assignments</i>	√	√	√	√	√		√	
<i>Audio/Video Conferencing</i>		√	√		√		√	√
<i>Authentication</i>	√	√	√	√	√	√	√	√
<i>Blogging</i>	√			√	√		√	√
<i>Calendar</i>		√	√	√	√	√	√	√
<i>Chat/IM</i>	√	√	√		√	√	√	√
<i>Content Authoring</i>	√	√	√	√	√	√	√	√
<i>Course Catalog</i>				√			√	
<i>Course Management</i>	√	√	√	√	√	√	√	√
<i>Discussion Forums</i>	√	√	√	√	√	√	√	√
<i>Document Management</i>			√		√		√	√
<i>E-mail</i>	√	√	√	√	√	√	√	√
<i>File Sharing</i>	√	√	√			√	√	√
<i>Glossary</i>	√	√	√		√	√	√	
<i>Internal/Web Search</i>	√	√	√	√	√	√	√	√
<i>Learning Paths</i>			√		√		√	√
<i>Mindmapping</i>					√			
<i>Multi-Language</i>	√	√	√	√	√	√	√	√
<i>News &amp; Announcements</i>	√	√	√	√	√	√	√	√
<i>Newsletter</i>	√		√		√	√		√
<i>Pod/Webcasting</i>					√	√	√	√
<i>Quiz Tools</i>	√	√	√	√	√	√	√	
<i>Reporting</i>			√		√		√	
<i>RSS Feed</i>	√		√			√	√	√
<i>Social Networking</i>	√	√	√	√	√		√	√

<i>Statistics</i>	√		√				√	√
<i>Surveys</i>	√	√	√			√	√	√
<i>Test/Exam Tools</i>	√	√	√	√	√	√	√	√
<i>Wiki Tools</i>	√	√	√	√	√	√	√	√
<i>Web Browser</i> (IE, Google Chrome, Firefox, Opera, Safari)	IE, Google Chrome	All	All	IE, Google Chrome, Firefox, Safari	All	All	All	Firefox

### E-Learning Features and Services

Computers and Internet technologies continue to be more integrated within the professional life of academics and IT experts mainly because the instructional designers have access to a wide range of new flexible and scalable technologies. Therefore, these technologies open gateways for a multitude of different online courses, webinars, discussion forums, and other E-Learning services. Students or the E-Learners use several technology resources for their online course such as VLEs with features that support synchronous/asynchronous communications, web collaboration, content authoring/presentation, and personal productivity tools.

Concurrent and distributed systems use two types of communication methods to exchange information: synchronous and asynchronous. When sending and receiving information between a sender and a receiver are simultaneous events, then the communication is 'synchronous'. On the other hand, when sending and receiving information between a sender and a receiver do not essentially occur at the same time instant, then the communication is 'asynchronous' (Cacciagrano and Corradini, 2006).

The web collaboration focuses on how the shared virtual workspace technologies and the web conferencing provide structured synchronous and asynchronous collaboration instead of physical face-to-face meetings. They simply achieve this goal by enabling the audio-visual interactions across the Internet and shared electronic workspace particularly for developing documents such as surveys and application sharing. Some of the most well-known web collaboration tools are blogging, wiki, RSS feed, surveys, social bookmarking, file/application sharing, collaborative white-boards, collaborative research, and collaborative mindmapping tools. Collaborative mindmapping or concept-mapping is used to create diagrams of the relationship(s) between various concepts, ideas, or other pieces of information; the collaborative mindmapping technique can improve learning and study efficiency in an online learning environment up to 15% as compared with the conventional note-taking (Farrand, Hussain, and Hennessy, 2002).



Content authoring is used to prepare information in order to be presentable and accessible to individuals and groups in all types of learning environments. There are many tasks involved in content authoring such as content manipulation, distribution, and presentation (Sharma and Meenakshi, 2005). The ultimate goal of content authoring is providing an integrated system that will satisfy the concept of “author once, publish to many platforms”.

The personal productivity tools within a learning environment are mainly used for an individual learner’s personal working and learning purposes. Table 2 summarizes some of the top synchronous/asynchronous communication, web collaboration, content authoring/presentation, and personal productivity tools which have been derived from the Center for Learning and Performance Technologies for 2011.

Table 2: Top Features and Examples of an E-Learning Platform

Feature/Tool	Example
<i>Synchronous Communication</i>	
<i>Audio/Video Conferencing</i>	<i>Skype</i>
<i>Web Conferencing</i>	<i>Elluminate/Wimba, Adobe Connect</i>
<i>Chat Rooms</i>	<i>ooVoo, Yahoo Messenger</i>
<i>IM</i>	<i>Skype, Google Talk, Windows Live Messenger</i>
<i>Voice Groups</i>	<i>Voxopop, TalkShoe</i>
<i>Asynchronous Communication</i>	
<i>E-mail</i>	<i>Gmail, Microsoft Outlook</i>
<i>Newsletter</i>	<i>eNewsletter Manager</i>
<i>SMS/Text Messaging</i>	<i>GroupMe, SMSBlaster</i>
<i>Discussion Forums</i>	<i>QuickTopic, Shareflow</i>
<i>Web Collaboration</i>	
<i>Blogging/Wiki</i>	<i>Blogger, Wordpress, Wikispaces, Google Sites</i>
<i>RSS Feed</i>	<i>Google Reader, RSS Feed Reader</i>
<i>Surveys</i>	<i>Google Docs, SurveyMonkey</i>
<i>Social Bookmarking</i>	<i>Delicious</i>
<i>File/Application Sharing</i>	<i>Dropbox, Livebinders</i>
<i>Collaborative White-Boards</i>	<i>Scriblink, GroupBoard</i>
<i>Collaborative Research</i>	<i>Wikipedia, Diigo</i>
<i>Collaborative Mindmapping</i>	<i>Freemind, Mindomo</i>
<i>Content Authoring/Presentation</i>	
<i>Content Authoring</i>	<i>Adobe Captivate, Adobe Flash, eXe</i>
<i>Testing/Quizzing</i>	<i>ClassMarker, Quiz Revolution</i>
<i>Presentation Creation/Hosting</i>	<i>Microsoft PowerPoint, Prezi, Google Docs, Slideshare</i>
<i>Spreadsheets</i>	<i>Edit Grid, Google Docs, OpenOffice</i>
<i>Personal Productivity</i>	
<i>Personal Organizers</i>	<i>Evernote, OneNote</i>
<i>Calendars/Event Schedulers</i>	<i>Google Calendar, Doodle</i>
<i>Calculators</i>	<i>Screen Calculator</i>
<i>Spell Checkers</i>	<i>Spellify, SpellJax</i>
<i>Search Engines</i>	<i>Google Search, Bing</i>
<i>Research Tools</i>	<i>Google Scholar, Zotero</i>
<i>Social Networks/Collaboration Platforms</i>	<i>Facebook, LinkedIn, Twitter</i>

## Research Methodology

The quantitative research is the selected research type for conducting the study on learning management systems and E-Learning within Cyprus universities. This clearly implies that empirical data were collected using online questionnaires from all the public and private universities in Cyprus which indicated a relatively large sample. The respondents were asked a set of structured questions and their responses were tabulated. The collected data were then modeled and analyzed using statistical methods and finally the derived

results were carefully evaluated. Software packages such as SPSS <sup>[1]</sup> (Statistical Package for Social Sciences) were typically used for this purpose. The required data for this research study were gathered from the undergraduate/graduate students, alumni, faculty members, and IT professionals who currently work and/or study at the public and private universities of Cyprus using an online questionnaire in Google Docs <sup>[2]</sup>.

### Sampling Technique

The general population for this study contains all the general practitioners, i.e. students (undergraduate, graduate, and alumni) as well as the faculty members and the IT/ICT professionals of the public and private universities of Cyprus. The respondents were asked to express their views regarding the current E-Learning practices in Cyprus as well as their personal perceptions and preferences towards E-Learning services and/or features available in the mentioned universities. Since the size of the population for this study was not clearly known, random sampling technique was used so that every individual in the population of interest, i.e. the students, faculty members, and IT/ICT professionals of all the Cypriot universities have an equal chance of being selected for the specific sample. It should be noted that as the population size increases, the percentage of people needed to achieve a high level of accuracy decreases. In order to determine the correct sample size for this study, the exact size of the population, the desired error level, and the desired confidence level have to be known. The target population size was estimated to be 1,000 people even though the overall academic population of all the Cypriot universities is more than 1,000. This study aims for an error level (confidence interval) of 5% and a confidence level of 95%. The error level indicates that there will be an error margin of plus or minus 5% in the derived results. The confidence level of 95% shows how confident the researcher is towards the error level. With these inputs, the appropriate sample size for this research study is 278 which mean that if the online questionnaire is sent to 1,000 people within the mentioned universities, then at least 278 people have to complete the questionnaire in order to maintain the 95% confidence level and the 5% error margin.

### Research Analysis

The descriptive statistics especially the frequencies analysis is one of the first analysis methods used to check the validity of the data and if there are any errors in the collected data. Table 2 illustrates the frequencies analysis performed on the following variables:

- Current academic position
- Current academic institution

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[1] SPSS can be downloaded from: <http://www.spss.com>

[2] Google Docs can be accessed from: <http://docs.google.com>.

Taking a careful look at Table 3, it turns out that as the frequency increases the values for Percent and Valid Percent also increase. For instance, in the Current Academic Position table the highest frequency belongs to Faculty Member which implies that from the total number of 280 respondents to the online questionnaire, 93 are faculty members. This number corresponds to 33.1%. Moreover, the Cumulative Percent is calculated by adding the value of Valid Percent, i.e. 33.2% to the previous value of Cumulative Percent, i.e. 58.2% which becomes 91.4%; it simply indicates that 91.4% of the participants in the survey are faculty members.

Table 3: Descriptive Statistics – Frequencies Analysis

Current Academic Position					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Undergraduate Student	82	29.2	29.3	29.3
	Graduate Student	73	26.0	26.1	55.4
	Alumni	8	2.8	2.9	58.2
	Faculty Member	93	33.1	33.2	91.4
	IT Professional / ICT Support	13	4.6	4.6	96.1
	Other	11	3.9	3.9	100.0
	Total	280	99.6	100.0	
Missing	System	1	.4		
	Total	281	100.0		

Current Academic Institution					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	UCY	47	16.7	16.8	16.8
	CUT	2	.7	.7	17.5
	OUC	2	.7	.7	18.2
	UNic	157	55.9	56.1	74.3
	EUC	26	9.3	9.3	83.6
	Frederick	27	9.6	9.6	93.2
	NUP	4	1.4	1.4	94.6
	Other	15	5.3	5.4	100.0
	Total	280	99.6	100.0	
Missing	System	1	.4		
	Total	281	100.0		

Similarly, in the Current Academic Institution table the highest frequency belongs to UNic, i.e. 157 which indicates that 55.9% of the participants are from UNic followed by 16.7% which belong to the UCY.

Cross-tabulation is an efficient method to identify the relationship among certain variables. For this reason, a cross-tabulation test is performed to investigate if there is a relationship between the respondents' current academic position and their level of understanding about different forms of E-Learning, i.e. CBT, TBL, and WBT. The results of the cross-tabulation are shown in Figure 2.

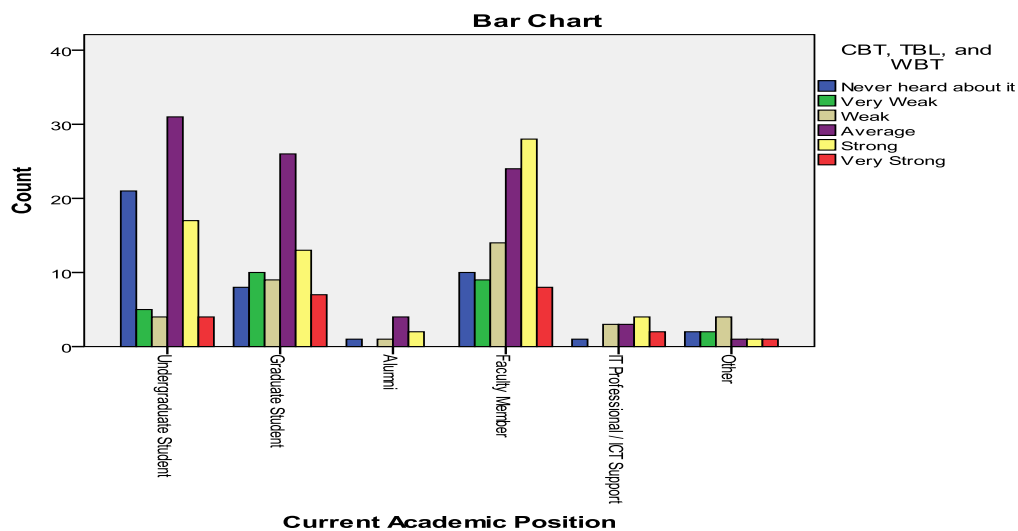


Figure 2: Cross-Tabulation (Academic Position and General E-Learning Understanding)

It turns out that the level of understanding about different forms of E-Learning, i.e. CBT, TBL, and WBT is high (Strong and Very Strong response options) among the faculty members, undergraduate students, and IT professionals mainly because the current undergraduate students incorporate E-Learning into their academic life much more than the graduate students and alumni who studied and graduated a few years ago where E-Learning was not an essential part of their educational life even though there is an average understanding of E-Learning among them. Furthermore, the cross-tabulation analysis is extensively performed on different variables, mainly the E-Learning features and/or services and their use within people with different academic positions. It turns out that the asynchronous communication tools like E-mail and synchronous communication tools like IM are widely used among the people with different academic positions who have participated in this research. Figure 3 illustrates the findings.

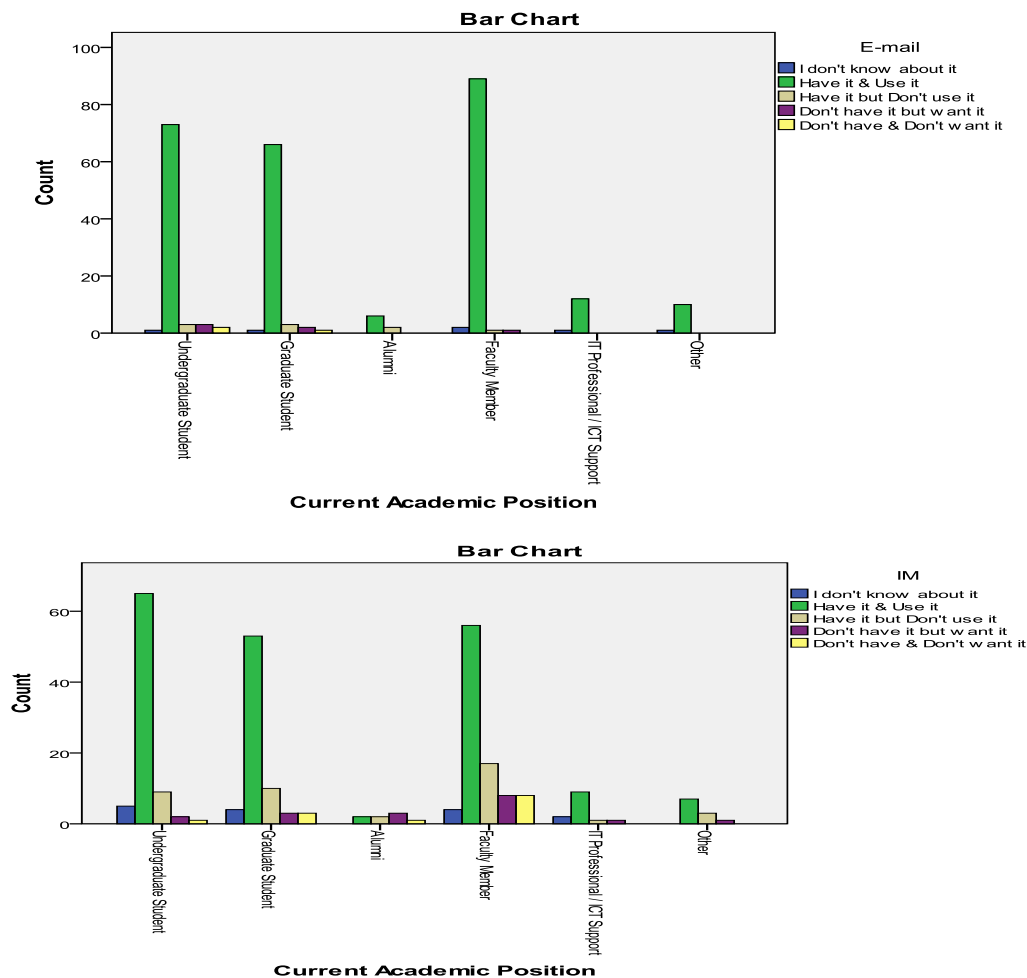


Figure 3: Asynchronous/Synchronous Communication Tools (E-mail and IM)

According to the cross-tabulation results shown in Figure 4, blogging tools are quite often used by the undergraduate/graduate students, the faculty members, and the IT professionals. The wiki tools and the survey tools are considered popular web collaboration tools as they are widely used by all the participants. The RSS feed tools are also popular among undergraduate students, IT professionals, and to some extent the graduate students; however, there is less knowledge about the RSS feed tools among the faculty members and alumni who have participated in this research study. According to the results, social bookmarking is a less investigated web collaboration tool by most of the participants mainly because the current E-Learning platforms used within the universities of Cyprus do not have social bookmarking as an embedded feature in the learning platform because some of the currently available E-Learning platforms in Cyprus universities have a feature called 'Glossary' which is sometimes used as a bookmarking service even though social bookmarking and glossary are two different features of an E-Learning platform. Another significant web collaboration feature is collaborative research by using tools such as Wikipedia which seem to be quite popular among most of the participants in the study. Similar to social bookmarking and collaborative whiteboards, collaborative mindmapping is

a new feature embedded in some of the open-source E-Learning platforms such as Dokeos; therefore, it is justifiable that most of the participants in this study have not heard about mindmapping, but they are interested in having this feature added into their learning platforms.

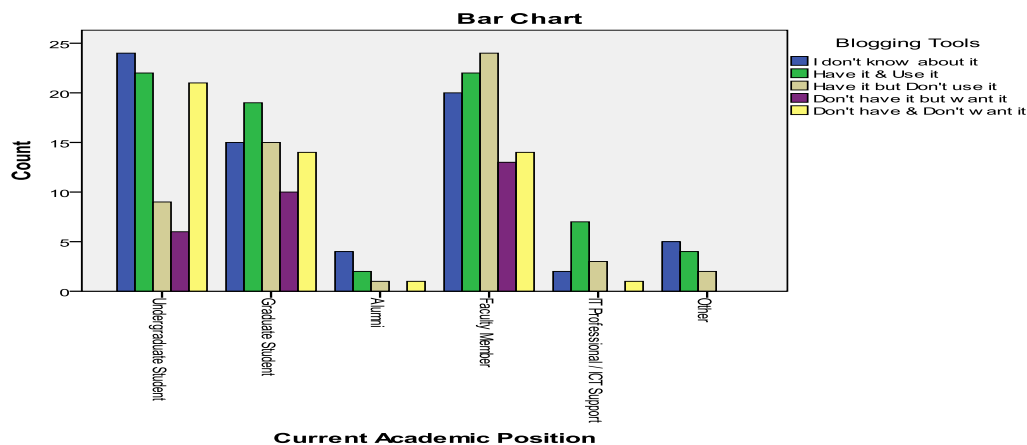


Figure 4: Web Collaboration Tools (Blogging)

One of the important parts of the conducted research was to analyze the utilization of various personal productivity tools by several groups of participants. The personal productivity tools essentially add value to the specific E-Learning platform used by the learners and instructors because they facilitate and speed up the process of E-Learning due to their 24/7 availability. The most popular personal productivity tools used mainly by the students and faculty members were online calculators, spell checkers, and social networks according to Figure 5.

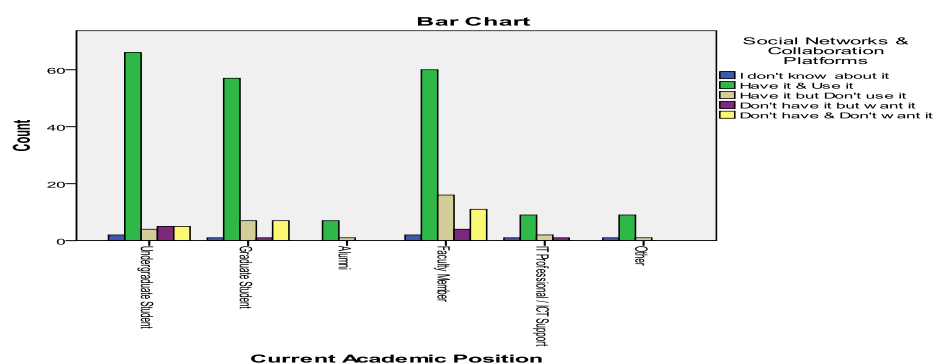


Figure 5: Personal Productivity Tools (Social Networks)

*Research Conclusions and Recommendations*

The increased utilization of E-Learning has enhanced the amount of self-directed learning among people because of the continuous improvements in the infrastructure, design, content,

and features added to the learning platforms. This has obviously created high competition among several open-source LMS vendors to dominate the E-Learning market. It turned out that adopting E-Learning solutions is beneficial for most businesses because the learning process is self-paced and self-directed, multiple learning styles can be incorporated, geographical barriers are eliminated, accessibility to the learning material is on a 24/7 basis, and the overall study costs are cheaper compared to the traditional learning.

The most noteworthy recommendations of this study based on the analysis of the collected data from the academically-oriented participants are to increase the overall knowledge about E-Learning, especially the different forms of E-Learning platforms, i.e. LMS and VLE among current students of the Cypriot universities. The derived analysis results clearly indicated that most of the undergraduate students that extensively use the specific E-Learning platform of their university do not have a clear picture of the differences between an LMS and a VLE. This gap has to be gradually diminished in order to make optimum use of the different features offered by the specific E-Learning platform.

## Future Research

The most feasible areas for future research related to this study include an in-depth analysis of the several features of the open-source LMSs other than those currently used within universities in Cyprus as well as the necessary considerations of converting the current E-Learning platforms into M-Learning platforms within the upcoming years, i.e. the next 5 years.

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## CONSIDERATIONS OF THE INTERACTIVE DIGITAL TELEVISION AS ADVERTISING MEDIA

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### Abstract

In a context of technological convergence between the television and Internet, the users can access to a multitude of audiovisual contents in the television sets or searching on line. The present work explores the effectiveness of the advertising in the new context. The objective of this research is verifying that the interactive advertising formats in television are more effective than the not interactive formats to inform, persuade and remember.

New techniques derived from multivalent logics come to be today, an interesting alternative for decision making by management compared to classical methods. Therefore, after the treatment of subjective expert input we have obtained results have revealed that the interactive advertising formats add efficacy to the media to inform and remember, highlighting the interactive spot, the TVsite and the microsite.

**Keywords:** Advertising Effectiveness, Advertising Formats, Convex Weighting, Fuzzy Subset, Relative Hamming Distance, Interactive Advertising Television.

### Introduction

The television is the media with major penetration in the population. This reach 88,7% of the people in Spain according to the EGM [1]. Its consumption, according to Kantar Media [2], is 230 minutes per person and day, and it is the main media of advertising investment according to Infoadex [3] with a quota of the 42,1% on the conventional media.

The changes produced in the television due to the spreading out of different technologies of diffusion (cable, satellite, TDT, ADSL, DVB-h, etcetera.), the digitalization of the signal, the arrival of the formats of high definition (HDTV) and 3D, the convergence with Internet, the appearance of technologies like the multimedia hard disks, the PVRs or InOut TV, as well as, the changes produced in the audiovisual sector with the concentration in multimedia groups and the appearance of new operators as Hulu, Netflix and Google TV, have modified the current panorama as for the number of existent canals as the form of access and the consumption of the audiovisual contents.

There are three key factors that have caused changes in the consumption of the users on the audiovisual content and the perception about the advertising. The first of them is the increase of the number of channels resulting from the introduction of new forms of diffusion and the use of the capabilities of compression of the digital signal, that have fragmented the

audiences (Toro, 2006) among a host of free and payment channels, so much generalist as thematic. In second place, the advertising saturation of the generalist channels as reflected in the work of González Lobo and Carreo (2003), Reinares and Reinares (2003), Sainz (2004), that constantly exceed the limits of advertising insertion getting the advertising blocks lengthen to him and disturb to the audiences, besides increasing the advertising noise (Reinares et al, 2003 ). In third place, the techniques of counter-programming applied by the channels, to combat the attacks from competitors, which cause that the users can't accede to the planning contents or waste time due to the delays of program. In this situation the users adopt technologies (PVRs and services as InOut TV) and habits of consumption (zapping and watching television on Internet), allowing them skip advertising and accede to the contents more interested in the desired moment, that is, each time the consume will be more active and personalized.

The Interactive Digital Television has introduced the concept of interactivity in the television, which is the ability to offer additional contents to the programs, allowing users to customize and view information associated with them, participate in contests and polls, acquire products and even participate in development of the programs with the remote control. The interactivity can be local, with data stored in the decoder, remotely, with a subsequent response through the return channel, or else, in real time by connecting to networks and content servers. This feature has allowed the development of the interactive advertising formats that allow the viewer to participate in the advertising communication process for alter part of the content, expanding the products information or the points of sale, request free samples or product tasting, start the buying process, etcetera.

Given the current context, advertisers and professional of sector rethinking the effectiveness of their advertising insertions in the media, being very questioned so much for organizations like the Asociación Española de Anunciantes (2005), AEDEMO (2005 and 2006), Mediaedge:cia (2006) and Taylor Nelson Sofres A.M (2006) as in the academic environment (Toro, 2006), (González Lobo et al, 2003), (Reinares, 2003), (Sainz, 2004).

Therefore the object of present work is study the efficacy of the advertising formats in the Interactive Digital Television. To resolve it there are two objectives of investigation. In the first place, it decides if the interactive advertising formats in television are more effective than the not interactive formats as for their ability to inform, persuade and remember. In second place, it decides if the Internet formats are effective in Interactive Digital Television or need carry out to him adaptations to the halfback.

Following it review the efficacy measures of the advertising formats in others researches, after it defined the advertising formats that take part in the study, it proposes the methodology for the analysis and it is presented the main obtained results. Finally expose the conclusions and involvements that have for the advertising industry.

## **Advertising Effectiveness**

Along the literature appreciate different measures of advertising effectiveness. Lavidge and Steiner (1961) use the hierarchy effects model to measure the effects of the advertising in every one of the phases of the process of disposition to the purchase: awareness, knowledge, taste, favourable attitude towards the product or feeling, conviction and purchase.

Stewart and Furse (1986) use the measures of efficacy proposed by the Research Systems Corporation: comprehension, persuasion and remember, to measure the efficacy of 1059 television commercials.

Aaker, Batra and Meyers (1992), as well as, Díez de Castro, Martin Armario and Sánchez Franco (2002) it proposes the use of variables related to profitability and the sales to measure the advertising effectiveness, the academic research shows reluctant, keeping in mind the difficulty to insulate the effects of the advertising effort in the sales of the others factors, as well as, the delay of its effects, as like takes Shelter in Clarke (1986) and Farbey (1994).

This research uses, to measure the efficacy of the advertising formats, the basic ends of promotion instruments introduced by Kotler (1989): inform, persuade and remember, similar to the measures used by Stewart and Furse (1986).

## **The Advertising Formats**

There is a great variety of advertising formats definitions, keeping in mind the different professional sources consulted: advertising managers of the main television channels, Infoadex, Kantar Media, AIMC and IAB, as well as, scientific publications: González López (2002), Reinares and Reinares (2003) and Aymerich (2007). For this it have wants to collect the definitions of the different evaluated formats, to avoid any confusion. In this sense, has differentiated between non-interactive formats and interactive formats so much the television formats and Internet derivatives formats.

Table 1. Definition of the non-interactive advertising formats

<i>Format</i>	<i>Definition</i>
<i>Advertorial</i>	<i>Commercials masked of news.</i>
<i>Self-promotion</i>	<i>Commercials of own products of channel.</i>
<i>Bartering</i>	<i>Cession of the emission fees to the channel in exchange for advertising space.</i>
<i>Mask of entrance</i>	<i>Spaces of 5 or 10 second to the start-up, pauses or finalization of the content.</i>
<i>Morphing</i>	<i>Element of program continuity with the logotype of the channel that serves to separate the content of the advertising, and that it can be mix with the elements of image of the advertisers.</i>
<i>Sponsorship</i>	<i>Inserting advertising in a televised show with the objective of reaching to the audience.</i>
<i>Infomercial</i>	<i>Teleshopping space for inform about the product characteristics or benefits by celebrities.</i>
<i>Microprogram</i>	<i>Space dedicated to talk about a particular product or topic related to the product.</i>
<i>Active sponsorship</i>	<i>The product integrates with the content of the program and pays the costs of creation and maintenance.</i>
<i>Passive sponsorship</i>	<i>Presence of the advertiser in a content or simply mentions to it, but the content is not about the product.</i>
<i>Product placement</i>	<i>Product insertion in the development of the content script.</i>
<i>Long-spot</i>	<i>Habitually, space of 1 minute related with informative advertising of the organizations.</i>
<i>Overlay</i>	<i>Advertising message or representative icon of the advertiser that occupies a part of the screen during the emission of a content.</i>
<i>Spot</i>	<i>Space of video where the advertisers send a message to the target. The standard size is 20 seconds.</i>
<i>Telepromotion</i>	<i>Space of video where the series or programs characters develop the communication about the product.</i>
<i>Teleshopping</i>	<i>Channels dedicated to offer infomercials.</i>

Table 2. Definition of the interactive advertising formats

<i>Format</i>	<i>Definition</i>
<i>DAL</i>	<i>Dedicated Advertiser Location. Application that provides access to information of the advertiser or games where the product or the brand is the protagonist.</i>
<i>Impulse Response</i>	<i>Interactive overlay of a advertising message in the screen that allows to request samples or catalogues and provide personal data to participate in a promotion.</i>
<i>SMS messages and calls to 905 lines</i>	<i>Overlay that allow access to crowd of downloads services with other devices, such as cell phones, or interact with the contents by poll, contests, IRC, etcetera.</i>
<i>Microsite</i>	<i>Wallpaper with information about the advertiser for navigate with the remote control without leaving the programming content, which continues in a small screen.</i>
<i>Mini-Dal</i>	<i>Reduced version of DAL with less screens. It doesn't dispose of video and neither navigation menu.</i>
<i>Interactive program sponsorship</i>	<i>Introducing interactive form (banner, button, etc.) in a sponsoring program.</i>
<i>Interactive spot</i>	<i>Similar format to the spot but that has the ability to redirect to a space where viewer can extend information about the product or the points of sale, request free samples, etcetera.</i>
<i>Telescoping ads</i>	<i>Format that requesting users for the interaction through a banner to display out a section that provide more information. The content has been previously downloaded to the flash memory of the decoder or the PVR.</i>
<i>TV Site</i>	<i>Space outside of the contents enabled by the advertiser, where users can obtain more information about products, access to services or initiates a purchase process.</i>

## Methodology

In order to analyzing the effectiveness of the advertising formats in interactive digital television, propose the objective:

Determine if the interactive television advertising formats are more effective than the non-interactive formats in their ability to inform, persuade and remember. It wanted to reach this objective contrast to the following hypotheses:

H<sub>1</sub>: The interactive formats occupy the first positions of the ranking in the ability to inform.

H<sub>2</sub>: The interactive formats occupy the first positions of the ranking in the power of persuasion.

H<sub>3</sub>: The interactive formats occupy the first positions of the ranking in the ability to remember.

For the contrast of this hypotheses proposes analyze the efficacy of every advertising formats, keeping in mind, in a side, the importance that has the characteristics that compose them to get inform, persuade and remember; in other, the desirable level of the characteristic that it must have to get it, and finally the degree to which the advertising formats meet those characteristics.

The analysis is based in two basic assumptions: first, overcoming the desirable level of the characteristics does not penalize the effectiveness of the format, and second, there are not characteristics that have a minimum level of compliance.

It has wanted to start the analysis of the formats effectiveness using a fuzzy subset for describing (Kaufmann et al, 1986) formed with a referential composed by 20 features, 9 of those are features related to the format (Images, Texts, Slogan, Video, Animation, Music, Voice in off, Duration, Size); 5 are related with the context of insertion of the format (Timing, Environment affinity, Environment engagement, Display, Ability to customize the message); and 6 are related with its interactive ability (Content manipulation, Linearity, Free navigation, Response delay, Return channel, Giving up the emission).

Keep in mind the 34 formats of Referential set (Kaufmann et al, 1986) F:

$$F = \{F_1, F_2, F_3, \dots, F_{32}, F_{33}, F_{34}\}$$

And the 3 proposal objectives:

$$O = \{O_1, O_2, O_3\}$$

Experts suggest the principal characteristics than configure the advertising formats and value all elements of the referential set for completing the characteristic membership functions (Kaufmann et al, 1986) of everyone of the fuzzy subset, so much of the formats:

	C <sub>1</sub>	C <sub>2</sub>	...	C <sub>m-1</sub>	C <sub>m</sub>
F <sub>n</sub> =	$\mu_{C_1}^{(n)}$	$\mu_{C_2}^{(n)}$	...	$\mu_{C_{m-1}}^{(n)}$	$\mu_{C_m}^{(n)}$

Being  $\mu_{C_i}^{(n)}$  valuations between [0, 1], m the number of characteristics and n number of formats.

As of the proposal objectives:

	C <sub>1</sub>	C <sub>2</sub>	...	C <sub>m-1</sub>	C <sub>m</sub>
O <sub>p</sub> =	$\mu_{C_1}^{(p)}$	$\mu_{C_2}^{(p)}$	...	$\mu_{C_{m-1}}^{(p)}$	$\mu_{C_m}^{(p)}$

Being  $\mu_{C_i}^{(p)}$  valuations (confidence intervals) between [0, 1], m the number of characteristics and p number of formats.

After the description by fuzzy subsets of all formats and the three specific objective (Table 3), experts have decided to weight each characteristic belonging to each objective describes by convex weighting:

$$\omega_n = \frac{v_n}{\sum_{i=1}^n v_i}$$

Obtaining:

$$\omega_1 = \frac{v_1}{\sum_{i=1}^n v_i}, \omega_2 = \frac{v_2}{\sum_{i=1}^n v_i}, \dots, \omega_m = \frac{v_m}{\sum_{i=1}^n v_i}.$$

In this case, it made "subweight" and "sub-subweight" according to characteristics sets analyzed (Table 3).

Obtained the total of the necessary information, find the relative Hamming distance with Convex Weighting that separate each format of the analysis to the three established objectives, because the experts consider that the excess of the features values is so bad like the defect in the effectiveness analysis of the format, the degree of "proximity to the ideal", must being 0.

For this, we calculate the Hamming distance:

$$d(\tilde{F}, \tilde{O}) = \sum_{i=1}^n \omega_n |\mu_O(x_i) - \mu_F(x_i)|$$

where  $x \in \forall i = 1, 2, \dots, n; \mu_F(x_i), \mu_O(x_i), \omega_n \in [0, 1]$

Thus, it will obtain the distance between the objective 1 and the format 1:

$$d(\tilde{F}, \tilde{O}) = [0.358, 0.371]$$

and, in the same way, all the remainders (Table 3).

The arithmetic between confidence intervals has for some time allowed us to arrive at satisfactory results. Nevertheless, when we do a subtraction in which the subtrahend confidence interval is partially or totally greater than the minuend, we would be faced with the incongruence that on looking for the absolute value (logical operation if we are speaking about a distance such as the Hamming distance), the negative values would become positive, in this case leading to the fact that the distance instead of being minimum (or 0), would become greater than that corresponding to reality.



A simple easily understood example for this case could be:

For characteristic  $C_n$ , the objective considered ideal (**I**) is valued by the experts with: **.5**. If one of the formats has been granted by the experts, for this same characteristic, values included between **[.3, .6]**, we can see that, in the calculation process for the Hamming distance the result of this partial operation would be:

$$| [.5, .5] (-) [.3, .6] | = | [-.1, .2] | = [.1, .2],$$

a solution which is totally erroneous if the hypothetical value included in the confidence interval **[.3, .6]** were **.5**. It is clear that the result: **.5 (-) .5 = 0** would not be found between the minimum **.1** and the maximum **.2** that make up the confidence interval that is the result of the operation.

At this juncture we would like to make a small consideration by pointing out that when the result of the subtraction is a confidence interval in which the lower extreme is negative, we must consider, on doing its absolute value for the calculation of a distance, that the minimum distance (lower extreme) will always be equivalent to zero.



## Resolution

The table 4 show the distances [0, 1] obtained for the advertising format in its ability to inform, persuade and remember. 1 means that the format is not allows getting the objective, while 0 indicates that the format allows getting the totality of the objective. There is not any format with maximum proximity to ideal but neither exist a format that allows getting the absolute purpose.

Table 4. Ranking of proximities to the ideal

	Inform				Persuade				Remember		
	Interval		Mean		Interval		Mean		Interval		Mean
Interactive spot	0,243	0,324	0,284	Interactive spot	0,280	0,290	0,285	Interactive spot	0,243	0,269	0,256
TV Site	0,266	0,319	0,292	Telepromotion	0,271	0,314	0,292	TV Site	0,294	0,313	0,303
Microsite	0,316	0,328	0,322	Spots	0,280	0,336	0,308	Microsite	0,327	0,334	0,331
Long-spot	0,315	0,332	0,323	Long-spot	0,317	0,349	0,333	Telepromotion	0,332	0,339	0,336
Mask of entrance	0,336	0,355	0,345	TV Site	0,306	0,362	0,334	Long-spot	0,334	0,373	0,354
Telepromotion	0,324	0,388	0,356	Infomercial	0,329	0,379	0,354	Spots	0,348	0,360	0,354
Microprogram	0,341	0,371	0,356	Advertorial	0,352	0,370	0,361	Advertorial	0,376	0,389	0,382
Spots	0,333	0,379	0,356	Mask of entrance	0,343	0,383	0,363	Active sponsorship	0,346	0,423	0,384
Infomercial	0,348	0,380	0,364	Active sponsorship	0,330	0,403	0,367	Mask of entrance	0,376	0,397	0,387
Advertorial	0,358	0,371	0,364	Microprogram	0,383	0,384	0,383	Microprogram	0,385	0,389	0,387
DAL	0,353	0,389	0,371	Product placement	0,356	0,445	0,401	DAL	0,396	0,417	0,406
Active sponsorship	0,346	0,406	0,376	Overlays	0,394	0,424	0,409	Product placement	0,361	0,461	0,411
Passive sponsorship	0,381	0,408	0,395	Microsite	0,413	0,415	0,414	Infomercial	0,396	0,429	0,413
Mini-Dal	0,384	0,417	0,401	Passive sponsorship	0,399	0,430	0,414	Passive sponsorship	0,398	0,446	0,422
Impulse Response	0,367	0,465	0,416	DAL	0,423	0,465	0,444	Mini-Dal	0,435	0,458	0,446
Product placement	0,406	0,447	0,426	Morphing	0,430	0,464	0,447	Overlays	0,459	0,464	0,461
Telescoping ads	0,393	0,475	0,434	Impulse Response	0,446	0,537	0,491	Impulse Response	0,416	0,512	0,464
SMS messages & 905 lines	0,414	0,460	0,437	Mini-Dal	0,480	0,514	0,497	Telescoping ads	0,449	0,500	0,475
Morphing	0,445	0,453	0,449	Telescoping ads	0,467	0,530	0,498	SMS messages & 905 lines	0,463	0,494	0,479
Overlays	0,449	0,455	0,452	SMS messages & 905 lines	0,488	0,515	0,501	Morphing	0,471	0,505	0,488

The results of the table 4, allows contrasting of the three hypotheses to reach the objective.

H<sub>1</sub>: The interactive formats occupy the firsts positions of the ranking in the ability to inform. The interactive spot (0,284), the TV site (0,292) and the microsite (0,322) are the most effective advertising formats and the three are interactive formats.

H<sub>2</sub>: The interactive formats occupy the first positions of the ranking in the power of persuasion. The interactive spot (0,285), telepromotions (0,292) and spots (0,308) are the most effective advertising formats.

H<sub>3</sub>: The interactive formats occupy the first positions of the ranking in the ability to remember. The interactive spot (0,256), the TV site (0,303) and the microsite (0,331) are the most effective advertising formats and all three are interactive formats.

Keeping in mind the results the hypothesis H<sub>1</sub> and H<sub>3</sub> can be confirmed but not is possible to confirm the hypothesis H<sub>2</sub>. Then is possible conclude that the television interactive advertising formats are more effective than the non-interactive formats in their ability to inform and remember.

Table 5. Ranking of means of the distances to the ideal

<i>Format</i>	<i>Distance to ideal</i>
<i>Interactive spot</i>	<i>0,27</i>
<i>TV Site</i>	<i>0,30</i>
<i>Microsite</i>	<i>0,32</i>
<i>Telepromotion</i>	<i>0,33</i>
<i>Long-spot</i>	<i>0,34</i>
<i>Spots</i>	<i>0,35</i>
<i>Advertorial</i>	<i>0,37</i>
<i>Active sponsorship</i>	<i>0,37</i>
<i>Mask of entrance</i>	<i>0,37</i>
<i>Microprogram</i>	<i>0,38</i>
<i>DAL</i>	<i>0,39</i>
<i>Product placement</i>	<i>0,40</i>
<i>Infomercial</i>	<i>0,41</i>
<i>Passive sponsorship</i>	<i>0,41</i>
<i>Mini-Dal</i>	<i>0,44</i>
<i>Overlays</i>	<i>0,44</i>
<i>Impulse Response</i>	<i>0,46</i>
<i>Telescoping ads</i>	<i>0,47</i>
<i>SMS messages &amp; 905 lines</i>	<i>0,48</i>
<i>Morphing</i>	<i>0,48</i>

In table 5 it observes the mean of the distances to the ideal (inform, persuade and recall) to facilitate the selection of the format in the totality of its objectives, because the consulted experts accept a trade off between objectives. The interactive spot (0,27), TV site (0,30) and the microsite (0,32) are in the top of the ranking of proximity to the ideal. This ideal is a conjoint measure of the objectives (inform, persuade and remember). The formats in the top of the ranking are interactive advertising formats.

## Conclusions

The development of the study has confirmed the hypotheses H<sub>1</sub> and H<sub>3</sub> that sustained the objective of the research. Then is possible affirm that the advertising interactive formats are more effective than the non-interactive advertising formats to inform and remember. In a multiobjective decision, usually in the media planning, the interactive spot, the TV site and the microsite are the most effective formats in television. In this sense, the interactivity has certain influence on the advertising effectiveness.

Advertisers and advertising agencies must keep in mind the interactivity formats in their planning of television advertising campaigns. And the television sets must be introducing interactivity in their advertising portfolio to improve the attractive of television as advertising media.

Moreover to the results and their application in the professional field, it is necessary to consider the effort of collect of the different formats as reference for futures works.

The study was conducted for the Spanish market of the television, but could be extended to other markets, resulting a multi-market study that allows comparing their differences.

In the study three measures of advertising efficacy have kept in mind, in future research could be completed adding other measures attending the wellness of obtained results with the proposed methodology. Agreement with the Interactive Advertising Bureau the users refused formats that breaks the flow and theses that produce unexpected effects. Future research can be incorporating an additional effectiveness measure of the advertising formats as the format user's rejection considering their negative effects in the prosecution of the message.

Additionally, the general objective can be decomposing in specific advertising objectives to facilitate to the advertisers an instrument for improving the effectiveness in the television advertising planning.

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## THE INVOLVEMENT PROCESS THROUGH SOCIAL MEDIA IN 2010 UK ELECTIONS: IS IT A REAL FACEBOOK BASED PARTICIPATION?

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### Abstract

As far as the use of the Internet for election campaigns is concerned, the most interesting experiences seem to draw an evolution from the traditional party organization to a more innovative digital participative organization. On the one hand, the associative dimension of the parties, based on membership and on local rootedness (party on the ground), is deemed to be in crisis by a large number of scholars (Kartz and Mair 1995). This decline is linked to a loss of legitimacy and trust in political parties (Dalton 2002). On the other hand, the evolution of the Internet creates the opportunity for supporters to find the operative and organizational tools necessary to get involved in consensus-developing activities. In this scenario it would be simplistic to consider the Internet a mere means of communication, instead we need to focus on its mobilization, organization and participation potential.

This paper focuses on the way of generating participation on Facebook, by analysing UK General Elections 2010. In particular, the analysis investigates which are the communication strategies used by the three main party that are able to elicit participation of Facebook users.

The study is based on data collected on the Facebook pages of the three main candidates: on this basis, we verify the following research questions.

1. Participation level increases with the number of posts written by the party?
2. Participation level increases by writing call to action posts?
3. Participation level increases by writing posts about the candidate?
4. The issues addressed in the post influence the participation level?

**Keywords:** Political marketing, Social network, Social media marketing, Facebook, UK 2010 elections, Social media users behaviour.

### Introduction

As a political instrument, the Internet is mainly dealt with from two main points of view. On the one hand we focus on the opportunities offered by the Internet to encourage political participation (e.g. see the recent analysis of Coleman and Blumler, 2009; Mayer-Schonberger

and Lazer, 2007; Sunstein, 2009 and Bennet and Wells, 2009). On the other hand, the Internet is considered a means of mass communication, potentially useful to politicians in sustaining TV, radio and newspapers to influence voting behavior during electoral campaigns.

In recent years there have been any studies on the significant experiences of the U.S. (Vaccari, 2007, Haney, Newman & Sylvester 2010, Chadwick, 2006), France (Vaccari, 2008; Bastien and Greffet 2009), England (Coleman and Ward 2005, Ward, Gibson et al. 2003; Ward, Gibson et al. 2005) and other countries on the use of the Internet for election campaigns. The most interesting experiences seem to draw an evolution from the traditional party organization to a more innovative digital participative organization. The associative size of the parties, based on membership and on local rootedness (party on the ground), is in crisis (Kartz and Mair 1995). This decline (Della Porta 2001; Ranieri 2002; Massari 2004) is linked to a widespread loss of legitimacy and trust in political parties (Dalton 2002). Parties have tried to remedy this trend through the adoption of measures to ensure greater participation of members in decision-making processes, in the selection of candidates and managers, and of the policy choices (Ignazzi 2004). To the model of 'modern' election campaigns, based on mass communication, unidirectional, centralized, televisional, advertising and general, oppose the campaign so-called "postmodern", in which the public can be divided into segments to whom parties can offer more targeted content, up to customized one-to-one targeting (Vaccari 2009).

In this scenario it would be simplistic to consider the Internet a mere means of communication. Instead we need to focus on its mobilization, organization and participation potential. Supporters of a political party can find on the Internet the operative and organizational tools necessary to get involved in consensus-developing activities aimed at the members of their social network. The Internet allows to reach influential voters, creating effective decentralized and flexible political participation activities.

Various researches (Stroud, 2008; Baum and Groeling 2008) have in fact demonstrated that users choose political contents on the web on the basis of their ideology and political preference. In short, a candidate who communicates through the Internet is much more likely to contact a decided voter rather than an undecided one. This is why the Internet has a greater potential as an organizational and mobilization tool rather than as instrument to persuade recipients. Using the Internet as a mere means of mass communication, with the aim of expanding the propagation of the messages conveyed through other media, is a primitive and partial use of the instrument.

Within the studies on how the Internet is used for political and electoral marketing purposes, the literature typically takes into consideration the election campaigns, the characteristics of the voting population and the role that the so-called new media can play in the political marketing strategy. During the 2010 elections in the United Kingdom, the three main parties used the Internet as a communication tool and integrated it into their political



marketing strategy. In this direction of research, this paper focuses on investigating some of the conditions that can promote or not the participation of electors through social network sites.

### **Social Network Sites as a Political Marketing Tool**

Social network sites are web-based services that allow individuals to construct a public or semi-public profile within a limited system, to articulate a list of other people with whom you share a connection, and view and cross their list of connections and links of reports produced by others within the system. The nature and the name of these connections may vary from site to site (Boyd and Ellison 2007).

In other words social networking sites show a set of tools and third-generation Internet applications such as Facebook, Twitter, Youtube, Forsquare that facilitate the involvement and participation of users to an event or action. The diffusion of Social networking sites are the subject of debate and in particular the effect they have on human behavior (Barker 2009, Kolbbitsch and Murer 2006), their potential as a marketing tool and communication (Costantinides and Fountain 2008; Mangold and Faulds 2009) and in politics.

Specifically, in terms of creating political involvement, online social networks prove to be particularly successful. They can be grouped into two macro-types (Haney, Newman, Sylvester, 2010):

Social networking sites designed for general purposes, such as Facebook, MySpace, etc., which allow users to build social networks by using different tools, such as chat, e-mail, sharing photos and videos, status updates, applications, etc. This type of social networking site may also include those sites more oriented towards file sharing (such as YouTube and Flickr). These web tools can enable political parties to connect with potential voters and supporters. In fact, besides being able to get in touch with their supporters, a party or candidate can meet its supporters' friends, and exploit viral marketing mechanisms to communicate with them through the privileged filter represented by the current supporters.

Social networking sites designed by politicians specifically for consensus-building purposes. Typically, a candidate can integrate social networking features on his website, thus creating a network of supporters and providing them with the correct tools to convert their will of involvement and support into tangible actions. Moreover, to broaden the effectiveness of their action, supporters can connect to one another via these website areas.

In this paper, we will focus on Facebook. As a matter of fact, Facebook is the most used social networking sites by UK Internet users (23.9 million UK unique users in 2009, Comscore analysis) and is also the Social networking site designed for general purposes mainly used as a marketing tool by the main candidates during 2010 UK elections.

## **Empirical Analysis**

The analysis of how the three main UK parties used Facebook was conducted according to the following methodological approach.

### ***Research objectives***

The research objective is to understand the factors leading to participation on Facebook. In particular, the research investigates:

- What is the degree of use of certain communication strategies by the three main candidates.
- What communication strategies are able to elicit participation of the electors.

The analysis covered both the macro level (all parties) and the micro level (every party individually).

### ***Identification of variables and analysis of research hypotheses***

The variables of analysis that will lead to research hypotheses were chosen according to these guidelines.

The dependent variable is the degree of involvement of Facebook users. This level was measured by the average number of comments to posts on Facebook published by the three parties. This is the most reliable quantitative metrics to measure the effective participation of a page, beyond the fan number.

The independent variables were chosen about:

- aspects related to the verbal form of published content;
- issues related to the topics addressed.
- aspects of the role of the candidate.

First, were examined three independent variables, potentially correlated with the degree of participation:

- The number of posts published during the election campaign
- The number of posts published about the candidate during the election campaign. Through this variable, we measure the candidate's charismatic ability to inspire participation in the users.
- The number of posts that include a call to action published during the election campaign. The call to action is an imperative form that invites the viewer to act. Through this variable, we measure the ability of this verb form to inspire greater participation in the users.

With regard to these three variables, the research hypotheses investigated are:

- The number of comments will be positively related to the number of posts published.
- Use of call to action will be positively related to the number of comments. This hypothesis was verified by analyzing the difference between the average number of comments to all the posts and the average number of comments to posts that contain the verb form of the call to action.
- The presence of the candidate's name in the content of the post will be positively correlated with the number of comments. This hypothesis was verified by analyzing the difference between the average number of comments to all the posts and the average number of comments to posts that contain the name of the candidate. Then, research investigates the issue more present in the post of the candidates, and measure for the three main issue the ability to generate participation, comparing the average number of comments to all posts with the average number of comments to that post dealing with one of these issue. In this way, it is possible to reconstruct what are the issues addressed by the politicians, and if these issues are able to elicit participation.

### Data collection

All activities on the parties' Facebook pages between March 6th 2010 and May 6th 2010 have been collected, and for each post the following information has been gathered:

date in which the party published the post;

text of the post, with the aim to trace the issues addressed by the message;

name of any politician mentioned in the post;

presence or absence of a verbal call to action, which directly and imperatively calls upon the user to perform an action;

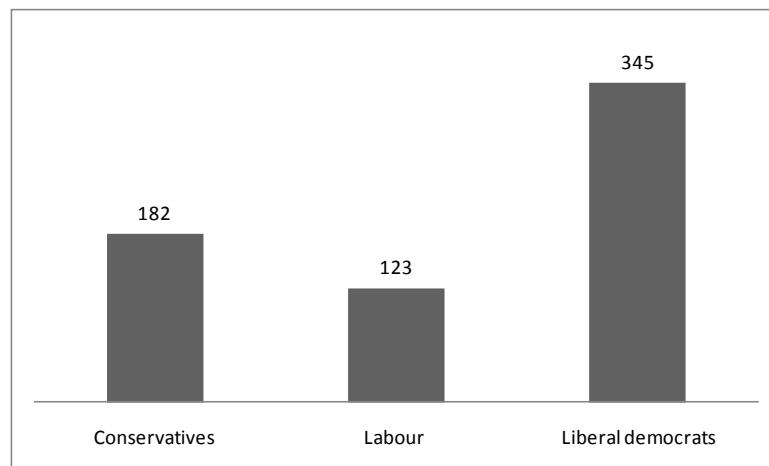
number of comments to the message.

### Findings

H1 The number of comments will be positively related to the number of posts published.

Figure 1 shows the number of posts written by each party during the analyzed time frame.

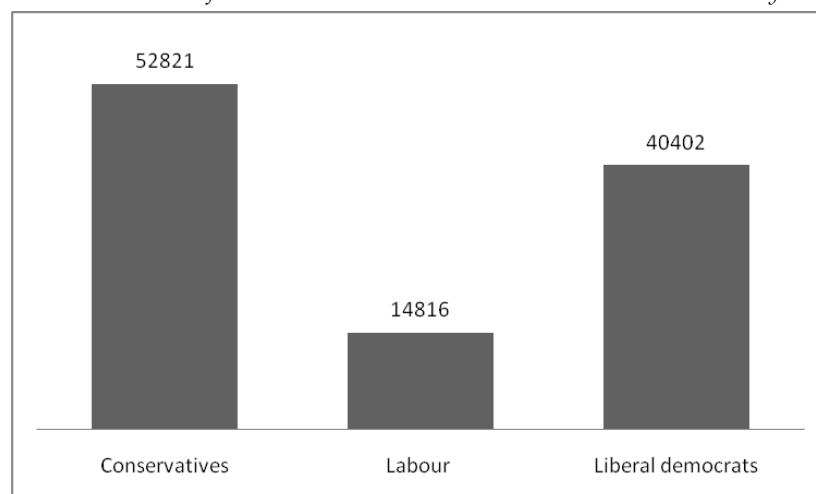
*Figure 1: Number of Facebook posts between March 6th 2010 and May 6th 2010*



*Source: Our elaboration of collected data*

The Liberal Democrats achieved a much more intense activity compared to its competitors, producing 345 posts in the 60 days analyzed, with an average of 5.75 posts per day. The Conservative Party published little more than 3 posts a day, and the Labour Party just over 2 posts a day.

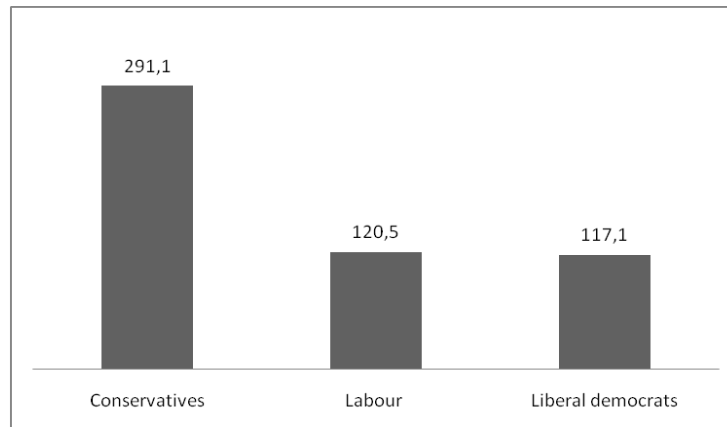
*Figure 2: Total number of comments on Facebook between March 6th 2010 and May 6th 2010*



*Source: Our elaboration of collected data*

The comparison changes if we analyze the total number of comments on the Facebook page of the three candidates. The Conservatives' page hosted 52,821 comments, showing an overall trend to a much stronger participation than the pages of the other parties. Of course, the difference becomes even more obvious considering the average number of comments per post.

Figure 3: Average number of comments per post on Facebook between March 6th 2010 and May 6th 2010



Source: Our elaboration of collected data

It appears from this analysis that participation in terms of comments on Facebook is not related to the number of posts.

H2: Use of call to action will be positively related to the number of comments.

Table 1: Number of comments to call to action posts (macro analysis)

	Total	Percentage Variation (%)
Average number of comments to call to action posts	203,43	22,21
Average number of comments	166,46	

Source: Our elaboration of collected data

The hypothesis is tested: the comments to posts increase when using the call to action. We can also perform the same analysis for each party.

Table 2: Number of comments to call to action posts for each party

	Conservatives	Percentage Variation (%)	Liberal-democrats	Percentage Variation (%)	Labour	Percentage Variation (%)
Average number of comments to call to action post	317,89	+ 8,93	115,93	-1,00	125,65	+ 4,31
Average number of comments	291,82		117,1		120,46	

Source: Our elaboration of collected data

Looking at the hypothesis for each party party, this is true for Labor and Conservatives, but not for the Liberal Democrats.

H3. The presence of the candidate's name in the post will be positively correlated with the number of comments.

*Table 3: Average number of comments to posts including candidate's name*

	<i>Total</i>	<i>Percentage Variation (%)</i>
<i>Average number of comments to posts including candidate's name</i>	171,88	3,26
<i>Average number of comments</i>	166,46	

*Source: Our elaboration of collected data*

The posts that mention the name of the candidate show a degree of participation higher than the average level of participation.

We can also perform the same analysis for each party.

*Table 4: Average number of comments to posts including candidate's name for each party*

	<i>Conservatives</i>	<i>Percentage Variation (%)</i>	<i>Liberal-democrats</i>	<i>Percentage Variation (%)</i>	<i>Labour</i>	<i>Percentage Variation (%)</i>
<i>Average number of comments to posts including candidate's name</i>	324,12	+ 11,07	135,7	+ 15,88	171,88	+ 42,69
<i>Average number of comments</i>	291,82		117,1		120,46	

*Source: Our elaboration of collected data*

In all three cases, the presence of the candidate's name in the post generates a degree of participation than the average. The mention of the candidate is, therefore, an element capable of generating involvement.

Moreover, through the analysis of the content of Facebook posts, we can identify the issues on which the candidates have focused.

The main issues contained in all Facebook post during UK elections are (table...):

- Tv: all posts about Tv Campaign and Tv debates: Facebook is used by all parties as a tool for commenting and spreading tv events.

- Economies and work: all posts about economic issues.
- Other candidates and parties: all posts that contain comments about other parties.

Table 5: Number of post containing the main issues

	<i>Posts number</i>	<i>Percentage Variation (%)</i>
<i>Posts</i>	649	100
<i>Posts about TV</i>	116	17,87
<i>Posts about Economies</i>	94	14,48
<i>Post about other parties</i>	74	11,40

Source: Our elaboration of collected data

The following table illustrates the main issues contained in the posts published by the three candidates.

Table 6: Number of post containing the main issues for each party

<i>Conservatives</i>	<i>Total</i>	<i>Percentage Variation (%)</i>
<i>Totale Posts</i>	181	
<i>Posts about TV</i>	25	13,81
<i>Posts about economy</i>	25	13,81
<i>Post about other parties</i>	23	12,71
<i>Liberal-democrats</i>	<i>Total</i>	<i>Percentage Variation (%)</i>
<i>Posts</i>	345	
<i>Posts about TV</i>	83	24,06
<i>Posts about economy</i>	57	16,52
<i>Post about other parties</i>	14	4,06
<i>Labour</i>	<i>Total</i>	<i>Percentage Variation (%)</i>
<i>Posts</i>	123	100
<i>Posts about TV</i>	8	6,50
<i>Posts about economy</i>	12	9,76
<i>Post about other parties</i>	37	30,08

Source: Our elaboration of collected data

The Liberal Democrats proved to tackle a wide range of issues, and to strongly rely on posts which directly call for votes and involvement, by significantly increasing the number of posts linked to media events such as TV debates. The Labour Party, to a higher extent than the other parties, relies on criticizing competitors: this trend can be considered unusual coming from the governing party. The Conservative Party focuses strongly on economy and jobs, and proves to effectively make online communication interact with the offline one, by using Facebook to support the candidate's TV appearances.

Now, we can test whether the three main issues have been able to inspire participation, comparing the average number of comments to all posts with the average number of comments to posts that deal with one of such issues.

*Table 6: Average number of comments on posts about the three main issues*

	<i>Total</i>	<i>Percentage Variation (%)</i>
<i>Average number of comments on posts about TV</i>	179,38	7,76
<i>Average number of comments on posts about economy</i>	151,76	-8,83
<i>Average number of comments on posts about other parties</i>	132,57	-20,36
<i>Average number of comments on all posts</i>	166,46	

*Source: Our elaboration of collected data*

We can also perform the same analysis for each party.

*Table 6: Average number of comments on posts about the three main issues for each party*

	<i>Cameron</i>	<i>Percentage Variation (%)</i>	<i>Clegg</i>	<i>Percentage Variation (%)</i>	<i>Brown</i>	<i>Percentage Variation (%)</i>
<i>Average number of comments on posts about TV</i>	328,6	12,60	141,84	21,13	125	3,77
<i>Average number of comments on posts about economy</i>	306,88	5,16	92,7	-20,84	109,08	-9,45
<i>Average number of comments on posts about other parties</i>	241,69	-17,18	66,21	-43,46	89,83	-25,43
<i>Average number of comments on all posts</i>	291,82		117,1		120,46	

*Source: Our elaboration of collected data*

The average number of comments to posts about the issue TV is higher than the overall average of the comments, both at the macro level of all candidates and at the micro level of each candidate individually examined. The theme of the presence of the candidates on TV is the only real issue that can generate a participation degree above the average for all candidates.



The degree of participation in post about economy is below average. Only in the case of the Conservatives, economy is able to generate above-average level of participation. Finally, the average number of comments to posts on the issue "other candidates or parties" is below average at both macro and at the level of all candidates individually examined.

## Conclusions

Participation by Facebook users as a result of posts made by parties is not tied to the number of posts: this testifies to the fact that political parties and candidates should focus not only on the frequency of updating the page, but also on content and verbal aspects of posts.

In particular, posts containing the quote of the candidate proved unable to create an above average level of participation, is testing the hypothesis at the macro level, both by analyzing the relationship between two variables within a single party.

With regard to the presence of call-to-action, this proved to be a verbal form generally effective in generating investment, but not for all parties: in effect, the call to action can be used in different ways, calling users to various actions: for instance, a user who is invited to click on the link in the post on Facebook, will probably tend not to comment on the post, despite having taken action. Therefore, the content of the post that includes the call to action should be analyzed with a qualitative technique, and not just a cardinal variable (presence or absence of a call to action) in order to understand the real effectiveness of this verb form. This is one of the possible evolution of research.

The analysis of the issue mainly dealt with by the parties and the assessment of their ability to generate participation showed a strong relationship of dependency with the TV on Facebook. In fact, all parties used Facebook as a tool for boosting the participation of the candidates on TV, and users have become heavily involved and participatory to post about the theme of the TV. If this, on the one hand, can be interpreted as a positive attempt of integration between the different instruments, on the other shows the subordinate role of Facebook compared to other media in the communication mix of candidates. Furthermore, the high average number of comments to post about TV shows that the participation of users on Facebook can be only partially attributed to the activity of the candidates on the Internet, and is also linked to other media. Starting from this consideration, future research will focus on the interactions between different media, online and offline, as well as to identify other metrics for the evaluation of participation on Facebook.

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**CONSUMER BEHAVIOUR IN THE ARENA: A CLASSIFICATION OF FOOTBALL FANS**

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**Abstract**

The purpose of this research is to analyze consumer behaviour in the arena and identify the different segments of football fans.

A survey was done based on a structured questionnaire that was compiled using scales from previous research and personally administered to a purposive sample of 312 respondents from two major cities in Greece. Data analysis was done with SPSS 15 and included cluster analysis; discriminant analysis; crosstabulations; and one-way ANOVA.

Results showed that 95,2% of cases can be classified into 5 segments of fans: occasional fans; football lovers; socialites; loyal fans, and devoted fans. Each segment was described based on their demographic characteristics; their motives to come to the stadium; their usage behaviour in the stadium; the factors that affect their satisfaction in the stadium; their involvement and loyalty to the team, and their future intentions.

This study extends findings in the area of consumer behaviour in the football arena. However, the sample is purposive and is limited to 303 fans from two cities in one country. Future research can validate these results with wider samples or multi-country studies.

The findings of this study present many implications for team management such as customizing offers for different types of fans; enhance the possibilities for socializing in the stadium; customize advertising messages; deal with loyal customers, and manage effectively the service mix (physical evidence and processes).

**Keywords:** consumer behaviour, sport fans, segmentation, football

**Introduction**

Today's marketplace is characterised by high competition and rapidly changing customer needs. As a result, sport organizations have started to look closely at the behaviour of their customers. Knowledge of consumer behaviour helps in effective segmentation and in creating successful service offers. So, by studying fan behaviour, sport managers are trying to identify smaller groups of customers within their customer base that have different characteristics or needs. This is done with an aim to select customer groups for long-term, close relationships or for identifying the best targets for

creating loyal customers. The practice of pinpointing groups within the current fan base is necessary for success, because a sport organization cannot gain a strong foothold within the marketplace if these individuals are not identified and managed appropriately through the development of marketing strategies tailored to their needs (Ross, 2007). This process of identifying well-defined clusters of consumers is known as segmentation, and many researchers have tried to segment customers using several bases (e.g. Wedel & Kamakura, 1998). In the sport industry we find specialist segmentation approaches based on attendance commitment; lifestyle, or social class; attitudes towards winning, and loyalty to the team (Quick & Van Leuwen, 1998; Mullin et al., 2000; Tapp & Clowes, 2002). However, results vary according to the context of the studies and there is no universally accepted typology of sport fans. The purpose of this study is to analyse consumer behavior of football fans before, during, and after the game and identify appropriate fan segments.

### **Literature review**

Today's marketplace is characterised by high competition and rapidly changing customer needs. Knowing your customers and being able to provide what satisfies them is a critical issue for today's service providers and at the core of today's marketing paradigm. Knowledge of consumer behaviour helps in effective segmentation and in creating successful service offers. However, consumer behaviour varies across industries and is considered to be multi-dimensional (Zeithaml et al., 1996). Many researchers have investigated the effect of various factors, such as service quality; customer satisfaction; perceived service value, and cost of services on consumer behaviour in different industries including banks; fast-foods; dry cleaning; athletic services; entertainment; thematic parks, and health institutes (Cronin & Taylor, 1992; Kelley et al., 1993; Cronin et al., 2000; Butcher et al., 2002; Bigne et al., 2005). In athletic services, research has focused on service quality and customer satisfaction dimensions and how these affect current and potential behavioural intentions (Parasuraman et al., 1994; Wakefield & Blodgett, 1994; Theodorakis & Kambitsis, 1998; Baker & Crompton, 2000; Kouthouris & Alexandris, 2005).

Furthermore, various studies have tried to analyse consumer behavior and segment customers according to their needs and preferences. During the past few decades of market segmentation research, several bases have been used (Wedel & Kamakura, 1998) including demographic and socioeconomic characteristics; personality, values and lifestyle characteristics (psychographics); product usage patterns; attitudes towards products; benefits sought, and attitudes toward marketing strategies (Beane & Ennis, 1987; Dickson & Ginter, 1987; Tynan & Drayton, 1987; Wind, 1978).

In the sport industry we find specialist segmentation approaches unique to professional sports. Mullin et al. (2000) emphasized the importance of value based segmentation in which supporters are grouped according to their attendance commitment, and other approaches including segmentation by lifestyle or social class. Also, other segmentation bases used in sport include fans' attitude towards winning of the team and their loyalty to the team (Quick & Van Leuwen, 1998; Tapp & Clowes, 2002). As a result of segmentation, researchers have suggested different typologies of fans, recognizing in each segment a particular behaviour. Stewart and Smith (1997) identified various segments of fans

namely, aficionados; theatregoers; passionate partisans; champ followers, and reclusive partners. Hunt et al. (1999) present the concepts of temporary, local, fanatical and dysfunctional fans. Tapp and Clowes (2002) come up with 3 categories of fans, fanatics; regulars (repertoire supporters and glory hunters), and casuals (professional wanderers and carefree casuals) according to their commitment to the club and their interest in entertainment or winning. Tapp (2004) replaces earlier concepts with “regular fans by repertoire” and “season ticket churn” categories. Finally, Ross (2007) segmented fans according to their brand associations and identified two clusters that differ in gender; educational level, and household income.

Although prior research has analysed the different types of sport fans, there is no universally accepted typology. The purpose of this study is to analyse consumer behaviour of football fans before, during, and after the game and identify appropriate fan segments according to their demographic characteristics; their motives for attendance of games; their usage behavior in the arena; the factors that affect their satisfaction during the game; their loyalty and involvement with the team; and their future intentions.

## **Methodology**

The study is descriptive in nature intending to describe the way fans behave in the football arena. A survey was done based on a structured questionnaire that was personally administered to a purposive sample of 312 respondents from two major cities in Greece. The questionnaire contained 6 parts with questions related to the demographic characteristics of fans; their motives for attendance of games; their usage behaviour in the arena; the factors that affect their satisfaction during the game; their loyalty and involvement with the team; and their future intentions. Data collection was done in 2 University campuses; a team’s cafe in the stadium; betting agencies; cafeterias that show football games on TV, and in fitness centres. In total, 303 questionnaires were usable. Data analysis was done with SPSS 15 and included cluster analysis; discriminant analysis; crosstabulations; and one-way ANOVA.

## **Results**

### **Sample profile**

Of 303 respondents, 236 (77,9%) were male and 67 (22,1%) were female. A 3,3 % were aged between 15-18 years, 32,6% were 19-24 years old, 38,5% were 25-34, 12% were 35-44 and 13,6% were 45 or older. Almost half of the sample (45,8%) has a bachelor’s degree whereas 25,8% are secondary education graduates and only 28,5% have a masters or Ph.D degree. 54,2% of the sample has a monthly income of up to €1.000 and only 4,3% make more than €3000. Furthermore, 73,2% of respondents are single; 31,7% are students and 43,6% are free professionals. Finally, only 15,1% of respondents had a season ticket; 71% were from Athens and 29% were from Tripoli.

### **Clusters identified**

Hierarchical Cluster analysis was run first in order to determine the number of clusters identified. The dendrogram that resulted from this analysis was combined with discriminant analysis in order

to determine the optimum number of clusters to be used for distributing the observations of this survey. Using k-means cluster analysis different numbers of clusters were tried (2,3,4 and 5) and then discriminant analysis was applied to each case separately in order to define the optimum number of clusters. Results showed that 95,2% of cases can be classified into 5 clusters. The 5 segments of fans identified were analysed with Crosstabulations; one-way ANOVA and the criterion Duncan. Table 1 shows the descriptions of each segment identified.

## **Managerial Implications**

The findings of this study present many implications for team management.

- Football fans differ in many ways and team managers face the difficult task of satisfying all these different people. The emergence of four different types of fans presents a challenge for sports managers. Their different needs and preferences should be taken into account when teams create customized offers for different groups of customers. For example, devoted fans would appreciate better offers in season tickets, premium seats and the discounted prices of team products. On the other hand, socialites would appreciate more a good quality service and facilities; an entertaining show with the game, and a sociable environment.
- The social aspect of going to the game is a very important motive for most segments of fans. The socialites are the biggest of the segments identified in our sample. As a result, stadium design should enhance the possibility for communication between fans and stadium facilities should provide the opportunity for fans to meet before or after the game and have a good time with friends. Also, game and team promotion should emphasize the social aspects of watching games and spending time in stadium facilities so that the socialites will be willing to increase their frequency of attendance.
- The motives for going to the stadium differ between the 5 segments identified. This means that sport managers should carefully segment their market and customize their advertising messages according to the group of customers targeted. Also, it is important for teams to enhance the power of their brand by strengthening associations that relate to the motives of their target market.
- The quality of facilities and of services offered and the avoidance of waiting times are the most important factors affecting fans' satisfaction. Therefore, effective management of the physical evidence of the stadium and the processes of service (entering stadium, toilets etc.) are priorities that should not be neglected by managers.

Table 1: Segments of football fans identified and their profile

	<i>Occasional fans(18,6%)</i>	<i>Football lovers (15,3%)</i>	<i>Socialites (31,9%)</i>	<i>Loyal fans (13,3%)</i>	<i>Devoted fans (20,9%)</i>
<i>Demographics</i>	<i>Men and women 25-34 years old, single, with a bachelor's or masters degree, and an income of up to €1.000.</i>	<i>Men mostly, 25-34 years old, single or married; secondary education graduates, of any income level.</i>	<i>Men mostly (65%) and women, 19-34 years old, single, with a bachelor's degree and an income of up to €3.000.</i>	<i>Men mostly, young, 19 -24 years old, single; secondary education graduates or with a bachelor's degree, and an income of up to €1.000.</i>	<i>Men 19-34 years old, single or married, with a bachelor's degree and any income level.</i>
<i>Motives</i>	<i>Their major motives for coming to the game are their marginal interest in football and to kill some time.</i>	<i>Their major motives for coming to the game are that they feel good in the stadium and that they meet other people.</i>	<i>They go to the stadium to relax and socialize. They are interested in sports; their team, and the show of the game.</i>	<i>They often go to the arena to watch games with friends or family. They don't like sports in general.</i>	<i>They go to the stadium because they like sports; they want to communicate with other fans, and they feel good in the stadium.</i>
<i>Usage behavior</i>	<i>They seldom go to the arena to watch games with friends or family. They spend up to €150 in tickets and up to €30 in products; only 5,4% have season tickets</i>	<i>They often go to the arena to watch games with friends or family. They spend from €150-400 in tickets and €30 or more on products; 29% of them have season tickets</i>	<i>They go to games rarely. They spend up to €150 in tickets and up to €100 in products. They go to the stadium with their friends. Only 1,1% of them have season tickets.</i>	<i>They spend from €150-300 in tickets and 10% of them have season tickets. They go to the stadium once every two months or less but spend a lot of time in the stadium facilities.</i>	<i>They spend from €150-400 in tickets and 35% of them have season tickets. They go to the stadium almost every weekend. They spend a lot of time in the stadium facilities.</i>
<i>Satisfaction factors</i>	<i>They like a clean stadium and well-maintained facilities and can't stand long waiting times.</i>	<i>They don't like ill-maintained facilities; long waiting times, and bad service.</i>	<i>Important factors for them are quality of service; waiting times and quality of facilities.</i>	<i>They don't care about sports or about the facilities and staff. They only care about the progress of the team.</i>	<i>They don't give attention to quality of service and facilities.</i>
<i>Loyalty</i>	<i>Their involvement and loyalty to the team are low</i>	<i>They love sports and their team; They are loyal to their team and talk about it all the time.</i>	<i>Their involvement and loyalty to the team is moderate.</i>	<i>Their involvement and loyalty to the team is high. They say that «it is worth going to the stadium».</i>	<i>They are loyal to their team; They talk about their team all the time and defend it.</i>
<i>Future intentions</i>	<i>They don't particularly want to go to the stadium again in the future.</i>	<i>The leave the stadium happy and are willing to pay more money if necessary to see their team in the future.</i>	<i>They moderately support their team in the stadium and say positive things about their team to others.</i>	<i>They are not willing to pay more if necessary to see their team in the future. They say positive things about their team to others</i>	<i>They are willing to pay more if necessary to see their team in the future. They say positive things about their team to others</i>

- Identification of the groups that are less loyal and more likely to spread negative word of mouth can help in preventing customer defection and enhancing long-term relationships with customers. On the other hand, identification of the most loyal customers that are willing to say good things about the team can help teams to strengthen their bonds with long-term customers and use these customers as advocates to promote the team to less loyal fans.
- Results show that an effective way of segmenting fans is to look at their behavior before consumption (motives); during consumption (usage behavior, factors affecting satisfaction), and after consumption (loyalty, involvement and future intentions). Successful teams must manage effectively all three areas of behavior simultaneously.

In summary, the results of this study will help team managers understand their customers; segment their market appropriately; satisfy all types of customers; and focus on the most profitable customers in order to create long-term relationships with them that lead to higher profits.

### **Limitations – Suggestions for Further Research**

This study extends findings in the area of consumer behaviour in the football arena. However, the sample is purposive and is limited to 303 fans from two cities in one country. Future research can extend the sample; use a random sample from the whole country; do multi-country studies or do longitudinal studies showing changes in consumption or behavioral patterns.

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## CORPORATE SOCIAL RESPONSIBILITY (CSR) IN SPORTS: ANTECEDENTS AND CONSEQUENCES

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### **Abstract**

The purpose of this research is to identify the types of CSR initiatives employed by sports organisations; their antecedents, and their consequences for the company and society.

This study is exploratory in nature. Two detailed case studies were conducted involving the football team and the basketball team of one professional, premier league club in Greece and their CSR initiatives. Both teams have the same name, they belong to one of the most popular teams in Greece with a large fan population; have both competed in International Competitions (UEFA's Champion League; Final Four of the European Tournament) and have realised many CSR initiatives in the past. The case studies involved in depth, personal interviews of managers responsible for CSR in each team. Case study data was triangulated with documentation and search of published material concerning CSR actions. Data was analysed with content analysis.

Both teams investigated have undertaken various CSR activities the last 5 years, the football team significantly more than the basketball team. Major factors that affect CSR activity include pressure from leagues; sponsors; local community, and global organisations; orientation towards fulfilling their duty to society, and team CSR strategy. Major benefits from CSR include relief of vulnerable groups and philanthropy as well as a better reputation for the firm; increase in fan base; and finding sponsors more easily due to the social profile of the team. However, those benefits are not measured in any way although both teams observe increase in tickets sold; web site traffic and TV viewing statistics after CSR activities. Finally, promotion of CSR is mainly done through web sites; press releases; newspapers, and word-of-mouth communications.

This study involves only two case studies and has limited generalisability. Future research can extend the sample and validate concepts with quantitative methods.

Results indicate that for successful CSR activities team management should deal effectively with the pressure from various entities (community; sponsors; leagues; global organisations); balance the social and corporate benefits of CSR; integrate CSR in their strategy; measure the effects of CSR on major performance indicators such as

brand equity; reputation; attendance figures; and fan loyalty, and create an effective promotional plan for their CSR activities.

**Keywords:** Corporate social responsibility, sports, football, basketball, case study

## **Introduction**

Corporate social responsibility (CSR) has become an area of increasing importance for many companies and thus, has received considerable attention in the academic literature. Guthey et al., (2006) argue that despite the possibility that CSR might be a management fashion, the CSR concept is of value, because it has real consequences in the business world. The growing influence of CSR policies (Bowd et al., 2003) and the rise of a respective consultancy industry (Fernandez Young, Moon & Young, 2003) provide strong support for this argument.

While the study of CSR has become increasingly prevalent in the management and organizational behavior literature, the concept has only recently entered the sport management area (cf. Babiak & Wolfe, 2006; Bradish, 2006; Brietharth & Harriss, 2008; Smith & Westerbeek, 2007; Walker, Kent, & Rudd, 2007). On the other hand, virtually all organizations within the sport industry, broadly defined, have adopted CSR programs from Nike and Reebok to the NBA and NASCAR (Wallace, 2004). Also, professional sport teams, are increasingly engaging in socially responsible activities (Irwin, Lachowetz, Cornwell, & Clark, 2003; Kern, 2000; Robinson, 2005). It seems that, from a research perspective, professional sport is a rich context in which to study CSR because all organizations in the industry are involved in such efforts.

However, for many years the focus of academic research has been on identifying the link between financial and social performance (Margolis & Walsh, 2003). While the evidence of this relationship remains unclear, it does point to a positive association. Rather than continuing to focus on the financial-social performance relationship, Margolis and Walsh (2003) argued that researchers should shift their lenses and focus on the context, processes, and outcomes of CSR. A few recent studies have looked at these issues but there is still a paucity of studies on this subject and more specifically in the area of sports. This paper follows the suggestion of Margolis & Walsh (2003) and aims to explore the antecedents and consequences of CSR practices in sports. This paper is organized as follows: first a review of the relevant aspects of the CSR literature is presented; second the design of the study is analysed; third, findings are presented, and fourth managerial implications and suggestions for further research are noted.

## **Literature Review**

### **Corporate social responsibility**

The origins of CSR lie in philanthropy, the oldest social initiative among American private enterprises (Godfrey, 2009). Preston and Post (1975) articulated the “principle of public

responsibility,” which argues that a business should deal with the social issues that are impacted by the normal operating activities of the company. Sethi (1975) suggested that corporate social responsibility contained three logically distinct elements: social obligation (responsibility to obey the law), social responsibility (congruence with prevailing societal norms, values, and expectations), and social responsiveness (development of policies, programs, and capabilities that would minimize adverse consequences of societal demands). Theoretically, Carroll (1999) reviewed and discussed over 25 different ways that CSR can be defined in the academic literature. The general consensus academically would be that CSR represents a set of actions that appear to further some social good, extend beyond the explicit pecuniary interests of the firm, and are not required by law (McWilliams and Siegel, 2000). Definitions among practitioners proliferate as well, with groups such as the World Business Council offering their own definition (World Business Council, 1999, p. 3), which is that “corporate social responsibility is the continuing commitment by business to contribute to economic development while improving the quality of life of the workforce and their families as well as of the community and society at large.”

Organizational scholars have been theorizing about, and investigating, CSR for over three decades (Carroll, 1979; Margolis & Walsh, 2003; McWilliams & Siegel, 2000). The essential components of the phenomenon, as described in the literature, have remained quite constant over time. Ullmann (1985) described CSR as “the extent to which an organization meets the needs, expectations, and demands of certain external constituencies beyond those directly linked to the company’s products/markets” (p. 543). In a similar manner, other CSR definitions address “societal relationships” (Wood, 1991, p. 693) and the “expectations that society has of organizations” (Carroll, 1979, p. 500). CSR thus, “tends to focus on the effects of organizations on external constituencies (e.g., consumers, local communities, charitable organizations)” (Sethi & Steidlemeier, 1995, p. 20). Others describe CSR as a set of actions aimed to further some social good, beyond the explicit pecuniary interests of the firm, that are not required by law (McWilliams & Siegel, 2000) and as “practices that improve the workplace and benefit society in ways that go above and beyond what companies are legally required to do” (Vogel, 2005, p. 2). Finally, Carroll argued that CSR is composed of four elements: economic (the basic responsibility to make a profit and, thus, be viable), legal (the duty to obey the law), ethical (responsibility to act in a manner consistent with societal expectations), and discretionary (activities that go beyond societal expectations).

Despite efforts to formalize and regulate CSR-related evaluations, measurements and reporting (e.g., ISO 14000, AA 1000, GRI), the concept and its application largely remains dynamic, diverse and context specific. It has also been criticized as a modern age branding tool, a “greenwash” of corporate behaviour, boardroom talk, and a public relations invention

(Frankental, 2001), However, CSR is no longer a “fad” or an “extra option” but describes a deeper change in looking at organizations and their relationships to their stakeholders

(Lewis, 2001). However, most of the related research is related to the conceptual understanding of the construct (Carroll, 1999), perhaps due to the relative infancy of CSR scholarship and the general ambiguity of the term.

### **Antecedents of CSR**

A stream of CSR literature has sought to reveal which factors influence organisations in their decision to use CSR initiatives. Paine (2003) found that risk management; institutional relevance; organizational functioning; market positioning, and ethical assumptions are said to be core reasons why businesses get involved in CSR management. Many articles focused on the motives (e.g., managerial and corporate) of corporations to engage in CSR activities (cf. Bucholtz, Amason, & Rutherford, 1999; Fitzpatrick, 2000; Quazi, 2003; Thomas & Simerly, 1994). Brown, et al. (2006) developed a list of motivations for English football clubs to get involved with their communities (ethical/ideological, business, political/legal motivations).

Also, others explored whether CSR initiatives have been adopted as a strategic response to external pressures (Hess, Rogovsky, & Dunfee, 2002; Hess & Warren, 2004; Marquis, Glynn, & Davis, 2007). Belliveau, Cottrill, and O'Neill (1994) proposed a model that predicts an organization's social responsiveness based on external factors such as institutional variables (e.g., CSR behavior in the industry), economic variables (e.g., level of concentration, market share), and managerial variables (e.g., innovation). Furthermore, research has sought to study the effect of external forces such as customers (Lewis, 2003; Vogel, 2005; Yan, 2003), activist groups (Den Hond & De Bakker, 2007), legislation (Dawkins & Lewis, 2003), and members of local communities (Boehm, 2005) on the type and focus of CSR activity in which an organization engages. Far fewer studies, have explored the effect of internal resources and competencies of an organization on their CSR-related activities (Bruch & Walter, 2005; Porter & Kramer, 2006). Also, researchers such as Joyner & Payne (2002) have explored internal forces such as values and ethics as drivers of CSR behavior and highlighted the positive link between these areas and financial performance.

### **Consequences of CSR**

Wood (1991) introduces the concept of Corporate Social Performance as an outcome of two types of CSR, Corporate Social Responsibility (companies' intentions, philosophies, and commitments to social engagement) and Corporate Social Responsiveness (effectiveness of dealing with stakeholder concerns in both calm and stormy times). Furthermore, CSR is being shown to have dual—organizational and social—benefits and is linked to corporate financial performance (Aguilera, Rupp, Williams, & Ganapathi, 2007; Barnett, 2007; Waddock & Post, 1995). Many researchers agree that CSR is good financially for the organization and can lead to greater profits or greater public support which may in turn bolster profits (cf. Burt, 1983; Margolis & Walsh, 2001; Pava & Krausz, 1996; Roman, Hayibor, & Agle, 1999; Stanwick & Stanwick, 1998; Ullman, 1985).

Also, apart from financial benefits there are also intangible strategic assets such as reputational capital (Fombrun, Gardberg, & Barnett, 2000; Lewis, 2003), and employee commitment (Turban & Greening, 1996; Vogel, 2005) as well as acquiescence among key regulatory institutions or legislative bodies (Campbell, 2007; Jenson, 2002; Vogel, 2005); the development of the firm's business and institutional environments (Porter & Kramer, 2002), and/or help mitigate negative media scrutiny (Alsop, 2002).

Furthermore, it has been suggested that CSR actions can influence purchase intentions (cf. Murray & Vogel, 1997; Sen & Bhattachary, 2001), and that these may be related to whether the company's ethical record exceeded consumer expectations (Creyer & Ross, 1997). Brown and Dacin (1997) found that corporate associations, which included corporate ability (CA) and CSR, affected consumers' product and overall corporate evaluations. Klein and Dawar (2004) demonstrated that CSR associations had a strong and direct impact on consumers' attributions, which in turn influenced brand evaluations and purchase intentions. Mohr and Webb (2005) maintained that within the domains of philanthropy and the environment, CSR had a positive impact on company evaluation and purchase intentions. Furthermore, several authors have demonstrated a link between social initiatives and affective, cognitive, and behavioral responses by consumers such as perceived quality, price, and consumer attributions about company motives (e.g., Becker-Olsen, Cudmore, & Hill, 2006; Brown & Dacin, 1997; Creyer & Ross, 1997; Ellen, Mohr, & Webb, 2000; Folkes & Kamins, 1999; Murray & Vogel, 1997).

### **CSR in the Sport Context**

The issue of CSR in sport is a good one. As sport becomes an increasingly prominent economic and social institution across the globe, the question of what social responsibilities athletes, coaches, team owners, league officials, and global sport organizations' personnel have, should constantly be asked (Godfrey, 2009). While as recently as 15 years ago, CSR did not play a significant role in sport (Kott, 2005; Robinson, 2005), professional sport organizations are now entering into socially responsible initiatives at a rapid pace. A variety of factors have led to the growing importance of CSR for sport organizations (Lau, Makhanya, & Trengrouse, 2004). First, the omnipresence of sport has led to the elevation of sport organizations as influential members of the global community, especially as they have become big businesses themselves. Second, sport organizations are facing a consuming public that is increasingly aware of the social aspects of corporate policy, due to the notoriety given to recent corporate misdeeds. As a result virtually all organizations within the sport industry, broadly defined, have adopted CSR programs. From Nike and Reebok to the NBA and NASCAR, examples abound of activities undertaken to bring messages and resources to underprivileged and other members of society who may not otherwise be the targets of socially responsible initiatives.

While the study of CSR has become increasingly prevalent in the management and organizational behavior literature, the concept has only recently entered the sport management area (cf. Babiak & Wolfe, 2006; Bradish, 2006; Brietbarth & Harriss, 2008; Smith & Westerbeek, 2007; Walker, Kent, & Rudd, 2007). From a research perspective, professional sport is a rich context in which to study CSR because all organizations in the industry are involved in such efforts. Some organizations believe that doing good is the right thing to do (Mintzberg, 1984), and are involved in these initiatives for noble reasons. Some organizations, on the other hand, believe that doing good is good business (Mintzberg, 1984), and are motivated by pragmatic matters such as projecting a positive image; generating goodwill among various stakeholders; (e.g., employees, extant and potential customers, the local community (Porter & Kramer, 2002)), countering negative media scrutiny, and/or receiving tax breaks and subsidies from government bodies.

For example, (FIFA) has created a CSR unit and spends more than 40% of its income to support the grassroots of the game; development work, and partnerships with relief organizations" (FIFA, 2004, p. 66). Adidas Group has launched two new corporate responsibility publications which cover working conditions, the environment, community affairs, and employee programs (adidas Group, 2008). Nike's Fair Labor Standards Act promotes sound worldwide labor practices. The NFL and NBA's partnerships with the United Way and Read to Achieve, respectively, are just two of the many humanitarian and educational initiatives that sport leagues are involved with. "We have just two missions at the NBA," says Commissioner David Stern, "... the most immediate is to be a successful league. But the other is to use our strength for social responsibility" (Genzale, 2006, p. 34). In football, consulting firm Deloitte and Touche (2005, quoted in Holt, Michie, Oughton, Tacon & Walters, 2005) has recommended that football clubs integrate CSR management to insure healthy relationships with their communities.

Overall, team CSR activities include, but are not limited to: athlete volunteerism, educational initiatives, philanthropic/charitable donations, community development, community initiatives, fan appreciation, health-related initiatives, and community-based environmental programs. Walker & Kent (2009) propose that CSR activities for professional sport teams include four categories: philanthropy; community involvement; youth educational initiatives, and youth health initiatives.

Despite the increase in CSR activities in sports, there has been little empirical work examining the factors that motivate professional sport organizations to become involved in socially responsible activities and on the outcomes of such activities. This paper addresses this gap in the literature and aims to determine the antecedents and consequences of CSR activities in professional sports.

## Methodology

This study is exploratory in nature. Two detailed case studies were conducted involving one professional, premier league football club and one first division basketball club in Greece and their CSR practices. Both teams were selected because they are very popular teams in Greece with large fan population, and have competed in UEFA's Champion League and the Euroleague many times in the past. Also, they are frequent practicers of CSR initiatives. The case study approach was selected because it is argued that CSR agendas and policies are influenced by context-specific factors (Roome, 2005). Or putting it in Votaw's (1972) words: CSR "means something, but not always the same to everybody" (p. 25). Therefore, it is a difficult phenomenon to research, with case studies being a suitable approach to attach meaning to the concept in its respective context of appearance. Also, by using case studies, we follow researcher calls for "concrete studies of real case studies" in the industry (Freeman & McVea, 2001, p. 204). Furthermore, the sport industry is very interesting for the study of CSR due to its distinct attributes such as the "star power" of the athletes; the connections sport teams have to the local communities, and the level of affect displayed by its many consumers (Walker & Kent, 2009).

Data collection involved in depth, personal interviews of managers responsible for CSR as well as collection of documentation and search of published material concerning the teams' CSR actions. Documents reviewed included press releases; newsletters; web page descriptions; CSR mission/vision statements; and annual reports. Documents were used to provide background information, to substantiate and illustrate findings, and to supplement information obtained from the interviews. The questions used in interviews served the purpose of the study and included the following: 1) Which CSR activities have you undertaken during the last 5 years? 2) Which factors affected you in deciding to enter into those CSR activities? (internal – external pressures), 3) What are the benefits of these CSR activities for your organization and for society?, 4) Do you measure the effectiveness of CSR activities and if yes how?, and 5) How do you promote CSR activities?

The questions we used are consistent with the suggestion of Margolis and Walsh (2003), that the CSR research agenda move away from the much studied relationship between CSR and financial outcomes to addressing (a) the external pressures to engage in CSR that organizations face; (b) how the internal resources of organizations are used in CSR initiatives, and C) the impacts of CSR on recipients and society at large.

## Findings

Results showed that both the football and the basketball teams analysed have undertaken many CSR initiatives in the past 5 years. The football team focused on social character actions related to global days such as that of poverty, peace etc. plus other activities that were more local or donated money to various causes. Specifically, the following activities were realised:



- 8th Global game against poverty with the participation of famous athletes such as Zidane and Ronaldo (December 2010). There was great participation from spectators and big promotion abroad. Money collected was donated to flood victims from Pakistan and Haiti and to a foundation in Piraeus «Argo». All media had positive comments and the event was a success.
- Award to the Paraolympic team on the Global day of disabled people (7-11-2008).
- On old-people day (1-10-2008) players visited an old-people's home in Piraeus and gave out presents and clothes.
- On global peace day (21-9-2008) there were a number of events in the arena, posters shown, and players played with a wrist band that had the peace symbol.
- Every year at Christmas players visit the children's hospital «Agia Sofia» and give presents, money, and balls and sign autographs and jerseys.
- Donation of €100.000 to tsunami victims in Japan.
- Donation of €80.000 to «Hope» foundation in 4 Christmas events.
- Donation of clothes to various foundations such as «Onisimos».
- Donations of balls, money, food and clothes to «Children's smile» in an event done in December 2009.

In the basketball team, there was a restructuring effort and as a result from 2008 onwards there was an autonomous CSR programme based on 5 pillars important for the team: education, sports, health, environment and smoking. Specifically, the following activities were realised jointly with sponsors:

- Organised events for protecting the environment by recycling ink cartridges together with sponsor, Cartridge World.
- Joined activity with major sponsor Wind in European Final Four. For every time the team scored in the final four, an amount was donated to the «World's Arc» a foundation for abandoned children, adding up to around €80.000 total.
- Joined activity with PEPSI (sponsor) to place recycling bins with PEPSI's logo at various spots.
- Joined activity with Novo Nordisk , event for informing people about diabetes in Piraeus.

Furthermore, table 1 below summarises the results for both teams regarding the antecedents and consequences of CSR; measurement of CSR success, and the promotional mix used to promote CSR activities. Antecedents are split into external and internal pressures, and consequences are split into social and corporate benefits.

Table 1: CSR antecedents, consequences, measurement and promotion

	Football team	Basketball team
External pressures	<p>Link to the City of Piraeus – all requests from Piraeus's foundations, schools etc are satisfied (players visiting, money, etc.)</p> <p>Pressure from major sponsor to upload all CSR activities on <a href="http://www.goodchannel.gr">www.goodchannel.gr</a>.</p> <p>Calls for help from philanthropic organisations all over Greece (hospitals or schools etc.)</p> <p>Global organisations such as U.N (asked if team could organise the game on global poverty day)</p>	<p>Smoking problem in the arena</p> <p>Expectations of society</p> <p>Sponsors that request joined activities</p>
Internal pressures	To do our duty to society	<p>The 5 pillars strategy in CSR</p> <p>Giving to society is one of our primary organisational goals</p>
Social benefits	<p>Philanthropy</p> <p>To be loved by people</p>	<p>Relief for society's vulnerable groups</p> <p>Promote a problem that needs attention</p> <p>Philanthropy</p>
Corporate benefits	<p>Reputation building</p> <p>Expand fan base</p> <p>Easier to find sponsors</p>	<p>Positive team image</p> <p>Fans applaud our actions</p>
CSR success measurement	<p>No standard measurement used.</p> <p>A record is kept of any promotional action linked to CSR activities (web sites, newspapers, TV etc.).</p> <p>Observation of increase in tickets sold; web site visits and TV viewing after CSR activities but not in a measurable way</p>	<p>No standard measurement used</p> <p>Observation of interest in CSR activity and web site traffic but not measurement per se</p>
Promotional mix	<p>Web Site of the team – press releases that are presented by journalists in sport-related or general type newspapers &amp; sites.</p> <p>Other Web Sites that support the team</p> <p>Fun clubs' sites</p> <p>TV channel that supports the team</p> <p>The CSR web site of Super League managed by a major sponsor (goodchannel.gr)</p> <p>Fast word of mouth communication. Every CSR activity is promoted immediately by sites friendly to the team before a press release is even available.</p>	<p>Press releases</p> <p>CSR page in team's Web Site</p> <p>Plan to design a more comprehensive promotional plan for CSR activities</p>

## Managerial implications

The result of this study pose challenges for CSR managers of sport organisations. Specifically we observe the following:

- This study identifies the most important factors that seem to affect CSR activities. These include the power of various groups that the team belongs to (leagues etc.)

and of international organisations; the power of society and of social problems that need to be addressed; the importance of the local community, and the demands of sponsors.

- CSR is shown to have both social and corporate benefits although in the athletic market, social benefits are considered more important and that is why the effect of CSR actions is not measured with any measurement tools. The only corporate benefits acknowledged are related to the team's image and reputation that attracts more fans and sponsors. So, if teams want to increase their brand equity; enhance their reputation, and attract sponsors, CSR activities are essential.
- However, since there is no standard measurement tool for CSR success, team management should look deeper into the effects of CSR; incorporate them into the team's strategic plan and measure them. Results indicate that CSR success can be measured by attendance figures; fan loyalty, exposure to messages, and team attractiveness for sponsors.
- Finally, the promotional mix for CSR activities seems to be ad hoc and there is no specific promotional plan designed from teams. This is probably because there is widespread public interest for the team even without any organised promotion. However, a more organised approach towards the promotion of CSR activities can increase their effectiveness significantly.

### **Limitations and suggestions for further research**

This study involves only one case study and has limited generalisability. Future research can extend the number of cases; focus on different segments of the sport industry such as sport federations, sporting goods companies, sport betting companies, professional leagues etc.; do multi-industry studies; do longitudinal research, as has been also proposed by Godfrey and Hatch (2007), in order to see how CSR practices change over time, and test CSR related concepts with quantitative methods.

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## INNOVATIONS IN PUBLIC SECTOR: THE BRUNEI CASE

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### Abstract

The paper seeks to provide an overview of the service modernization introduced in Brunei's public sector and discusses its overall aims, benefits and challenges. The paper has adopted descriptive and analytical methods and is primarily based on secondary and some primary data and information. The primary data was collected through interactive discussions with some senior government officers at the Ministry of Finance. Also, the paper has provided a systematic and careful analysis of the general literature on service delivery innovations and those pertaining to Brunei.

Despite the concerted effort of the Government of Brunei to improve and expedite the internal processes at the Ministry of Finance through the use of ICT, there remain some challenges which need to be addressed by the government. Chief among them are people, cultural issues and existing administrative procedures and policies. Another concern is the lack of coordination and collaboration among various stakeholders. The findings of this paper are not based on a comprehensive and rigorous empirical work and, therefore, can only be interpreted as indicative of the current situation of Brunei public sector. Further attempt needs to be done to assess, whether TAFIS as an e-government project, has achieved or going to achieve its planned objectives. The value of the paper lies in clearly delineating the nature of change in the Brunei public sector and adds to the limited literature in the use of IT systems to support the functional areas at the Ministry of Finance. The findings can be of interest to policymakers and practitioners in the Brunei public service.

**Keywords:** Technology led Policy, Innovations, public sector reform, e-government, Brunei

### IT and the demand for improved public sector performance

All over the world, there have been demands for improvements in the efficiency and responsiveness of public sector organizations. The effect of fiscal crises, the perceived lack of accountability of public organizations, the questioning of traditional public administration models of service delivery, and concern about mounting corruption, among other factors, have fuelled demands for change, and contributed to the emergence of what has been called 'New Public Management' (NPM). This is a framing of government in terms of outputs rather than process, and is characterized by devolution of authority, empowerment of officials, alternative ways of providing public goods and service, managerial techniques and mentality

from private business, and the search for better mechanisms of public accountability (Hughes, 2003, Hood; 1995; Pollitt, 2001; Osborne and Gaebler, 1992). Governments started the adaptation to this new reality in order to improve their effectiveness. In developed countries with well structured systems of public administration, this adaption went smoothly, but in developing countries, the absence of acceptable norms of bureaucratic behavior, has hindered the efforts toward creating effective system of public administration (Kiggundu, 2002). Governments moved to acquire new technology to achieve NPM and build new and comprehensive approaches to administrative modernization. In particular, the adoption of ICT in public sector organizations, or e-government, is seen as enabling public sector reform by providing the requisite information for public management (Hughes 2003, (Kamar and Ongo'ndo, 2007). It can simplify the administrative processes, making them more transparent, and help to deliver services more efficiently, with better integration of services and processes (Siddiquee, 2008, Mitullah and Waema, 2008, United Nations, 2004).

These reforms have been pursued in a number of Southeast Asian countries. Singapore was cited as among the top countries in utilizing ICT in reforming every aspect of government, including the financial system (Yong, 2003). The Malaysian Ministry of Finance and South Korean Ministry of Finance have established information systems to automate their countries' national finance administration. These systems aimed to improve the efficiency and effectiveness of the government financial administration by connecting and integrating the financial systems of all government agencies to facilitate the processing of government financial transactions (Rais, 1999; Yong, 2003, Araya, 2004).

in Brunei Darussalam, ICT has been adopted in public sector reform, and the government invested large amounts to develop IT infrastructure and enhance public sector performance (Haji Musa, 2008, Kifli, 2009). Public sector organizations in Brunei were seen to need management information systems which would enable them to be result-oriented, cost-effective, transparent, accountable and responsive to citizen needs. This demand for change is strengthened by globalization, the existence of technological improvements, rising public expectations, and the stagnation of public sector organizations' performance compared with their counterparts in other jurisdictions and the private sector (Commonwealth Advanced seminar, 2003; Siddiquee, 2008).

With help from Accenture, all Ministries had prepared their own potential e-government projects. TAFIS (Treasury Accounting and Financial Information Systems) has been introduced as a project intended to modernize the services provided by the Ministry of Finance. It has been chosen for the focus of this study. TAFIS was led by the Ministry of Finance (MOF) and maintained and supported by BAG Networks, a joint venture company between Brunei Government & Accenture. TAFIS application was aimed to improve the functional areas of the financial accounting and financial services of MOF and consequently affected all the departments, sections and units of all 12 Ministries (Mitullah and Waema,



2008; [www.e-government.gov.bn/flagship/tafis.htm](http://www.e-government.gov.bn/flagship/tafis.htm), (Haji Musa, 2008,). This study uses secondary data and some primary data extracted through a semi-structured interviews with some key administrators at the ministry of finance. The interview was aimed to acquire a realistic and fresh insight into TAFIS implementation as a case study of administration modernization in developing countries.

### **E-Government Readiness in Brunei Darussalam**

According to Kerby, a leading Inter-Regional Adviser in e-government, e-readiness is not simply a matter of the number of computers servers, websites and mobile phones in the country, but also relates to the country e-business environment and how amenable the country's market is to Internet-based opportunities (E-Government Survey, UNDESA, 2010). Among South-East countries, Brunei in general has achieved a modest score in e-readiness. A UN study of the e-readiness of eleven South-East Asian countries (see Table 1) shows that Brunei has made considerable progress in e-readiness in 2010. In 2005 and 2008, Brunei was fifth among the eleven countries surveyed, though in global terms, it had slipped off from 73rd to 87th, but by 2010, Brunei's regional ranking had risen from fifth to third and its global ranking from 73 in 2005, 87 in 2008 to 68 in 2010, though it is still well behind Singapore, which ranks first in Asia as well as South-east Asia, and eleventh among top twenty countries in the World (UN-e-government Survey 2010). Supervisors at the MOF tend to agree that e-government in Brunei is still not performing at its expected level and they questioned the level of competence of employees who would have to operate and manage the information systems. They hoped that the e-government initiative would lead ministries being open to the public and provide relevant, reliable and accurate information via the internet.

Table 1 South-East Asian countries e-government readiness index 2005/2008/2010

Number	Country Name	Index 2005	Index 2008	Index 2010	Global ranking in		
					2005	2008	2010
1	Singapore	0.8503	0.7009	0.7476	7	23	11
2	Malaysia	0.5706	0.6063	0.6101	43	34	32
3	Negara Brunei	0.4475	0.4667	0.4796	73	87	68
4	Thailand	0.5518	0.5031	0.4653	46	64	76
5	Philippines	0.5721	0.5002	0.4637	41	66	78
6	Vietnam	0.3640	0.4558	0.4454	105	91	90
7	Indonesia	0.3819	0.4107	0.4026	96	106	109
8	Cambodia	0.2989	0.2989	0.2878	128	139	140
9	Myanmar	0.2959	0.2922	0.2818	129	144	141
10	Timor-Leste	0.2512	0.2462	0.2273	144	155	162
11	Lao People's Democratic Republic	0.2421	0.2383	0.2637	147	156	151

### The Brunei case

Brunei Darussalam is a small oil-producing state in Southeast Asia. It is ruled by Sultan Hassanal Bolkiah, and as it does not have an elected parliament, nor does it receive foreign aid, it is not subject to many of the pressures which have fuelled the demand for improved public sector performance in many other countries, but there has still been considerable interest in the potential of information and communication technology (ICT) to improve

public sector performance. Brunei is a member of a number of international groupings, including the Commonwealth, which through CAPAM (the Commonwealth Association for public administration and Management) has focused on the role of ICT in modernizing the public services and coping with the increasing needs of citizens. There is a general agreement that the ICT has led the public services to be delivered in more convenient, customer-oriented, efficient, and in a different and better way. In addition, globalization has changed the world economy and re-defined the role of public sector in relation to regulation as well as the direct provision of public services. Reforms such as privatization, outsourcing, and other market mechanisms aimed at increasing competition in the provision of public services, have prompted governments to look for innovative ways to reinvent the engine of government and to reduce costs and increase efficiency and effectiveness of service delivery, and to be in harmony with the new paradigm labeled New Public Management.

Although as an oil producer, Brunei is not subject to the same financial pressures as most other countries. However, the government is subject to the pressures of globalization, social & economic change and the increases in citizen expectations. This has not involved any moves to reduce the size of the public sector - the public bureaucracy in Brunei has remained large and the citizens continue to rely on government for the bulk of their needs – but the changing context of public administration has prompted a number of innovations in the internal operation of the public sector and the delivery of services. (ACCSM Main Conference, Brunei Darussalam, 2003). Following global trends, the government introduced major reforms to redesign and re-engineer the public sector systems and processes in order to achieve dramatic improvements in terms of quality, access and speed in service delivery. In particular, it has sought to move Brunei into paperless governance through the use of multimedia technologies for information and data exchange, within the various areas inside and outside the sphere of public sector. . These changes use ICT to transform not only the structural and procedural aspects of public sector organizations but also covered the operational expectations and values of public officials.

The government commitment to ICT policy was clearly reflected in the 8<sup>th</sup> and 9<sup>th</sup> National Development Plans (2002-2006, 2007-2012) and the National Strategic IT Plan called “IT 2000 and Beyond” (Musa, 2008; Hazair, 2010; Borneo Bulletin, 2005). The Sultan, in his address to the National Summit on Information Society on September 2005, emphasized on the need for the comprehensive, visionary e-government strategy and collaboration among government agencies to enable the provision of quality online customer services. But although the government of Brunei has recognized the importance of broadening the use of ICT in enhancing governance and improving public service delivery, there has not been much detailed and objective assessment of these measures (Siddiquee, 2008). Most of the writings on the Brunei public sector are descriptive and chronological accounts from senior bureaucratic figures. These descriptive works (e.g. Musa (2008), Ruhaidah (2004), and Hazair (2010)) offer readers a broad review of the nature of reforms introduced in some areas of

public sector, but lack analyses. There is dearth of literature that examines how electronic government is being used in the delivery and improvement of public services and their contribution in theoretical and practical terms.

Although attempts have been started as back as the 1970s in building e-Government in Brunei, but the government of Brunei has decided to speed up the IT development in various sectors of the economy ever since 1990s (Hazair, 2010). In 1995, the Information Technology Program was introduced for the civil service and aimed to raise IT usage and awareness, promoting planned IT programs for various public sector organizations and improving service levels to the citizens. Currently all the ministries and other semi- government agencies have a specialized IT department of Information Technology. A central Department within the Ministry of Finance was established in 1996 to conduct technical studies, identify IT needs, provide consultation services, develop software for governmental applications, and supervise information systems implementations. In 1997, a national IT Strategic Planning was launched but it only took off in year 2000. It is called "IT 2000 and beyond" and aimed to promote effective application of IT in the public and private sectors, raising the level of IT literacy, and ensuring of IT skilled manpower to fuel growth of Brunei economy (Musa, 2008). The Brunei Darussalam Information Technology Council (BIT Council) and its affiliated EGPEC (e – Government Program Executive Committee) was established in the year 2000 with purpose to ensure that the various ICT initiatives undertaken by the government organizations will be on line with the Public Sector vision. ICT Strategic Plan vision is:

- Brunei Darussalam to exploit IT to its full potential for national prosperity and to make Brunei as the cyber hub in the ASEAN region.

ICT Strategic sector objectives are:

- Creating a paperless society through paperless governance and services (efficient and effective online service)
- Introducing electronic government through better training programs and IT coordination
- Creating better incentives for IT adoption and e-Business deployment in the public sector

The budgetary allocations for ICT have been steadily increased and even survived the recent economic crisis. The 8<sup>th</sup> national plan allocated \$ 526 million for ICT, which was later increased to B\$ 1 Billion (about US \$690 million) for the development and implementation of infrastructure for the e – Government. This represented 12.1% of the total funds of National Development Plan (Brunei Darussalam Public Sector Journey towards e-government, 2003, Musa 2008). The bulk of the ICT sector allocation in the 8<sup>th</sup> NDP was for infrastructural e – Government projects such as the provision of Data Center, electricity, telephone lines, hardware and software. Other projects included the development of Human Resource Management System, and Collaborative e-office for all ministries, and specialized projects in the ministries: TAFIS and E-Government Center (Ministry of Finance), SISMI (Islamic

Information System) Ministry of Religious Affairs, Mukim.Net (Ministry of Home affairs), E – Health (Ministry of Health), and E – Education (Ministry of Education).

In translating these e-government initiatives into realities, the government of Brunei has tried to learn from and emulate the best of practices of other countries. Government officers were sent to countries like Malaysia, Singapore, Canada and Australia to study their e-Government initiatives (Kaliannan et al., 2009). Workshops, seminars, and training programs on e-government were also organized in Brunei Darussalam in cooperation with consultants from South Korea, Singapore, Philippines, USA and Canada (Haji Hazair, 2010). The government's reforms involve the use of ICT to transform the structures, operations and the culture of government, leading to full integration between the government and both citizens and businesses, and effective front & back-office process (Janowski, 2008).

### **The Ministry of Finance initiative**

TAFIS was announced in a directive given by the Sultan in conjunction with his 55<sup>th</sup> birthday, which stated: "In pursuit of Information Technology Communication development, our government has approved the implementation of the 'Integrated computerized Electronic Government Accounting and Information Financial System' or TAFIS through the Ministry of Finance" (Extracted and translated from Pelita Brunei of 20<sup>th</sup> July 2001). Its introduction reflected concerns in the Ministry of Finance about public sector financial management. There had been increasing complaints about delays by government in paying bills for the private business contractors, the duplication of financial data entries, problems in the security of clients' personal files, the lack of quality criteria and performance measures, are among others which have pushed the government of Brunei to search for an improved financial management system. TAFIS was implemented on 1 March 2002 to speed up financial transactions, create reliable data, and enhance budgetary preparation and control by the Ministry of Finance. Its main objectives are:

- To improve efficiency of government financial transaction processes
- To improve tracking and management of government funds and thereby optimize utilization
- To transfer of technology-based knowledge, skills and abilities
- To move towards a 'paperless' government
- To set up TAFIS information technology networking

The main outcomes of this innovative tool, according to the Director of financial services, are increasing efficiency, effectiveness, enhancing financial transparency and accountability in the delivery of financial services (Ruhaidah, 2003). TAFIS is intended to make the administration of MOF more responsive and cost-effective. The computerized financial transactions means that transactions between the MOF and its clients can be online and thus

reducing cost and time and extending customer satisfaction. The other features of TAFIS according to the Director of Treasury Department are increasing accessibility of MOF' clients, reduction in data entry errors, integrated and real-time information, online and on-demand reporting and data retrieval, timely online approval, increased accountability and responsibility of financial services delivery, paperless workflow, and tighter security (Musa, 2008). These benefits will be reflected on enhanced financial performance, improved budget performance, and increased productivity of financial staff.

The implementation of TAFIS was preceded by the establishment of the institutional framework, the development of e-Government architecture, the deployment of both intranet and extranet facilities at all ministries and departments, and the establishment of common e-Government Application and Services which entails the setting-up of the E-government centre at the Ministry of Finance (Hazair, 2010, Ruhaidah, 2003).

### **The trajectory of reform**

It is now widely accepted that for organizational change to be successful, it has to be driven by the organization's key players (Hammer and Champy, 1993; Senge et al., 1999, Heeks, 2003). It is the senior managers who must sponsor, stand by and exemplify the change introduced. In the context of the related changes, the drivers of change are as important as the nature of change itself (Zmud; 1984; Kaliannan, Raman, and Dorasamy, 2009). In the case of Brunei, the sole driver is the Sultan of the country. In many occasions, he has reiterated the needs for creating an efficient and effective public sector through the application of ICT. It has been observed that the adoption of IT without a vision or strategy is unlikely to produce the expected benefits for business or a government (Jayasuriya, 1993). If it is not fully integrated with the business plans and strategies, then IT is unlikely to become an important resource for the public sector (Johnson and Carrico, 1988; Curries, 1996; Kaliannan, Raman, and Dorasamy, 2009). This holistic view integrates all processes across government ministries, job specifications with system capabilities, manual processes with computerized processes, work flow with physical layout, performance management with service, etc. In totality, the government considers not just the technology element but also the human processes, organizational internal operations, security, laws and regulations and environments (Ahmad, 2006).

The government objective is for TAFIS to be a Government-wide exercise involving all departments, sections and units in all 12 ministries. The project is structured around clear milestones which provide a focus for the TAFIS team. The first milestone centered on the functional activities for Ministry of Finance. These are divided into two functional areas. One focused on the improvements of financial reporting system which would contribute to the refinement of annual budget preparation. It covers activities such cash management, debt management, commitment control and auditing. All these activities are re-designed and TAFIS was aimed to enhance the re-engineered business process. The second was aimed of

providing core functionality to the Treasury Department and other Departments within MOF to manage funds make payments and perform bookkeeping. These are mainly financial services which include housing rent maintenance, daily rated payroll, and loan management, allowance processing, gratuity and pension and human resource record (Haji Musa, 2008). This milestone was intended to rollout TAFIS to all departments of MOF. The other milestones run concurrently with first Business Process Re-Engineering and involve all the Ministries.

Based on Haji Musa Study (2007), there are more than 2500 civil servants using TAFIS. This indicates a very low percentage of users (total public sector employees are 44, 000). An average of more than 30 thousands payment transactions are processed per month. According to a manager in the Ministry of Finance “about 73% and 91% of payments to employees and vendors are now automated and processed via TAFIS system”. This has enabled significant reduction in the time taken to process them. In term of re-engineering the processes, the average time taken to approve payments and pay for invoices has been reduced from 24 to 14 days. Other accomplishments of TAFIS implementation, according to Deputy Director of the Treasury are 16 days reduction in time taken to pay leave allowance (from 37 to 21) and 5 days reduction in time taken to pay education allowance (from 30 to 25).

Other accomplishments were noted by one prominent senior official of MOF (Head of Treasury Department). According to him, now new work practices are replacing the old habits in dealing with financial transactions. All employees at this Ministry are dealing with financial transactions by electronic mean. It is noted that the process of physically delivering diskettes to banks containing electronic financial transactions payments was replaced by the electronic transfer of files. Also, the manual entry of personal information and checks payments was curtailed by the adoption of TAFIS. It is used to run through three stages and now is handled by one stage, thus eliminating the inefficiencies of financial transaction processes (Ruhaidah, 2003).

### **Problems and responses**

The main challenge of adopting e-government in any developing country is whether the intended objectives are achieved or not achieved. This is a subjective judgment, reflecting the expectations of those involved in e-government projects. Definitely TAFIS's adoption will bring benefits to all stakeholders of the ministry of finance. Internally TAFIS will enhance the financial operations of the government and externally will have positive impact on citizens and businesses. However, implementing a project which entails such changes is not without any barriers. ICT integration means making a connection between the internal and external environment of the organization, and linking information, processes, people, and strategy (Heeks 2003, Schultheis & Summer 1998). This section discusses some critical issues surrounding the adoption of e-government in Brunei, drawing on interviews with officials at various levels in the Ministry of Finance.

- The integration of new proposed project (Like TAFIS) in the Ministry of Finance with current practice remains the main challenge facing Brunei (and most developing countries). (Heeks, 2003). According to Heeks (2003) most e-government implementation failure in developing countries lies in the conception-reality gap. In Brunei according to one financial officer at MOF, reform was stymied by the traditional, centralized IT structures within the Ministry. According to another interviewee, the distribution of computer networks on the desk of every public servant was intended to improve the management of financial resources. However, there was little improvement in the monitoring of expenditure. This is due to the structural division between central finance officers who held the monitoring information but had no power of enforcement and senior financial officers who had the power to enforce the expenditure warnings but had no information or motivation to do so. The centralized structure of the ministry of finance has hampered the efforts of the coordinated implementation of TAFIS. To rectify such problem, the MOF should undertake an integrative outlook to do necessary reforms to involve other specialists from finance, budget and human resource divisions. It needs to broaden its remit of financial information systems and devolving responsibilities and staff to other individuals departments.
- The implementation of TAFIS has raised the expected roles and responsibilities of the officials in responding to enquires of those dealings with the MOF. My interviewees suggested that many employees are still not ready to assume the new tasks and are not computer literate. The existence of technological illiteracy in most of developing countries makes it hard for people to interact with changes needed in an information society (Nagi 2009). The computer-illiterate see the technology as black art while those who are computer literate are guarded and speak another language (Obolensky 1994). This calls for involving and re-skilling staff through an active participation and training program. Communicating the new roles, responsibilities to the users of TAFIS and discussing the benefits and negative aspects of the new system will certainly increases the staff acceptance, involvement and cause them to feel that their interests are being served.
- The third challenge involves the reorientation of the public sector to make it more customer-oriented. Brunei government, according to senior government officer operates as a closed bureaucracy. Information is created by an agency, put in place by the generating ministry/department, classified as secret and held by the ministry/department which created it. The public's access to this information is determined by the creating agency. The high centralization of the government bureaucracy and the pressure to avoid making of errors by following rules and instructions are major factors which contribute to the secrecy and confidentiality of information (Hajah Sainah, 2000). TAFIS's change leaders at MOF need to



restructure the ministry's departments and processes in order to maximize the value of the information shared by the internal users of the system. Having taken a holistic approach to develop TAFIS, a key impact will be the integration of the work activities from the various teams organized along skills disciplines. It is important that MOF staff agree on the importance of incentives to ensure co-ordination and to promote a sense of ownership and accountability for decentralized initiatives.

- In Brunei, the national IT strategy is using English as the dominant language in navigating the internet. The first language of most Bruneians is Malay, although the schooling Curricula contain English as a major subject. But Malay-language IT formats exists in the neighboring countries of Malaysia and Indonesia. Based on interview with IT Director, Brunei national ICT strategy does not consider what users will do once they get connected, what content they may consume, and what services they will engage with.
- The fragmentation of government in Brunei also presents a challenge in the implementation of e-government. The Head of IT Department, MOF, felt that e-government activities are uncoordinated, resulting in a low level and quality of public sector of e-services, and insufficient information about e-content from low level employees. Duplication among ministries and the insufficient human resources have impeded the implementation of the e-government initiative. To rectify this problem coordination will minimize the redoing of things and eliminates duplication of interaction between the users of the new systems and other effected departments during the clearance stage of the financial transactions and the data gathering stage.
- The other challenge is the low level of computer literacy, both in the civil service and the wider society. This makes hard for a population to interact with the changes needed in an information society (Nagi & Hamdan, 2009, Heeks 2003). Employees at the MOF have shown a lack of skills and attitudes in relation to the use of TAFIS in their respective work areas (Interview with senior official at MOF). Staffs at the ministry of finance, according to IT manager, "have not shown high seriousness to the changes brought by the adoption of TAFIS". This is not only due to the lack of training but it is also attributed to the low level of commitment to engage seriously to the changes brought about in government. The adoption of IT calls for the interaction of both the cognitive and the affective state (Hazman and Alaa-Aldin 2001). Different types of training can be conducted to close the gap in skills and knowledge (i.e., project management, change management, IS and IT issues). Changing attitudes in relations to the use of TAFIS can be dealt with through a case study, role-playing exercises and group-forming activities (Heeks,

2003). A more radical participative approach would include clients groups (contractors, suppliers, citizens) as well as who are using the new system.

## Conclusions

TAFIS aimed to change the internal processes and bring more improvements in the efficiency and effectiveness of the financial management system of the Ministry of Finance. It integrates information from both the financial accounting and financial services areas, making processing more efficient, streamlined and customer-oriented. This in turn will help with generating timely, and informative financial statistics useful in formulating the annual budgetary process and enhancing the financial control at the MOF. Seeking to bring major improvements in term of efficiency and quality of services, TAFIS has altered institutional procedures at MOF. TAFIS has changed the internal operations and control from a traditional vertical, functional, and hierarchal to a horizontal, cross-functional, team-based, flat structure. This type of institutional arrangements was aimed to re-engineer the management process, cost-cutting, pleasing customers and to enhance the accountability aspect of the MOF (Ruhaidah, 2004). However, despite all promises and accomplishments, there remain serious limitations and challenges. According to an interview, there are still delays in clearing the vouchers into TAFIS computerized system, due to lack of competence and professionalism among the MOF employees. In addition, there is a high evidence of bureaucratic inefficiency, procedural complications, lack of coordination between employees at the different stages of the financial transaction processes and among them and other employees of the other ministries and departments

Although the promises of TAFIS as an e-Government initiative was to streamline the financial transactions and to manage the expectations of key stakeholders, there is still lacks of any G2C (Government-to-Citizen) and G2B (Government-to-Business) components. However, on the G2E (Government to employee) front, there has been a visible sign of development. Brunei has succeeded in streamlining and improving internal government operations and administrative efficiency through the implementation of ICT solutions such as TAFIS, as well as the recent embarkation of the \$ 1 billion-budgeted Human Resource Management System for the Brunei government (Center for Strategic and Policy Studies, Brunei, 2008; Brunei Times, 2008)

As an e-Government project using a browser-based architecture, a key challenge will be the adoption and scaling of TAFIS to use the Internet as the carrier of its financial transactions, taking into account the security aspect of the Internet uses. Also, having taken a holistic approach in the development of TAFIS, key consideration should be given is the integration of the work activities from the various teams along skills disciplines. Coordination among the various internal users, between the employees of the MOF and among ministries affected will minimize the redoing of work and eliminates duplication of interaction with users during the clearance stage of financial transactions and the data gathering stage. Managing the

expectations of the stakeholders is another key factor for successful adoption of TAFIS. Gupta (2007) and Ahmad (2002) emphasized the importance of involving and managing the expectations of all the key project stakeholders during the introduction of any e-Government project. Understanding stakeholders' expectations and vision for TAFIS have assisted in obtaining their continued buying and commitment to the project success. It is necessary to ensure there is consistent and regular feedback to the stakeholders to establish the implications of key decisions on issues and direction taken by the project teams. In the case of TAFIS, stakeholders include senior government officials, grass-roots employees, other users such suppliers of government services and the public at large.

To address the employees' perceptions and attitudes towards the new technology, the MOF should find the best possible ways of motivating users' behavior and attitudes to make the change work. Getting employees feedback regarding the problems encountered in the workplace will enhance their knowledge, understanding and commitment to the need for changes. The staff satisfaction with ICT is an important factor underscores the need to shape the perceptions of the key users about the potential outcomes of ICT adoption. Besides training which is aimed at closing the skills and knowledge gaps, literature mentioned other hybrids ways to change employees' attitudes and perceptions towards the adoption of ICT. Examples of such approaches are: case study analysis, role-play exercise, group-forming activities, demonstrations of functional information systems, communication and expectation management, active participation to build consensus.

In summary, we are not claiming that the techniques mentioned above will perfectly help to address all problems, but they are likely assisting the reform process. Information reform initiative such TAFIS which require too much change along many internal and external dimensions would be more likely to succeed if the MOF reduces the scope or the complexity of the project. The TAFIS project is proceeding as planned. But as it scale up to all government bureaucracy, the management of the expectations of the expanded stakeholders' population is more significance than ever. In other words, the challenge is to undertake an assessment study in a holistic manner which could address the expectations of all internal and external stakeholders of the government.

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## THE BRAND-INDIVIDUAL RELATIONSHIP: INFLUENCES FROM AND TO RELEVANT REFERENCE CONTEXTS

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### Abstract

The present paper, through a conceptual framework, aims at improving the studies regarding consumption and the relation between brand and individual/consumer.

The objective of the paper is to show that relations between the firm and the individual/consumer, created by the product/brand, are both cause/medium and effect of influences moving to and from the relevant reference contexts.

It focuses on the literature gaps about social consumption and the network approach, and on Giddens's and Golinelli's theories.

According to Giddens's and Golinelli's theories, relations between company/brand and individuals are influenced by and affect their reference contexts through a dual structural model cycle. This model features two isomorphic parts represented by the company/brand with its context and the individual with his/her context, bound by a mutual relationship.

Using the components of the dimensions of the duality of structure model as a checklist, the framework helps researchers and practitioners to assess the impact of social elements and structural influences on marketing decisions. Contextual influence analysis can shape segmentation and positioning strategies and policies.

The paper produces some useful considerations about the dynamic existing between the firm/brand and the individual and highlights some gaps in the studies regarding the network approach and the social consumption process.

**Keywords:** Brand Management, Consumer Behaviour, Viable System Approach, Structuration Theory, Theory of Communicative Action

### Introduction

As individuals' needs grow, companies are called to considerable interpretative efforts to respond to them, while academics and practitioners seek to better understand how the social context and individual characteristics affect the relationship between the individual and the brand and consequently how consumers respond to marketing and communication efforts.

The following methodological path should be followed in order to build a conceptual framework:

*Theoretical background:* what are the intellectual sources we should access in order to increase and refine our understanding of our object of study?

*Level of analysis:* the relationship between brand and individual may be studied at different levels. Can models and methods developed with relation to a certain level be applied to other levels as well? (academic gaps)

*Conceptualization:* what are the fundamental issues to address when proposing a definition of the consumption system?

*Methodology:* what are the appropriate data collection techniques, analytical tools and procedures to be used with structuration analysis?

*Relevance:* what theoretical and practical problems can the structuration theory help us to address? What is the added value? How can the structuration frame help us to promote or manage marketing relations?

## **Theoretical background**

Managers and researchers in marketing and consumer behaviour share a common concern: understanding the dynamic at the basis of their mutual relationship, which is crucial to their social and economic survival.

Therefore, along with the rise of relational approaches in marketing, the focus of marketing research has changed from products and firm to people, organizations and the social processes that bind the players involved (Webster, 1982; from Okonen et al., 2000).

In the last few years a lot of researchers studied the effects of consumer group membership within a social context and their responsiveness to marketing efforts (Aaker, Brumbaugh and Grier, 2000; Deshpandé and Stayman, 1994, Grier and Brumbaugh, 1999; Grier and Deshpandé, 2001).

Other researchers tried to determine why and under what conditions consumers enter into a strong, committed and meaningful relationship with a certain company, championing the company itself and its products (Battacharya and Sen, 2003). Drawing on theories of social identity and organizational identification, some researchers proposed that a strong consumer-company relationship often stems from the consumers' identification with the firm whose products help them to satisfy their self-definitional needs (Bhattacharya and Sen, 2003; McAlexander, Shouten and Koenig, 2002; Bergami and Bagozzi, 2000; Kunda, 1999; Scott and Lane, 2000).

Some researchers studied, using a conceptual model, how different aspects of the relationship existing between customers and the relevant brand community affect the intentions and behaviour of the former (Algesheimer, Dholakia and Herrmann, 2005; Cova, 1997). We can therefore say that while the earliest studies mostly focused on understanding the nature of the dyadic relationship, on the basis of the seminal observation for which both

consumer and supplier are active, hence the name 'interaction approach' (Håkanson, 1982; Turnbull and Valla, 1987), in the next phase the focus shifted towards the dynamic development of the dyadic relationships (Dwyer et al, 1987; Ford et al, 1986). Such dyadic relationship studies were also applied to intra-firm relationship, and one of the main conclusions reached by the Europe-based IMP (Industrial/International Marketing and Purchasing) Group was that a dyadic relationship has to be seen in the context of a larger set of intra-firm relations forming the business context of the focal dyad.

As Håkansson and Johanson (1992, p.49) point out, network structures are '... emergent and enacted phenomena that form webs of interdependencies extending far beyond the horizon of a single actor'.

The underlying rationale was to understand the actions of both the buyer and the seller and the longitudinal development of their relationship. Such 'network approach' has recently attracted considerable interest among business marketing researchers (Håkanson and Snehota, 1989, 1995; Webster, 1992).

The complex interaction between them needs to be addressed at organizational, departmental and personal level (Möller and Wilson, 1988). Although actors at different levels of aggregation may be identified, individuals are inevitably the basic interactors in all possible collective configurations. In other words, all aspects of interpersonal communication must be taken into account when researching exchange processes from an interaction/network perspective (Alajoutsijärvi and Eriksson, 1998).

In the last few years network researchers have focused their studies on the role of communication, saying that relations and networks are essentially formed by interpersonal communication processes which, in turn, are affected by their contextual and structural factors. On the other hand, communication processes may affect the contextual and structural features of the relationship or network (Olkkonen, Tikkanen, and Alajoutsijärvi, 2000).

### **Level of analysis**

Literature does not pay much attention to the influences affecting social players (individual/firm) operating in their relevant contexts. This mutual exchange of influences is, according to social dynamic scholars like Giddens, Sewell and others, the cause of the birth of society.

This work wants to focus both on the influences that reference contexts have towards social players when they choose and/or create the relationship, and on the effects that the relations have towards the players and their contexts.

Giddens describes the relationship between social players/organizations like a 'dual' process, meaning that such relationship affects and is affected by the relevant reference contexts.



The present approach will be useful to display the isomorphic feature, typical of complex structures. According to it, for each component within a structure there is a similar one in another structure, and the two parts play similar roles within their respective structures.

The paper is based both on sociological theories, like those of Sewell or Giddens, and on management theories, such as Golinelli's viable system approach. According to these, interactions between firms and individuals are likely to affect both the players involved and the relevant reference systems.

The core of the relationship between company and individual that we are going to analyse in this paper is consumption. It could be either viewed from an economic perspective, where products are considered as a set of attributes providing special benefits to consumers, or from a symbolic perspective, where products are perceived as conveying different meaning (Bourdieu, 1984, Halle, 1992, Morley, 1986; Press, 1991; Radway, 1984, Holt, 1995).

Consumption will be considered in this work as a process, a social action (Simmel, 1950) conveying cultural content and allowing consumers to reach different classification and/or integration targets both in relation to other individuals and within the relevant social groups. Such process triggers in turn changes on a broader scale within communities or structures (Holt, 1997).

The evolutionary process found in social structures is called by Giddens *structuration*: 'we create society (medium) at the same time as we are created by it (outcome)' (Giddens, 1984).

Classification and social integration reached through a symbol should be considered, according to an approach very close to Bourdieu's theories, as a non-problematic process that gets validated first by possession and then by social display of the object being consumed (Bourdieu, 1984).

As it is always very difficult to assess the outcome of any consumption process, due to the many ways in which different consumers view the same product, it is paramount to study the issue in question according to social system theories, which consider systems as dynamic expressions of transformative relations among different players (Giddens, 1984, p. 17).

It appears therefore necessary, in order to contribute to the study of both consumption and consumer behaviour, to analyse the relations between the social players firm and individual, the influences that the relations produce on the relevant reference contexts, and finally the effects that the contexts have on individual players and on group players.

This approach has both theoretical and practical implications for brand management. It requires a deeper understanding of personal interaction, where a brand develops its meaning and role influencing individuals, social groups/communities, families, competitors, suppliers and other stakeholders.

The aim of this paper is also to integrate the theories dealing with the relationship between individual/consumer and brand, drawing on approaches such as Habermas's 'theory of communicative action', and other sociological and managerial works.

As already said, the product/brand will be considered not only as something going beyond its functional and commercial value, but in particular as a visual clue mediating between distinctive identity projections, which are necessary to the individual to stand out and/or to assess his status within the social group(s) he/she belongs to (Fournier, 1998).

### **Conceptualization. The social function of brands: from individual to social individual**

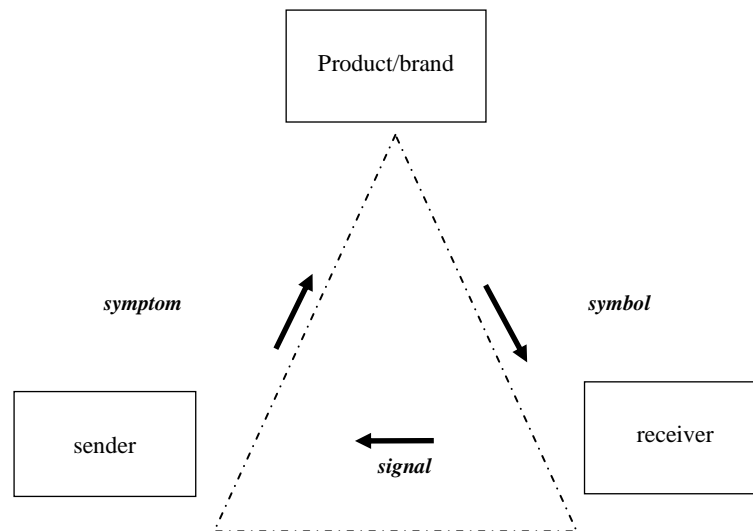
In order to achieve our goal, it is necessary to illustrate the role of the brand both among individuals, which we will discuss in this section, and between individuals and businesses.

It seems useful, when considering the first point, to refer to the philosopher Karl Bühler, who in his *Sprachtheorie* (1934) developed the notion of sign as a communication tool. His communication model regarding social players stems from his idea of linguistic sign (Bühler, 1990).

Bühler, focusing on the functional analysis of the sign, places it at the core of a threefold relationship involving the object (in our case the product/brand), the sender and the receiver.

According to this theory, the sign (product/brand) is to the sender/transmitter (individual/consumer) both a *symptom*, as it expresses his/her inner life and identity, and a *symbol* towards the individuals or groups the communication process is aimed at. The *symbolic* function, being linked to objects and behaviour, works as a representation of cultural and social cues displayed by the sender and aimed at the recipient. The latter (other individual or group member) then represents his perception (the *signal*) which is basically interest - or lack of - towards the sender (he is allowed into the social group, is qualified as a leader, etc) (see fig. 1).

Figure 1: Bühler's communication model



Mead integrated Bühler's model arguing that functional differentiation reached via a form of language leads in humans to a totally different organizing principle, which produces not only a different type of individual but also a different society. Linguistic symbols (products/brands), are therefore at the core of the behavioural interaction of many individuals (Mead, 1966, p.249).

Behaviour becomes therefore symbolically significant when it implicitly triggers in the acting individual the same response that receiving individuals explicitly experience, or are thought to experience (Mead, 1966, p. 273). The transmitting individual internalizes the relationship between his behaviour and the receiver's reaction (see the following case vignette). This dynamic develops both between individuals and between individuals and companies. The latter is the case examined by the present work.

### The Silly Bandz phenomenon

The multicolour silicone bracelets called Silly Bandz are certainly one of the best examples of the model described.

The original Silly Bandz are 100% silicone and moulded in different, very original designs. One can stress them in any possible way and they magically return to their original shape.

They are very simple, coloured silicone bracelets available in a number of different shapes, from zoo animals to letters, from cars to musical instruments. There are hundreds of different designs, to wear on wrists or ankles, or even to spice one's haircut.

The different shapes form a coded language used by teenagers first and now also by adults. People wearing dinosaurs say: 'I am on the prowl'. Flowers: 'I am romantic'. Rhinos and crocodiles: 'Today I bite'. Phosphorescent ones (glow in the dark) suggest: 'I am looking for company'.

Millions of meters of silicon to be part of a group, to be equal and different, to socialize. Nowadays, one either wears a Mickey Mouse set on the wrist or is a nobody.

It is a product which, depending on the model chosen, is an expression of a *symptom*, that is the individual's need to communicate (what is your shape?) through a *symbol* his classificatory behaviour towards certain contexts (the second word of the product name – Bandz – clearly evokes the idea of group). Such behaviour induces the recipients to produce a response *cue* (acceptance or non-acceptance, appreciation or non-appreciation). The last phase affects not only the players involved in the communication process but also, indirectly, the reference contexts or social groups, that will adapt to changes in their members' roles and/or distribution.

The product/brand, being a *medium* conveying values and identity, plays therefore a co-ordinating role with relation to actions that have social classification content and purposes.

Sender and recipient understand the meaning of a symbolic language if they know what contribution it could provide towards the establishment of a mutually beneficial relationship.

The model presented shows that the establishment of a social relationship requires the participation of at least two players, who start communicating each time one of them cannot reach his goal by himself, that is without involving other players. At this point there are two possible scenarios: if the two parties share a common goal, a *relational* activity takes place (for example, two people co-operate).

If however the goals of the two agents are complementary, each of them will act pursuing his own, turning to the other player only if necessary to the success of his own initiative: we call this *interaction*. In both cases, the action patterns of the two individuals will display some overlaps.

The two players exchange communicative cues that allow them to co-ordinate their actions, showing each other the benefits obtained from their interaction, that is from acting according to the other party's wishes (Habermas, 1997).

### **Conceptualization. Structuration Theory and the relations between brand and individual**

Communication between social players, as shown above, is mainly aimed at satisfying their own needs/requirements. Habermas says that such behaviour refers to the interaction between at least two social players capable of language and action who establish a relationship through either verbal or extraverbal means. The players seek an agreement to co-ordinate their action plans and their respective behaviour (Habermas, 2000).

If one of the actors is a social organization such as a company, it establishes a communicative behaviour aimed at creating a series of relations based on a common language and/or purpose, in order to reach a sustainable agreement with the other party, whether individual/consumer or stakeholder (Golinelli, 2008; Barile, 2006).

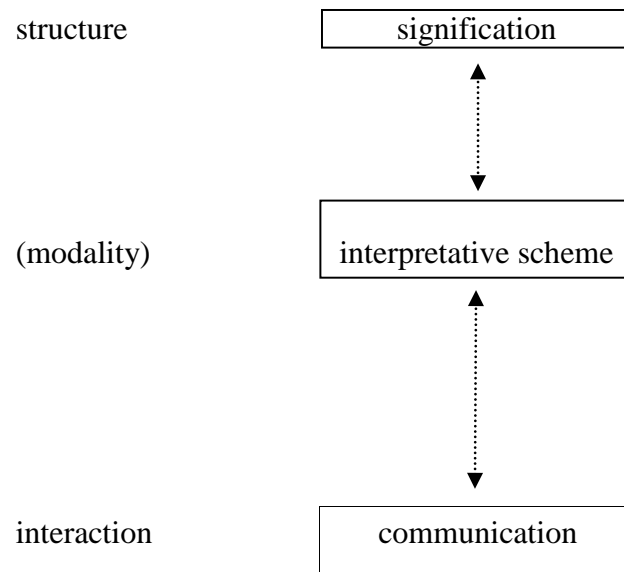
The communicative dynamic existing between company and individual evolves following a process of mutual interpretation, to be continuously reviewed, based on the definition of situations likely to be agreed upon (Habermas, 1997, p.157).

Symbolism causes therefore the establishment of both subjective and extrasubjective orientation systems, so analyzing the nature of the relevant relations becomes important in order to define their role in the dynamic operating within the players' reference contexts.

According to the structuration approach, whose main theorist is Giddens (1984), those are expression of the different social levels, both at micro and macro level, in which relations are established and reviewed.

According to Giddens the biunivocal relation processes shows the dimension of 'the duality of structure' as composed of two levels: *micro*, which is the interaction step between the social players, when the players modify their interpretative schemes giving, through the adoption of different behaviour and social practices, different 'signification' to the reference context; and the *macro* level in which, because of the different signification, the players receive in turn new/different influences to create/maintain other interactions (see fig. 2).

Fig. 2: the duality of structure



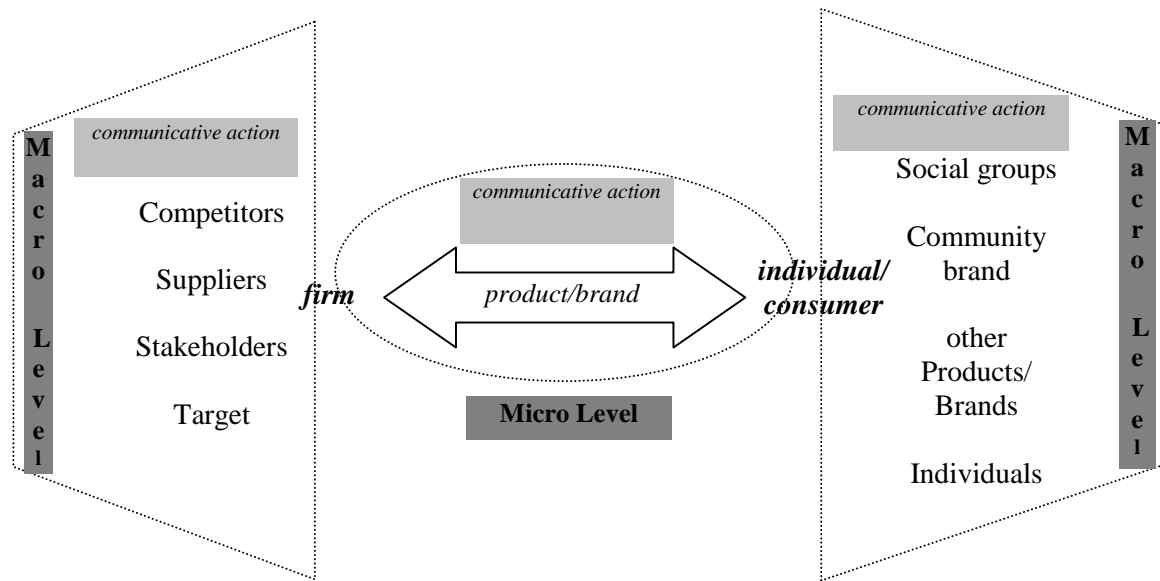
As for the firm, contextual influences occur when the management is forced to adapt the company's capability, know-how, marketing and communication behaviour to the specific stakeholder at micro level, and to the reference contexts (financial system, consumer system, labour market, et al.) at macro level.

This dynamic shows that viable system management continuously operates in a complex domain (Barile, 2009, pp. 37 e ss.).

The company has to take into account, *at micro level*, the consumers' psycho-social goals when defining its marketing mix with relation to both strategic (segmentation, positioning) and tactical issues. The company implements a communication activity, along the lines of Habermas's Theory of Communicative Action, in order to both announce its presence and to establish a relationship with the individual, based on mutual learning. This is aimed at conveying the message that its brand should be perceived as the right one by the individual/consumer pursuing his classification goals (Siano-Basile 2009; Siano-Basile et al, 2010).

If a consensus is reached between the parties as a result of such communication activity, we will call it social action. That, based on a constant dialogue between company and consumer, would allow them to share common ground *at macro level*. The individual would gain distinction and/or social participation, while the company would be able to establish intersystemic relations with all the relevant contexts (competitors, suppliers, financial system, fiscal system, et al.) it has to co-operate with (Golinelli, 2005, p.200) (see fig. 3).

Fig. 3: Relational framework according to the structuralist approach



The brand value will therefore be affected, in terms of positioning, not only by its own set of policies but also by marketing and communication policies adopted by competing brands.

This means that creation and/or maintenance of micro relations between firm and individuals involves re-positioning of the company and an 'induced' re-positioning operated by the competing brand.

This phenomenon shows a homeostatic condition where companies adapt, with or without links or networks, either in a direct or in an induced way, to their competitive condition. That highlights the importance for the firm to analyze – and respond to – the contextual influences caused by the behaviour of other actors (see the following case vignette). We might think for instance of how the Starbucks case, as studied by Thompson and Arsel, assumes different meanings in different cultural contexts, propagating a particular kind of place experience and shaping cultural expectations and ideas about what coffee shops should be (Thompson and Arsel, 2004).

### H&M and Zara: fashion Midas

The two giants of fast-fashion are the darlings of the market, once again boasting mind-boggling figures and results, which are forcing designers to plan an in-depth reorganization of the entire system.

With Pittimmagine Uomo on in Florence and men's fashion shows just about to start in Milan, the fashion world once more salutes two evergreen market giants, that is Zara and H&M. The two fast-fashion brands, in fact, have just released the first quarterly results for 2010. Inditex, the Spanish group also controlling Zara, recorded a 63% net profit increase: a figure towards which all other results pale in comparison, from those of cash-stripped fashion houses (including not only recently bankrupted Christian Lacroix, but also Mariella Burani Fashion Group and It Holding/Gianfranco Ferré, which is now in administration), to those displayed by much healthier companies. For H&M, on the other hand, the period running from December 2009 to February 2010 closed with a 42% net profit increase and a plus 10% in sales over the previous year.

Not only that: the two brands have also succeeded in penetrating brand new markets. Zara, for example, has recently opened its first store in India, also making its debut in the Middle East and Asia. H&M, on the other hand, arrived in Seoul, South Korea, in February after starting a successful franchise in Tel Aviv.

The fashion system, however, is not standing still: during 2009 a process of radical structural change started underground. Leaving aside snobbery and suspicion, many designers have introduced a series of 'flash' collections, that is of fashion packages that bypass the traditional stages of fashion shows and pre-collections. The results come very close to those of the 'ready-fashion' system, as the ultra-fast production, devised in our country and brought to global success by H&M and Zara, is now called (it is worth mentioning that the Spanish brand changes clothes inside its stores every 3/4 days, at a pace that is unthinkable for any traditional designer). The real challenge of tomorrow lies not much in design creativity or in copying the two fast-fashion giants, but in the ability to adjust to a market and to consumers that have radically changed.

<http://seidimoda.repubblica.it/dettaglio/hm-e-zara:-re-mida-della-moda/70241> published June 15, 2010

As to the importance of communicative action, Habermas argued that the necessity of co-ordinated action implies the need for social communication, that has to be made accessible in order to guarantee a smooth operation of the entire system (Habermas, 1997).



The theory of communicative action therefore focuses on linguistic/relational comprehension as the key to the co-ordination of social action.

According to this definition the company displays, through its product/brand and after a participative analysis of the destination market, a communicative behaviour aimed at inducing a co-ordinated response/action to be performed by the individual/consumer. He will in turn do the same, once again via the product/brand, towards other individuals or social groups.

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For these reasons companies increasingly tend to present the product/brand as conveying values and culture, in a marriage between real life and an imaginary (but possible) world needed by the individual to achieve his social goals.

Mini, for instance, does exactly that with its car. The values in question are those of Urban Culture, and people browsing the website are invited to provide fresh ideas in a sort of contest aimed at improving the ethical and aesthetic quality of urban life (see [http://www.minispace.com/it\\_it/](http://www.minispace.com/it_it/)).

Products/brands such as Dolce&Gabbana export the Mediterranean tradition, particularly the Sicilian one, on a global scale transferring imagery, colours, scents in products such as their fragrance Sicily, aimed at a world-wide market. The intention of representing Sicilian culture has also led to the publication of a 'dictionary' of the symbols employed by D&G in their campaigns (see <http://www.dolcegabbana.it/dg/profumi/sicily/>).

Such values remotely resemble the traditional market segment, but according to our framework they also represent contexts of reference characterized by spatial, social and cultural variables such as place, life and consumption style. These contexts influence and are influenced by social players.

Spatial variables are postmodernist symbols, therefore they can either be physical places like shopping malls/centres, or virtual places such as the social networks (facebook, second life, twitter).

## **Methodology**

Contextual analysis and/or multilevel analysis or hierarchical linear models (HLM) are becoming very important to evaluate both micro- and macro dynamic. They take into account mutual influences existing between reference social contexts (physical and/or virtual spaces) and individuals (Blalock, 1984; Snijders and Bosker, 1999).

Multilevel theories allow to assess how macro variables describing collective phenomena can affect micro ones, such as emotional and cognitive individual behaviour, and vice versa.

Such techniques could therefore describe the effect produced by macro factors on micro ones, employing a regression process in which a single variable depends on a set of other variables.

Such techniques not only significantly contribute to the evolution of consumer behaviour studies, but are also an invaluable support to practitioners, who are engaged in intercepting individual trends, and above all the variables affecting motivations and lifestyles, for segmentation and/or positioning purposes.

## Relevance

What the structuration theory adds to the comprehension of the brand-individual relationship is the knowledge that such interaction cannot be managed without taking into account all other mutual social influences.

Researchers and practitioners could therefore use it to understand the system of relations from (1) the perspective of a given focal 'micro level' regarding the relationship between individual and brand and from (2) a holistic perspective typifying the reciprocal social influences existing between players and their reference contexts.

Such approach implies that the role of marketing is increasingly that of sustaining both the individual in his/her social dynamic, and the firm, in order to establish, develop and maintain its position.

The views shown in this paper bring to light the importance of relations between the social players, and of the product/brand within the relations.

The product/brand is becoming more and more an expression of the individual's/consumer's lifestyle. We may even call it a symbolic platform co-managed by producers and consumers.

That leads to the conclusion, meaningful for both researchers and practitioners, that it is important to analyse the relations/influences existing between individuals and their reference contexts, in order to understand the motivations at the basis of the relationship between brand and individual/consumer.

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## A VALUE-BASED MANAGEMENT PERSPECTIVE FOR THE GERMAN AUTOMOTIVE INDUSTRY

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### Abstract

In recent years, the global automotive industry has generally recorded continual growth. The major market players in this industry are the original equipment manufacturers (OEMs) as well as suppliers at various stages of the value-added chain.

This study examines the value-based management (VBM) strategy and its implementation by the German automotive industry. The major findings of the study are fourfold. First, the German automotive industry operates on the basis of the VBM model. Second, the overall goal of the VBM model there is to maximize the value of an organization. Third, VBM enhances profitability in the automotive industry. Fourth, to achieve their target of creating value, organizations should design their VBM strategy to reflect their overall mission and goals.

**Keywords:** Value-based management, shareholder value, German automotive industry

### Introduction

Increasing shareholder value as well as strategies for measuring and assessing this value improvement together represents an important issue for corporation managers. Although numerous articles have been published about value-based metrics (Pellens et al 2000; Achleitner & Bassen 2002; Fischer & Rödl 2003; Aders et al 2003; Habersetzer & Hilpisch 2004; Droste et al 2006; PWC & Kirchhoff 2006; Quick et al 2008; Schultze et al 2009; Britzelmaier et al 2010), there seems to be little published work on how specific industries, especially the German automotive industry, have successfully utilized these metrics in enhancing their overall performance. Value-based corporate management, as a corporate objective, has also been established in German automotive enterprises (Kaufmann & Götzenberger 2006). For instance, according to its own statement, the Audi AG Ingolstadt, with its "Strategie 2020" (Strategy 2020), will align its business policy to this.

There is agreement in German business literature that, by way of VBM, enterprises are enabled to work towards the implementation, preservation and development of values in a target-orientated and active manner (Britzelmaier 2009; Becker 2000). Value-orientated corporate management can be seen from two points of view. On the one hand, value-based

management is explained by saying that the actions of enterprises must exclusively orient themselves towards increasing the enterprise's value from the point of view of the shareholders. This shareholder value approach was conceived by Rappaport (1986) in the 1980s. His concept of Creating Shareholder Value supports the management's orientation towards maximising the value of shareholder investments (Rappaport 1986). Therefore, the goal of this basic orientation is to obtain the maximum value creation for the OEM's shareholders. The practical implementation of this basic idea is also carried out in German automotive enterprises using various means.

Apart from the shareholder value approach of Rappaport, the economic value added concept (EVA<sup>TM</sup>), the discounted cash flow method (DCF), and the cash flow added method (CVA) among others, have been used since the 1990s. On account of neglecting other stakeholders, the orientation towards the owners' interests, as outlined above, has been subject to some degree of critical assessment (Britzelmaier 2009).

Hence, within the context of VBM, a second perspective is taken into consideration. In addition to shareholders, numerous other stakeholders of German OEMs as well as suppliers can be identified. Apart from shareholders, creditors, suppliers, employees, customers, competitors, and state organisations are also regarded as interest groups that serve original equipment manufacturers as tools for economic actions. Thus, experts call for a pluralistic and social orientation towards a value-based corporate management that also contains, in addition to the maximisation of shareholder value or economic objectives, flexibility and satisfaction goals in equal measure (Britzelmaier 2009; Beck & Britzelmaier 2010).

In this paper, we will examine the concept of value-based management (VBM) as it relates to the German automotive industry. We will consider the spread of VBM among the companies in this industry, the kind of VBM metrics they use, and the connection between VBM and executive compensation.

Before proceeding further, we will present the aims and objectives of this study.

## **Aims and Objectives**

The aim of this paper is to discuss the use of VBM strategy by the German automotive industry. Specifically, the objectives of the paper include:

- To discover if there is a connection between VBM and profitability in the German automotive industry;
- To identify the kinds of key metrics the industry uses in this regard;
- To discuss how the industry uses the VBM system, that is whether or not it uses it in risk management, planning and budgeting, change management, and so on;
- To discover the connection between VBM and executive compensation.

## Research Hypotheses

The following hypotheses will be tested in this study.

H0: Enhanced profitability does not depend on the management's willingness to adopt a VBM strategy.

H1: Enhanced profitability depends on the management's willingness to adopt a VBM strategy.

The above hypotheses will be tested by using a Chi-Square Test of Independence.

## Literature Review

The review presented in this paper is made under the following sub-headings:

- VBM perspective – a conceptual overview;
- Key metrics of VBM;
- VBM versus executive compensation;
- A critical analysis of VBM.

### VBM perspective – a conceptual overview

To obtain a clearer perspective on value-based management issues, we will first of all explain the meaning of VBM.

VBM can be best described as any management system that is adopted by an organization that enables the organization to be focused, measured and compensated based on its ability to create value for its stakeholders (Rappaport 1998; Biddle et al 1997; Copeland et al 2000; Eccles et al 2001; Britzelmaier 2009). The stakeholders in this regard include the shareholders, customers, vendors, employees, and the organization's host community. It is sufficient to note that under the VBM methodology, an organization's management strives to utilize practical analytical and planning steps to enhance, to a reasonable extent, all parts of the organization. To do this, they start by identifying the organization's key stakeholders (Petermüller & Britzelmaier 2008; Britzelmaier 2009). This is followed by an effort to understand the needs of these stakeholders and to develop a workable strategy for satisfying the expectations of the stakeholders as they relate to the organization's success. Hence, value in this case is considered by the organization's management to be the needs of the key stakeholders, which can then be satisfied by a prioritized strategy. In addition to this, organizations operating under a VBM philosophy always engage in activities aimed at analyzing their operational and economic performance with the objective of gaining a clearer understanding of their current position in the industry. With this form of analysis, the organization's management can easily establish a strong foundation that will be the backbone of any change initiative they may introduce. In addition, such analysis can enable the organization to create workable plans as well as reliable forecasts of their future operations.

Hence, it can be inferred that an organization operating under this perspective often describes its goals and objectives in terms of measures, and these can include a measure of their current performance, their desired performance, as well as a vector for their accomplishment. In other words, VBM works on the principle of performance measurement (Value-Based Management Institute 2001; Johnson 2009; Lazonick & O'Sullivan 2000; Martin et al 2009; Martin & Petty 2009; Beck & Britzelmaier 2010).

This simple explanation of VBM raises one important question: what are the major components of VBM? Generally speaking, value creation, value management and value measurement constitute the key components of VBM. Before proceeding further, it may be worthwhile to briefly discuss the basic key metrics of VBM.

### **Key metrics of VBM**

Broadly speaking, when implementing the VBM strategy, the first thing the organization does is to measure economic profit (EP), which is the same thing as measuring the value the firm has already created at that time. Measures that depict the extent of value creation include the economic value added (EVA<sup>TM</sup>), the shareholder value added (SVA), the cash flow return on investment (CFROI), the economic value added (EVA<sup>TM</sup>), the return on net asset (RONA), and EP (Britzelmaier 2009; Johnson 2009; Lazonick & O'Sullivan 2000; Martin et al 2009; Martin & Petty 2000; Rappaport 1986; Ryan & Trahan 2003; Young & Byrne 2000). The bottom line here is that, with these measures, a firm can assess the degree to which it is creating value for its shareholders. Even though the procedures for calculating these measures as well as what they portray may vary, these differences are insignificant when it is understood that they show the same thing, albeit from varied perspectives.

The point to note here is that by using these measures or metrics, investors and analysts can assess a company's performance relative to other companies in which they have the choice of putting their money. This, to a very significant extent, influences their decision to invest, as it relates to how much they will pay for the stocks of a company. We can get a better understanding of how this works by using EP as an example. Generally speaking, EP is a very broad metric in that it measures the performance of the entire firm of interest – measuring the firm's profit before interest minus the cost of its capital. However, it is worth pointing out that one does not really add any value to a firm by simply measuring its value using the EP approach. However, the view of the proponents of this approach is that if a firm links value-creation measures such as the EP to compensation, it will increase the chances of motivating its employees to increase their efforts towards achieving stellar results – results that can enhance the economic value of the firm. Thus, to the proponents of the EP procedure, managers need to make all necessary efforts to create measures in addition to creating performance targets that will be designed to facilitate the attainment of the firm's value-creation goals. Their suggestion as to the best way to undertake this feat is to recognize and manipulate those value drivers that influence the firm's performance (Britzelmaier 2009;



Johnson 2009; Lazonick & O'Sullivan 2000; Martin et al 2009; Martin & Petty 2000; Rappaport 1986; Ryan & Trahan 2003; Young & Byrne 2000).

It is also important to note here that the performance of the EP generally increases or decreases depending, to a large extent, on the performance of the identified value drivers. Basically, the key value drivers include operating profit margin, working capital, sales growth rate, cash income tax rate, fixed capital, growth duration period and weighted average cost of capital (WACC). Depending on the firm's goals, a manager can make decisions that can go a long way towards influencing the performance of each of these value drivers. Managers can attain the objective of enhancing sales growth, for example, through the implementation of marketing initiatives as well as by the acquisition of more distribution channels, among other strategies. Managers can also facilitate the planning process of the firm, depending on the firm's goal at the time, by engaging in tasks such as the analysis of management actions so as to determine which actions can lead to a significant increase in EP. They can also conduct sensitivity analysis, where necessary, with the aim of finding out which of the identified value drivers has the most significant impact on economic profit. If sales growth rate, for example, produces a more significant impact, this analysis can help the manager to decide to expend more resources to increase sales revenue. If any other value driver has a bigger impact on EP, the manager can divert more resources in that direction to further enhance the impact of that value driver. The implication of this is that, on the basis of the prevailing business circumstances, each of the identified value drivers will have a unique leverage impact on the EP (Beck & Britzelmaier 2010; Johnson 2009; Lazonick & O'Sullivan 2000; Martin et al 2009; Martin & Petty 2000; Rappaport 1986; Ryan & Trahan 2003; Young & Byrne 2000).

In this section, we have briefly discussed the key metrics of VBM. In the following section we will present the linkage between executive compensation and VBM, and the effects of such a link.

### **VBM versus Executive Compensation**

A useful perspective to begin this discussion is to state here that a comprehensive VBM strategy or model is one that, to a very large extent, ties executive compensation to the appropriate VBM metric. This is done by way of cash bonuses paid to the executives. Thus, for a company, establishing a reasonable relationship between executive compensation and the appropriate VBM metric involves aligning the interests of the executives or the managers of the company with those of the shareholders, as well as providing these executives with all necessary incentives to motivate them to improve the overall performance of the company. As a way of examining the potential impact of tying executive compensation to a company's VBM system, we will divide modern-day firms into two groups – those that tie executive compensation to the VBM system, and those that do not follow this approach.

Broadly speaking, most executives and managers in the 21st century often affirm that the factor that motivates them to put more effort into their work is the desire to create value. This implies that what drives most managers in their work is their goal of ensuring that their company's shareholders receive a good financial return – that is, a return that will exceed their (the shareholders') initial investment in the company as well as the amount they would have earned if they had invested in another firm, whether the firm is a competitor or not. It is necessary to note here that achieving this goal is very important, given that the present day business climate, which is characterized by hot IPOs, has created cut-throat competition for investment dollars among firms.

Modern-day managers also have other reasons for showing a keen interest in value creation. First, executive compensation packages usually include stock options. Second, if there is convincing evidence from the executive's track record that they (the executives) have consistently achieved the goal of increasing value for their companies, they will definitely increase their chances of commanding a premium with other potential employers in the industry. Moreover, an executive who can present a proven track record of value creation can significantly improve his or her professional longevity. This is because, during corporate mergers and acquisitions, they have more chance of retaining their jobs than those executives who are believed to be "under-performing" in terms of value creation (Sharman n.d.).

Note also that executives' performance was originally assessed on the basis of annual profit returns. However, the proponents of the VBM model have tended to view this approach as a short-term measure which, as a subjective assessment, does not provide any relevant information about financial return in the long run. It is thus not surprising that many firms have shifted from measuring value using the annual profit returns approach to using the VBM model. As we noted earlier, there are many metrics for assessing value performance, with the simplest being the EP. The bottom line here is that, in most modern-day firms, the compensation made to the executives is usually geared to their achieving their firms' goals as they relate to reaching the EP performance target.

Before leaving this review, we would like to make a brief critique of the VBM strategy. This will be the topic of the following section.

### **A critical analysis of VBM**

We want to start our criticism of the VBM strategy by noting that most managers that claim to adhere to the VBM model often focus on increasing shareholder value. We see this excessive attention to creating value for the shareholders as a form of shareholder capitalism – a model where corporate managers feel responsible only to the shareholders, with less attention given to other parts of the corporation. We have our reasons for assuming this position.

During the 1950s and 1960s, corporations were run in a manner that considered all the stakeholders as kings (Pfeffer 2009). Thus the managers and CEOs of firms understood

that their main role was to take appropriate measures to balance the interests of all the firm's stakeholders, which included customers, suppliers, shareholders, employees and the firm's host community. Thus the successful executives in that era were the ones that understood the complex nature of their role, both as stewards of their firm and also as professionals who were working to further the unique interests of their firm's stakeholders. The point to note here is that what was true in the 1950s and 1960s is still valid in today's business environment, which is characterized by outsourcing, knowledge work, activist's interest groups, and globalized supply chains (Pfeffer 2009; Rappaport 1998; Beck & Britzelmaier 2010).

It is worth noting here that the idea that CEOs or their corporations should focus on creating value for the shareholders (that is, the VBM model) took hold in the 1970s due to the widespread popularity of the theory of efficiency and intelligence of markets, especially among finance and business professionals. By that time, world societies had, to a very significant extent, organized themselves through financial markets. For instance, a home was no longer considered to be merely a dwelling place for families but as an option and investment on future real estate prices. In addition, a basic need such as child care, which was previously a family issue, was now a business which, like every other stock, was being traded on the floor of the stock exchange (Pfeffer 2009).

Considerable empirical evidence and sound theoretical arguments justify the maxim that the market allocates resources efficiently. However, the market can only do this when the prevailing conditions are appropriate. This implies that the market can allocate resources efficiently if, and only if, there is an adequate level of competition and information, and people have the opportunity as well as the freedom to make rational choices on an individual basis. It is important to note here that the proponents of the idea that the market holds the solution for efficient resource allocations often tend to overlook the fact that the aforesaid conditions do not always prevail in the business environment (Pfeffer 2009).

It is thus worth pointing out that opinions on issues related to finance, deregulation, time horizons, and the leading members of the corporate world are currently shifting to something new. Hence there are a growing number of corporate leaders who currently promote the view that the logic behind the idea of making shareholders' wealth the number one priority and putting it ahead of increasing stakeholder value is no longer valid. Hence, given that many countries worldwide are undertaking significant political realignment, and the fact that the world is still in the process of emerging from what is considered to be the worst economic recession since the Great Depression, there is a very high possibility that pursuing stakeholders' interest will be among the top priorities of most firms.

From a business standpoint, we consider it important to state here that there are numerous historical economic data that offer compelling evidence that companies can make significant improvements in profitability and productivity by putting the stakeholders'

interests first instead of those of the shareholders. Besides, numerous corporations in Germany have achieved laudable success by implementing measures that require high commitment in work practices. Some of the techniques used by these organizations in this regard include making significant investments in training and development, decentralization of the decision-making process within the organization, and linking staff or executive compensation to the organization's overall performance instead of the usual practice of making staff salaries contingent on individual performance (Pfeffer 2009). A large number of researchers have provided persuasive evidence that organizations can also reap huge benefits when they make the necessary effort to build customer loyalty and enhance or increase the levels of customer satisfaction.

Given the above background, we feel very confident in refuting the idea that the CEO and managers should only use those ratios or measures that indicate the financial performance of their firms in their work. Generally speaking, we do not believe that there is a legal reason or even basis for making the shareholders' interests the number one priority of a firm. The most striking point about giving shareholders exclusive priority is that it gives managers broad latitude to justify any action they take - regardless of whether or not such actions enhance profitability - by declaring such actions to be in the interest of the firm's shareholders. The bottom line here is that they are not bound by any law to do so (Pfeffer 2009).

Even in terms of logic, shareholder preeminence fails the test. Also, the maxim that the stock information from the stock market is accurate in terms of proving reliable measures and estimates of value has been refuted on many occasions. For instance, in the past two decades, there have been many firms that have collapsed some of them almost overnight, after they were rated as viable on the basis of stock market information (Pfeffer 2009).

As a concluding remark for this section, we want to state here that the stakeholders' interests should be the number one priority of every firm. The idea of VBM, which tends to promote shareholder capitalism, need not only be the golden rule for a firm's operations.

Having presented the short review above, we will now proceed to the next section, where we will cover sample description and the methodology for the study.

## **Methodology**

Before proceeding with the data collection exercise, we will recap our aims and objectives here to reinforce the focus of this study. Hence, our research questions are presented as follows:

- To discover if there is a connection between VBM and profitability in the German automotive industry;
- To identify the kinds of key metrics the industry uses in this regard;

- To discuss how the industry uses the VBM system; that is whether or not it is used in risk management, planning and budgeting, change management, and so on;
- To discover the connection between VBM and executive compensation.

Having restated these aims and objectives here, we will now proceed with sample description and data analysis below.

### Sample Description

Data collected from samples were used in this study. The first sample was based on a survey of relevant information culled from financial reports, presentations, press releases and papers on the German automotive sector, all of which are available on the internet. The companies in this industry include amongst other Adam Opel AG, Audi AG, BMW AG, Daimler AG, Dr. Ing. h.c. F. Porsche AG, MAN SE, Volkswagen AG, Behr GmbH & Co. KG, Borg Warner Beru Systems GmbH, Continental AG, ElringKlinger AG, Knorr-Bremse AG, Kolbenschmidt Pierburg AG, Mahle GmbH, Mann+Hummel GmbH, Robert Bosch GmbH, ZF Friedrichshafen AG. The second sample consisted of 100 managerial staff working in the German automotive industry, among whom are the staff of the above mentioned companies.

### Data Analysis, Results and Discussion

In this study, 100 emails were sent to a random sample of the managerial staff of the automotive companies listed above. In these emails, they were asked to respond with their opinions on how VBM strategy affects profitability in their organization. Eighty-eight of them replied and their responses were tabulated as shown in table 1 below. The null alternative hypotheses are re-stated as follows:

*Table 1: Has the VBM strategy enhanced your company's profits?*

<i>Company Location</i>	<i>Yes</i>	<i>No</i>	<i>Don't Know</i>
<i>Germany</i>	<i>12</i>	<i>21</i>	<i>19</i>
<i>United States</i>	<i>13</i>	<i>8</i>	<i>15</i>

H0: Enhanced profitability does not depend on the management's willingness to adopt VBM strategy.

H1: Enhanced profitability depends on the management's willingness to adopt VBM strategy.

To test this hypothesis using this sample data, we used the Chi-Square test of independence with a significance level of  $\alpha = 0.10$ . The results of this test are presented in table 2 below.

*Table 2: Chi-Square Test of Independence Computational Results*

<i>Significance Level, <math>\alpha</math></i>	<i>0.10</i>
<i>Degrees of Freedom</i>	<i>2</i>
<i>Critical Value (C.V.)</i>	<i>4.605</i>
<i>Calculated Value (<math>X^2</math>)</i>	<i>7.825</i>

From table 2, it can be seen that the calculated value (that is,  $X^2 = 7.825$ ) exceeded the critical value (that is, C.V. = 4.605). Hence the decision here is to reject the null hypothesis and conclude that enhanced profitability is a product of effective implementation of VBM strategies by managers.

It is necessary to point out at this juncture that although the results of the above analysis provide direct evidence that VBM enhances productivity, organizational managers need to be cautious about basing their strategy on profit maximization. This is because when an organization's success strategy is based primarily on profit maximization; there will be a high likelihood that the organization's managers may not provide adequate incentives to take care of the long-term consequences of such a decision. To obtain a clearer perspective of this issue, we will use one hypothetical example. Suppose a firm whose VBM strategy is profit maximization raised the price of its products and also cut costs dramatically, and hence increased its quarterly earnings to the satisfaction of its investors. In this scenario, two things could happen. First, the firm's market share would be affected significantly, and this could impact on the firm's ability to compete in the near future. Second, the quality of the firm's processes and products could also be affected, and the firm's ability to attract and retain talent would be severely handicapped.

Broadly speaking, operating profitably and efficiently, with cost-effective teams and projects, is the goal of every organization. No organization wants to ignore short-term goals. However, it is not a sustainable strategy for an organization to sacrifice long-term profitability in its bid to achieve long-term profits. Ultimately, the management of every organization always strives to build and maximize their organization's capability to be profitable in the long term. The bottom line here is that the VBM approach can enable management to do this only if they adopt an appropriate approach – increasing value for all the stakeholders (customers, shareholders, employees, and the host community).

The next question that needs to be answered in this section is aimed at ascertaining the key metrics used by these organizations in the VBM program. The analysis of the information culled from the company's websites (that is, the German automotive industry), press releases, financial reports and presentations that are available from the internet revealed that the key metrics are return on capital employed (ROCE), shareholder value analysis (SVA), economic value added (EVA<sup>TM</sup>), cash flow return on investment (CFROI), economic profit (EP), and net present value (NPV). However, ROCE should not just be considered as a value-based management metric because it does not integrate risk represented by the cost of capital and

different uses of options to capitalize and value assets and liabilities (Kauffmann, H. & Götzenberger, G. 2006; Britzelmaier 2010; Hannig, U. 2007). This variety of used metrics raises two interesting questions: what do these automotive organizations measure with the aforementioned metric? Is there a connection between VBM and executive compensation?

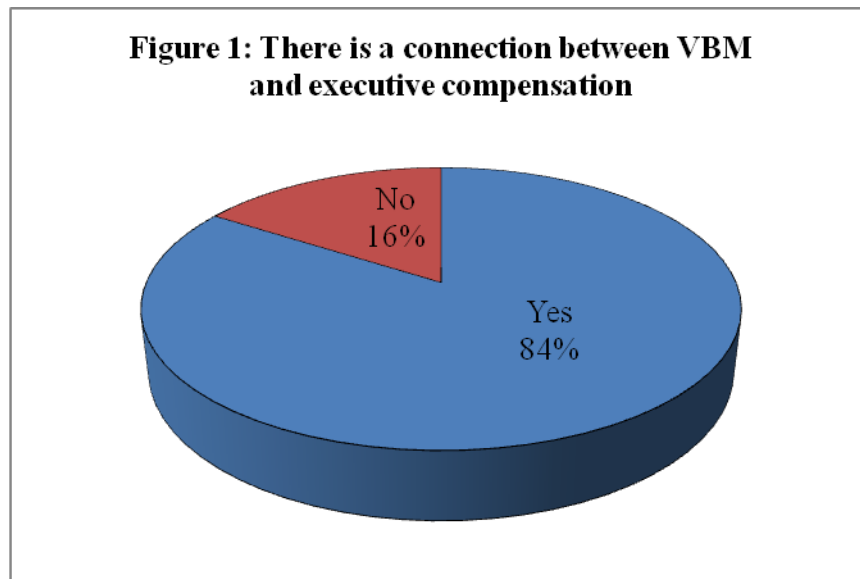
The first question can be answered by looking at table 3, which shows the response made by the respondents (88 managerial staff in the German automotive industry) on their use of VBM metrics.

*Table 3: During the past three years, did you frequently use any of the VBM metrics for ...?*

	Yes (%)	No (%)
<i>Measurement and control of organization's processes</i>	87	13
<i>Planning and budgeting</i>	90	10
<i>Risk management</i>	93	7
<i>Value driver management</i>	90	10
<i>Change management</i>	83	17
<i>Profitability assessment</i>	96	4
<i>Investment appraisal</i>	99	1
<i>Change management</i>	67	33

From the table, it can be seen that majority of the managerial staff interviewed confirmed that they use VBM metrics regularly in their work. For instance, 87% of them use them for measuring and controlling their organization's processes; 90% of them use them for planning and budgeting; 93% of them use them for risk management; and so on.

The second of the two questions can be answered by looking at figure 1 below, which shows the responses made on whether or not a connection exists between VBM and executive incentive compensations. The figure shows that there seems to be a connection between the two since 84%



of the respondents confirmed that a comprehensive VBM strategy or model is one that, to a very large extent, ties executive compensation to the appropriate VBM metric by way of cash bonuses paid to the executives. In their financial statements most companies give also an explanation about how they link their value-based management approaches to executive incentive compensation. This is also used to prove that there is a connection between VBM and executive incentive compensation.

Having completed the analysis and discussion of results in this section, we will now proceed to conclude the paper.

## Conclusions

This study has shown that most of the German automotive industry operates on the basis of the VBM model. The study has also revealed that the overall goal of the VBM model is to maximize the value of an organization. This means that in the German automotive industry, the desire for short-term profit is not the main factor that influences the decisions made by managers. Instead, the managers of these organizations generally take into consideration the potential impact of such decisions on the sustainability and profitability of their organizations in the long run.

Before concluding this study, it is important to note that managers and executives in the automotive industry need to understand the importance of constantly searching for investment and growth opportunities that will ensure their organization's success through the creation of value as well as effective utilization of the organization's capital. Broadly speaking, the belief in and the understanding of the fact that future cash flow and growth are the main source of an organization's value is the fundamental principle of VBM. In this paper, we have demonstrated of VBM in the automotive industry believe that looking at accounting-based measures, such as earnings per share, quarterly earnings, price/earnings



ratio, and so on, may not be the best approach for making strategic decisions in an organization. However, it may be an uphill task for the management of the German automotive industry to ignore these measures completely, especially in the 21<sup>st</sup> century business environment where short-term investors are putting significant pressure on corporations.

As a concluding remark, we want to state here that the VBM approach is not only a philosophy but also a methodology. The basic tenets of the VBM approach can be summarized as follows: every decision that managers make should be based on how the decision will contribute to the value of the organization. Hence, it is important that the automotive industry in general pushes for the implementation of the VBM strategy, both in boardrooms and throughout every level of organizations. However, we will also infer here that organizational success (especially of those organizations that manufacture automobiles), which can equally increase shareholders' returns, is the result of sound organizational practices that respect the interests of all stakeholders (customers, employees, suppliers, shareholders, and the organization's host community).

The survey has been conducted based on information given in the financial reports and answered emails that were sent to a random sample of the managerial staff of the automotive companies. The next research step could use interviews with decision-makers to obtain a higher degree of detail and to justify the results acquired from the information obtained so far.

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**COMPANY INTEGRITY MANAGEMENT IN THE NEW SOCIAL NETWORK  
ENVIRONMENT: A STUDY OF SMALL, MEDIUM AND LARGE FIRMS ON  
FACEBOOK AND TWITTER**

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**Abstract**

Companies are increasingly recognizing that social networks are a force to contend with in reputation management. There are numerous examples of how single voices using viral systems have, in a matter of days, reached out to millions about poor service or flawed products. Managing social networks is, however, not without cost and thus one could reasonably assume that larger companies would have better defined strategies for social network reputation management than smaller ones. The paper explores this assumption and offers a integrity management model. The social network activities of ninety nine different size companies (33 small, 33 medium and 33 Large) were examined and results supported that larger companies are slightly more responsive but smaller firms seem to respond more quickly. Of interest was the number of firms (of all sizes) without social media sites. There appears to be a general lack of a strategic framework for thinking about communities as most firms in the study were not monitoring, integrating and leveraging social media adequately.

**Introduction**

Recognition of the importance of brand and company image, how that image is established as well as factors that might influence the bond (to include word of mouth campaigns, catastrophic events and product recalls), is of increasing importance. This is highlighted by such recent events as the: 2011 massive product recalls of Johnson and Johnson putting into question the ability of the multinational to effectively control manufacturing quality; the devastating oil spills of BP resulting in significant stock devaluation and high level; Nestlé's forced adoption of a new policy (2010) to identify and exclude companies from its supply chain that own or manage 'high risk plantations or farms linked to deforestation after an online expose by Green Peace; and the Sony identity theft problem (2011) where hackers obtained personal information about millions of game station users. Each of these occurrences resulted in significant negative image effects.

Each event serves as a reminder that what may appear to be strong connections between consumers and a company or product brands may in reality be a fragile relationship. It is highly likely that how the relationship is developed, or maintained, can directly affect whether it will withstand short term disruptions. Once consumers word of mouth (WOM)

activities were conveniently isolated involving lone voices against large firms. With the aid of viral networks these voices now have the ability to garner the attention of millions. Sheth (Sheth, J. and Patvatiyar, A, 2002) has argued that companies promote relationships with consumers to insulate the firm from market whims. They believe, however, that decisions concerning whether to maintain a brand relationship repurchase or switch brands are often more emotional/behavioral than based on facts.

One environmental threat to the equilibrium of image, which is not being adequately addressed by firms, relates to the new internet social networks (SN) which include such platforms as Facebook, twitter, blogs as well as online reviews and rating sites. These instant sources of communication have made it possible, due to widespread and low cost information, for rapid image disruptions to occur for legitimate or irrational reasons. Such disruptions are likely to put pressures on the consumer relationship by altering consumer perceptions of the brand and/or the company. Taco Bell restaurants, for example, acted quickly through an internet and YouTube campaign to maintain image by addressing concerns that were raised when a group in 2011 requested the American Food and Drug Administration to look into beef percentage in the company's products. In another example the president of Domino's Pizza responded personally when a YouTube video was posted showing an employee putting Pizza in his nose and then serving it. Acting boldly the president, within days, posted his personal YouTube response noting video was a hoax but of grave concern to the firm. He not only cited actions the firm had taken but ended by offering an apology to the loyal employees of Domino's and the firm's faithful consumers who had been deceived. It was clear that these companies recognized the possible damage to their loyal consumer base designing internet media campaigns to preserve the relationship. Broadly the fears of companies, resulting from sufficient actual incidences over the past few years and the often disorganized responses to them, have resulted in the increased awareness of corporate social network business continuity programs designed to mitigate threats to the brand and company image. Previously the major responsibility of business continuity programs was to assure that a firm could operate after facing supply chains disruptions, damaged manufacturing facilities or disturbances in personnel. Josiah (2009) found that the continual monitoring of today's highly interactive social network environment now must be added to the list of threats to a firm's image. Managing the social network environment is essential to staying relevant and building a loyal fan base. Simply having a social network is clearly not sufficient. Firms must be both engaged with those sites through monitoring and timely responses as well as actively seeking to develop consumer trust. One of the critical aspects in developing a social network relationship relates to trust. Invoke Solutions, a social media research company, "found that the most trusted information was posted by people respondents knew, "people like them"—their friends, family and other online peers. Blog posts were more likely to be trusted "completely" than posts on Facebook and trust dropped off sharply when it came to Twitter. Twitter streams were trusted less than other media, even

amongst friends” (MacAlpine, 2011). The result of a broad research project by Invoke Solutions yielded several insights into the features that are important in developing trust. It is not surprising that the most important factors in developing trust were not the size of the reader base or the how long a person had been engaged with the company’s social media. The most important factors were whether the site was open to dialog (meaning both positive and negative postings) and if there was high level quality of the content. The importance of active monitoring and professional responses is clearly highlighted

<i>Table 1. Features important to inspiring trust in social media sites</i>				
<i>% of US frequent social media users</i>				
<i>Extremely Important</i>	<i>Somewhat Important</i>	<i>Neither Important nor Unimportant</i>	<i>Somewhat Unimportant</i>	<i>Not at all Important</i>
<i>The dialog is open to both positive and negative comments</i>				
37%	27%	21%	8%	8%
<i>Quality of the comments and content</i>				
35%	27%	25%	7%	6%
<i>Responsiveness of sponsor or author</i>				
30%	27%	22%	9%	7%
<i>Volume of participation</i>				
20%	29%	32%	11%	9%
<i>Quality of content</i>				
16%	26%	39%	11%	8%
<i>How long you have been a fan, follower or participant</i>				
15%	27%	34%	10%	13%
<i>Number of people who are fans, followers or participants</i>				
12%	26%	31%	13%	18%
<i>Source: Invoke Solutions “Invoke Life:Social Marketing Networking” July 29, 2010</i>				
<i>(<a href="http://www.emarketer.com/Article.aspx?R=1007863">http://www.emarketer.com/Article.aspx?R=1007863</a>)</i>				

Robert Kozines (March, 2010 p.71) in a historical perspective of word of mouth (WOM) research offers a series of models to explain how WOM, and the company reactions to it, have changed over time. He calls attention to Ryan and Gross’s (1946) statement six decades ago that, “conversations among buyers were more important than marketing communications in influencing adoption” as one of the first articles addressing consumer interaction. Referring to this stage as The Organic Interconsumer Influence Model Kozines notes that what is involved is action by one consumer to another without direct prompting, influence, or measurement by marketers. According to Kozines this stage was followed by the Linear Marketer Influence Model where marketers attempted to influence consumer WOM. It was during this stage that companies began to recognize the concept of the opinion leader and how they could be used to sway consumer preferences. Building on these models he developed, the Network Coproduction Model where marketers are positioned as becoming

directly involved in focused “one to one seeding and communication programs... allowing unprecedented new levels of management and measurement (p. 72)”.

According to Davis and Moy (2007) the internet has created a new wave of intensely engaged “professional consumers” that they term “prosumers”. These active prosumers create company news and can rapidly effect a firm’s image. Through them a one-time incidence of bad service can be echoed around social networks reaching thousands of consumers within minutes. Network social groups obtain their power in the same manner that Inter-networks do. As the popularity of social online communities increases companies need to take cautionary measures in protecting reputations and brands become essential. (Jones, 2009) pointed to new expanding active online consumer roles such as “consumer watchdog, investigative journalist, and opinion influencer”.

Robert Metcalf’s law designed to illustrate how computer networks on the internet derived their value is equally valuable in helping to understand how social network derive theirs. The law states that the “value” or “power” of a network increases in proportion to the square of the number of nodes on the network (Hendler, J. and Golbeck, J. ,2007). This means that as the number of people in a network grows the value of the content they share grows exponentially. For example, if there are 10 people in a social net the power of the structure is  $10^2$  or 100 . If the number is, however, increased by simply one member the power now becomes  $11^2$  or 121. This quickly explains why viral networks, which can quickly amass thousands of members/viewers, can be so dangerous.

Jolly (2001) refers to company’s choice of communication as either “dialogue” or “monologue” as companies traditionally have had a one way communication channel to their consumers. In social networks one way communications directed toward consumers are becoming increasingly ineffective. Company Web postings promoting the firm or products as well as paid on-line advertisement cannot by itself protect image since it is externally viewed as self-serving propaganda. Companies now must establish interactive communications with the many social platforms consumers use to exchange ideas, cooperate and even to seek advice from consumers in what is considered as “social casting” (Jones, 2009). Companies must have well thought online social network strategies that call for implicit collaboration between a company and the social network environment in order to shape and protect their image. In response to the recognition that social network members can significantly influence the value (positively or negatively) of a company brand or image there have been a number of new products designed to passively monitor social sites and inform users of potential dangers. These software products are similar to the “old” press clipping firms that monitored news and popular magazine articles.

The concern that social media networks are increasing in power is not exaggerated. A finding of The Rising CCO III (2010), an annual survey conducted by global executive search firm Spencer Stuart and global public relations firm Weber Shandwick stated that 34 percent

of global chief corporate communications officers (CCOs) report that their companies experienced a social-media based reputation threat during the past 12 months. That firms have yet to incorporate social networks into their monitoring or business continuity plans is clear as the same report noted that approximately 33 percent of the companies surveyed stated that were not prepared for managing social network types of online reputational threats. Without a defined strategy firms remain vulnerable to attacks and can only operate in a defensive manner. Given the seriousness of the need for social network monitoring the low figure raises questions. Is it that the CEOs of large firms grew up in the “pre-social network” generation that causes these firms to fail to recognize the threats? Is Facebook’s or Twitter’s membership and power base relegated to being not of high importance to company business because of the age of upper management? The ease with which social networks seem to be dismissed as significant business threats in spite of the clear examples is troublesome. In a recent financial times article, “The challenge of protecting reputation” Paul Argenti (2005) of the Tuck business school points to three distinct types of threats failing, as so many do, to include social media networks. His three threat areas are: 1) natural disasters, such as earthquakes, fires and hurricanes (how the company responds represents the risk); 2 ) man-made fiascos, such as ethical violations (for example, Martha Stewart’s questionable trades); and 3) attacks from antagonists (such as attacks by the Centre for Science and the Environment, an Indian environmental group, on Coke and Pepsi” Argenti (2005 p. 3). Argenti points out the importance of having, “an engaged CEO along with a cross-functional task force is often the best insurance a company can have as it attempts to assess its reputational risk” and recommends that firms should: Prepare for potential problems; Plan company responses; Analyze constituencies and Provide as much certainty as possible (Argenti, 2005 p3).

It is clear that small firms as well as large ones are increasingly becoming aware of the power of social media and some, to varying degrees of sophistication, are incorporating these tools in their communications portfolios. One would assume that large companies, by virtue of their resources, would be ahead of curve compared to smaller ones. A recent study (McCann, 2010) conducted by communications firm Burson-Marsteller noted “65% of the largest global companies have Twitter accounts, 54% had Facebook fan pages, and 50% had YouTube video channels” The study also noted that while financially significant for large firms a social media campaign can be “less than 1% of their overall marketing budget. The study while discovering that a number of firms had accounts did not investigate how the firms use these tools or if they were part of a organized communications strategy or answering the fundamental questions of:

- Who will monitor and control the company social media websites?
- What kind of analytics data will be gathered?
- If visitors post to the site how is this noted and how will/does the firm react?

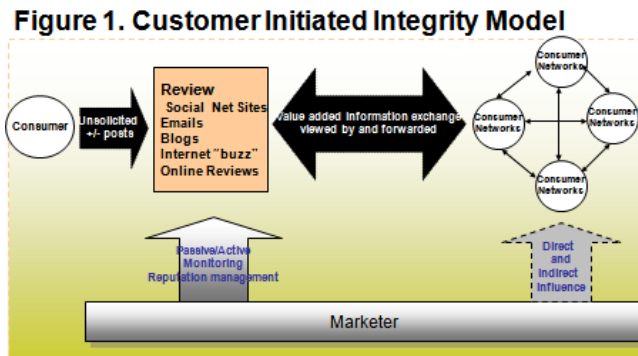


- Who is responsible for observing what people are saying on the web (other websites, blogs etc.) and what is in place to monitor and act to influence reputation externally?

### **A new social media model**

The authors have developed a new model which expands the concepts of Kozines' Linear Marketer Influence Model to reflect the new reality that consumers have assumed a power base of their own which operates external to company influence. While Kozines recognizes the importance of monitoring the social environment the authors believe that a model of company/brand reputation management needs to reflect the continual interplay and accumulation of many consumer networks as a dynamic ongoing and interconnected process. In the Consumer Initiated Integrity Model the marketer recognizes the geometric growth and power of Web Word of Mouth (WWOM) and continually monitors Internet postings while cautiously attempting to influence/respond to them (Figure 1). The consumer initiated integrity model is more comprehensive in nature, and expands the reputation management list of Argenti (2005) by including social media monitoring and response. The new list includes:

- Plan reputation management strategies to be able to allow the right respond to risks in an immediate manner
- Develop a crisis management process
- Understand all threat environments
- Apply new technology to monitor social media
- Set priorities for reputation *risks*
- Plan scripts and/or policies for response including a broad representation of company departments (management, legal, marketing) as preclearance allows rapid responses
- Assure management understands the disruptive potential of Social Networks
- Analyzing constituencies to include "opinion leaders" ," influencers"" and "prosumers"
- Provide as much certainty as possible to how the firm will respond and who will be responding



The research was designed to address the Consumer Initiated Integrity Model's aspect of social media monitoring by investigating the monitoring of postings to company sponsored social networks sites (Facebook and Twitter). The purpose of the research was to explore the tenets that: (1) large firms would have more active presence in social media activities than small firms, (2) that these large firms would also recognize the importance of an ongoing vigilance of their sites and (3) large firms would be in a better position to respond in a more value added manner. Facebook and Twitter postings were made to ninety-nine firms, selected from large, medium and small capitalization United States firms. The postings asked for a response indicating the postings had been observed in order to check if:

- Firms have social network platforms in place
- These platforms are monitored and responded to
- The length of time to takes a firm to respond related to the firm's size

To this end the follow three hypothesis were formulated:

- Hypothesis 1: Large firms will respond to social network (Facebook and Twitter) posts at a greater frequency than small firms.
- Hypothesis 2: Large firms will respond more quickly to social network posts (Facebook and Twitter) than small firms.
- Hypothesis 3: Large firms will post more positive category posts than small firms.

#### Research Methodology

##### Firms studied

Ninety-nine firms were investigated from 13 industry sectors. Thirty-three firms were taken from the Fortune 500 (2010) listing, 33 were from medium sized firms (New York Stock Exchange medium size capitalization listings) and 33 firms were taken from the Small Capitalization listing of the New York Stock Exchange (all 2010). The sectors were: Airlines and Hotels, Apparel, Food and Beverage, Automobile and Services, Entertainment and Publishing, Finance (Banking, Insurance), High-tech (IT, Electronics), Health Care (Pharmacy

and Other Services), Energy (Mining, Crude-Oil Production), Transportation and Logistics, Telecommunication, Internet, Wholesalers.

Responses were classified into three categories: active, neutral and no response. Companies were considered to have responded to researchers actively if they not only replied to the post but also offered further help are considered “active response.” If a firm responded with a value added contribution (e.g. “interesting research”, “can I help more”) the response was considered active. A firm that responded with simply doing what was requested (note the posting) was considered neutral and firms that failed to respond were classified, no response.

## Methods

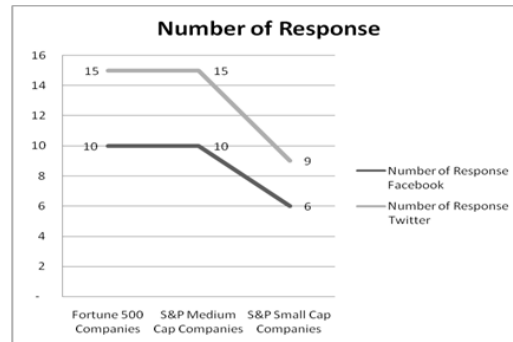
Companies were selected in a random manner from the Fortune 500, NSE midsize capitalization and the NSE small capitalization listings (2010 lists). If a firm did not have a Facebook page the firm was discarded and another from the sector was selected. The process was continued until 33 samples were obtained for each of the three firm sizes. A post was made to the Facebook page of each firm and to the firm’s twitter site. The time of the posting was noted as was the time of a response (if there was one). The Facebook site and the Twitter site of each firm was monitored every five minutes for the first hour and then on a systematic basis for a total period of seventy-five hours. The posting on each company site was standard. The posting on Facebook was *“Boston University Research Project in Reputation Management. Could the company Facebook site manager respond to let us know this post was seen. Thank you.”* and the posting to the Twitter site was *“Boston University Research Project in Reputation Management. Could you respond to let us know this post was seen. Thank you.”* The Twitter posting was slightly different than the Facebook posting due to the limit of 140 characters. The total number of possible responses if all firms in the study had both a Facebook and Twitter site was 132. The actual number of was 119 as 13 firms were missing either a Facebook or Twitter site.

## Results

While many take for granted that having a presence on a social network is something that firms now do of the 99 firms (33 of each size) six small firms, eight medium and four large size firms had no Facebook site. These firms were replaced in the selection process by firms that did, so as to maintain the total sample at ninety-nine. Two of the large firms (FedEx and Comcast) did not allow posting to their Facebook page but were kept in the study). For the medium firms there were 10 feedbacks from Facebook, 15 feedbacks from twitter (3 companies don’t have twitter pages (Waste Connections Inc, Shaw Group and Martin Marietta Materials). Of the 198 possible posts figure 2 presents the responses to the postings by the three different size firms. There were twenty-six feedbacks from Facebook and thirty-nine feedbacks from twitter. Appendix 1 depicts the number of responses per sector during the seventy-two hour timeframe in which the sites were monitored for company feedback.

There were ten responses on Facebook from the large capitalization firms and fifteen from Twitter.

Figure 2

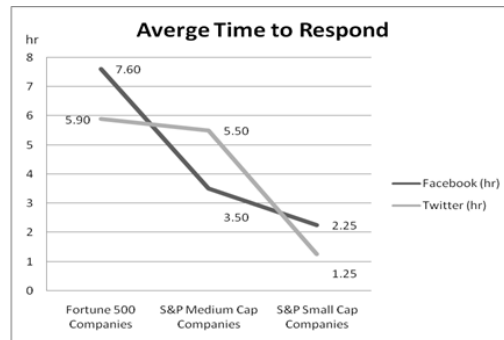


Firms differed significantly in regard to the time to respond (Table 2 and Figure 3). Of the small firms the fastest responding firm was Comsore, on Twitter (3 minutes) and the slowest was Heartland Express, Inc. taking twelve hours and fifty-nine minutes on Facebook. The fastest medium size were Westar Energy and Telephone & Data Systems Inc (Twitter, 4 minutes). The slowest was Advance Auto Parts Inc (Twitter, 27hr 15m). Of the large capitalization the fastest was Starwood Hotels & Resorts (Twitter, 3 minutes), UPS (Facebook, 3 minutes) and AT&T (Facebook, 3 minutes). The slowest large firm was Ford (Twitter, 49 hours). The average reply time (of those responding only) for large firms on Twitter was 7.6 hours and the average time to reply to a Facebook posting was 5.9 hours. The average for the medium on Facebook was 3.5 hr 32m and 5.5 on Twitter and for the S&P small-cap 600 the average was 2.25 (Facebook) and 1.25 (Twitter). Medium sized companies tend to respond to posts faster on Facebook than they do on twitter which was different from the Fortune 500 companies and S&P Small cap companies, however, medium sized firms did (as did the others) have more posts on twitter.

Table 2. Average Time to Respond

	Facebook hr (# rpl)	Twitter hr (# rpl)
Fortune 500	7.6 (10)	5.9 (15)
S&P Medium	3.5 (10)	5.5 (15)
S&P Small Cap	2.25 (6)	1.25 (9)

Figure 3

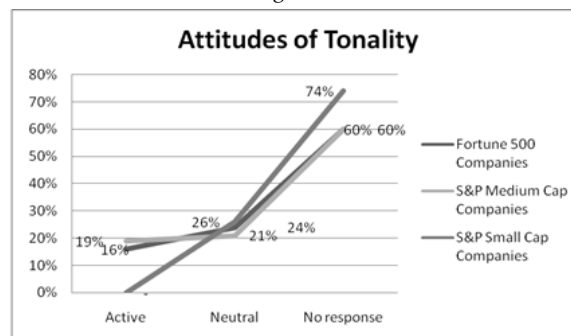


Large, medium and small firms did respond differently in regard to the quality of the response (Table 4 and figure 4). Ten large firms (16%) and 12 (19%) medium size responded in an active manner while no small firms do so. The responses of Large, Medium and small firms were relatively the same (Large 24%, Medium 21% and Small 26%) for the natural category response. More small firms did not respond (74%) than medium or large firms (both 60%).

Table 3. Attitudes of Tonality

	Active	Neutral	No response
Fortune 500	16%	24%	60%
	10 out of 62	15 out of 62	37 out of 62
S&P Medium Cap	19%	21%	60%
	12 out of 63	13 out of 63	38 out of 63
S&P Small Cap	-	26%	74%
	-	15 out of 57	37 out of 57

Figure 4.



## Conclusions

The purpose of the research was to investigate some of the behaviors linked to the management of online social media site posts for three different size firms and how that management could relate to managing a company's online reputation. It is interesting that in some of the research companies behaved in a similar manner regardless of size and in some areas there was a difference. In contrast to Twitter which remained open (when available) to posts by consumers, companies imposed controls on their Facebook pages. For an individual to post a comment on any of the company sites surveyed one first had to "like" or become a "fan" of the company. A significant number of companies would not allow individuals to comment on their home Facebook pages. Normally when they did the comments went to a second level page. Most of the Small and medium cap companies acted the same as Fortune 500 companies in not allowing individuals' comments being shown on their Facebook pages.

The overall response rate was as low as 35% and several firms from all categories did not have social media sites. This is consistent with the findings of research conducted by two media firms who found that while 34 percent of global chief corporate communications officers reported their company had experienced a social-media based reputation threat in the past 12 months approximately 33 percent of the companies stated that were not prepared for managing social network types of online reputational and had yet to incorporate social networks into their monitoring or business continuity plans (Rising CCO III, 2010). Reinforcing that firms are unclear how to properly use social networks, of those firms included in this study, a significant number did not respond to postings on the firm's Facebook or Twitter sites (60% large and medium and 74% small). This is a worrisome finding, given the increasing importance of social networks to the development and maintenance of a brand or company image. The high non response rate for both small and large firms indicates that all size firms have yet to seriously focus on the use of social networks as a part of an overall integrated communications strategy. Given the increased exposure and number of examples citing the importance of recognizing the power of social networks this is surprising.

The first hypothesis that large firms would respond to social networks at a greater frequency than small firms was supported. Forty percent of the large size firms responded to postings on either their Facebook or Twitter pages while only twenty-six percent of the small firms did. The relative size of the firm was related to the frequency of response as large firms had the most responses, followed by medium with small the fewest.

While most social network sites surprisingly did not allow for interaction the majority of facebook pages were well organized with news of products and services posted regularly. Without interaction, however, one could question if these sites are not really "social media" sites but extensions of the firms static webpages. Twitter's less organized and more informal

(and less expensive) display appeared to make a more efficient two-way communications platform for firms of all sizes than Facebook.

The second hypothesis that large firms will respond more quickly to social network posts (Facebook and Twitter) than small firms was not confirmed and the opposite was observed. It is interesting that when small firms responded they did so quicker than large firms. The average time to respond to the post indicated the companies respond faster on their twitter pages than they do on their Facebook pages. Contrary to expectations the smaller the size, the faster they responded as the small companies were the shortest, the medium ones took longer, and the largest companies were the slowest. All companies responded to postings faster on twitter than Facebook. The reason could be that twitter offers a more instant-message like environment that encourages immediate communication. When small firms did respond they tended to use Twitter, not Facebook, and responded quicker than large firms. The use of Twitter might account for the lack of value added responses as fewer characters (140) are available to respond. It might also point to the use of mobile devices for small firm monitoring which makes longer messages more cumbersome and thus less likely.

The third hypothesis, that large firms will post more positive category posts than small firms was supported. Large firms posted 16% positive responses while small had no such postings. It is important to note, however, that medium sized firms (with 19%) had more posts in this category than large. It is interesting to note that the difference between small and large firms is found, not in the number of neutral response as the responses of Large, Medium and small firms were relatively the same for the neutral category (Large 24%, Medium 21% and Small 26%), but in the number of value added responses (active classification). Given that no small firm provided anything other than a neutral response might further indicate that small size firms in general are not devoting resources to maintain a professionally trained staff so as to quickly and personally reply to social posts.

There was no significant difference in the percentage of neutral category responses comparing the large, medium and small firms (Large 24%, Medium 21% and Small 26%). It is interesting to note that the positive response rate by medium firms (19%) was slightly higher than large companies (16%). One might wonder if medium firms are better positioned for change having more funds to devote to social network activities than small firms but are, at the same time, not as encumbered with massive slow moving bureaucratic processes as the larger ones.

An unexpected finding was the number of non-monitored social networks and that, regardless of category, few firms were actively involved with their own social media to the extent one would expect. The overall poor response rate is a worrisome finding. It tends to indicate that while the business world is aware of the power that social networks can yield companies of all sizes remain naïve as to how to establish truly interactive personal relationships. This is interesting given the increasing importance of social networks in

developing and maintaining a reputation and image. While surprising, the general lack of appreciation of the increasing importance of social networks has been previously noted. Murphy (2006) found an overall lack of either presence or response to sites pointing out that some traditional marketers believe that they have nothing to gain from customer empowerment, and that blogging only results in brand bashing. Sing (2008) provided some insight into why many firms have taken a rather passive approach to social networks stating that ,“Marketers have been accustomed to telling the customer the message they want the customer to hear, rather than the message the customer truly cares about” (Singh, et. al, 2008 pp. 282).

A significant number of companies, large and small, did not have Facebook sites that could be directly responded to which would seem to indicate that while some firms have recognized the need to establish social network sites, most do not know what to do with them. Small companies, in particular, give less emphasis on establishing social network sites or joining the discussion of their clients. Generally there appears to be a lack of a strategic framework for thinking about communities as most firms were not monitoring, engaged, integrating and leveraging social media adequately. This points to the need for top administration to move beyond from the classic communication models as outlined by Kozines (2010 ) and seek to develop the highly interactive customer initiated communication model proposed by the authors.

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### Appendix 1. Type of responses by industry sector for small, medium and large firms

Large Sized Company						
Industry	Active		Neutral		No Response	
	Facebook	Twitter	Facebook	Twitter	Facebook	Twitter
High-tech	1	N/A	N/A	1	2	2
Finance	2	N/A	N/A	1	1	2
Healthcare	N/A	N/A	1	N/A	1	2
Energy	1	N/A	1	N/A	N/A	2
Hotel & Airline	N/A	2	1	N/A	2	1
Apparel	N/A	1	N/A	1	2	N/A
Food & Beverage	N/A	N/A	N/A	1	2	1
Automobile	N/A	N/A	N/A	1	2	1
Entertainment	N/A	1	N/A	1	2	N/A
Telecommunication	N/A	1	1	1	1	1
Internet	N/A	N/A	N/A	N/A	2	2
Wholesale	N/A	N/A	1	1	2	2
Transportation	N/A	1	1	1	1	1
Sub Total	4	6	6	9	20	17
Response Facebook	10					
Response Twitter	15					
Total Active Response	10					
Total Neutral Response	15					
Total No Response	37					
Medium Sized Company						
Industry	Active		Neutral		No Response	
	Facebook	Twitter	Facebook	Twitter	Facebook	Twitter
High-tech	1	N/A	2	1	N/A	2
Finance	2	1	1	1	N/A	1
Healthcare	N/A	N/A	1	1	1	1
Energy	N/A	N/A	N/A	1	3	2
Hotel & Airline	N/A	1	N/A	N/A	2	1
Apparel	1	1	N/A	1	2	1
Food & Beverage	N/A	1	N/A	1	2	N/A
Automobile	N/A	1	1	N/A	N/A	N/A
Entertainment	N/A	N/A	N/A	N/A	2	2
Telecommunication	N/A	N/A	N/A	1	1	N/A
Internet	N/A	N/A	N/A	N/A	1	1
Wholesale	N/A	1	N/A	N/A	1	N/A
Transportation	N/A	N/A	N/A	N/A	3	1
Manufacturer	N/A	2	1	N/A	5	3
Sub Total	4	8	6	7	23	15
Response Facebook	10					
Response Twitter	15					

Total Active Response	12					
Total Neutral Response	13					
Total No Response	38					
Small Sized Company						
Industry	Active		Neutral		No Response	
	Facebook	Twitter	Facebook	Twitter	Facebook	Twitter
High-tech	N/A	N/A	N/A	2	3	1
Finance	N/A	N/A	2	1	2	3
Healthcare	N/A	N/A	N/A	N/A	3	2
Energy	N/A	N/A	N/A	N/A	2	2
Hotel & Airline	N/A	N/A	N/A	N/A	2	N/A
Apparel	N/A	N/A	N/A	1	2	1
Food & Beverage	N/A	N/A	N/A	N/A	3	3
Automobile	N/A	N/A	1	1	1	1
Entertainment	N/A	N/A	N/A	1	1	N/A
Telecommunication	N/A	N/A	1	1	N/A	2
Internet	N/A	N/A	N/A	1	1	1
Wholesale	N/A	N/A	N/A	1	2	2
Transportation	N/A	N/A	2	N/A	1	1
Sub Total	0	0	6	9	23	19
Response Facebook	6					
Response Twitter	9					
Total Active Response	0					
Total Neutral Response	15					
Total No Response	42					

## GOING PRIVATE IN ITALY. CHARACTERISTICS AND MOTIVATIONS OF PTP TRANSACTIONS

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### Abstract

This paper is part of a larger work examining the characteristics of public to private transactions (PTP, delisting) in Italy.

The aim of the paper is to verify if Italian PTP transactions can be explained referring to the agency theory perspective (Jensen, 1986a; 1989). Incentive realignment in Anglo-Saxon markets is a motivation for public to private transactions, especially for those companies that feel the need to reunite ownership and control in order to realign the incentives of managers and owners.. Weir et al. (2004) found support for the idea that the decision to go private is affected by concentrated institutional shareholdings. This finding is consistent with earlier studies (Maupin, Bidwell and Ortengren, 1984) which demonstrated that US companies with high managerial shareholdings in the 70s were more inclined to engage in PTP transactions.

One of the main differences between the Italian stock market and more developed ones is that often in Italy there is not a real separation between ownership and management, so that in public companies the agency problem invests the conflict of interest within majority and minority shareholders note then management and shareholders. Keeping in mind this framework, we propose the following:

H1: A motivation for delisting is the need to realign incentives; we thus expect high concentrated ownership firms to be more inclined to delist

According to Ronnemboog et al. (2007), managers (in Italy majority shareholders) are insiders and know better than everybody what is the real worth of the firm. This implies that if the firm is undervalued, they might delist it in order to develop the firm's potential with greater freedom. These situations occur especially among small listed companies which generally are not able to attract institutional shareholders and to fund growth. Empirical findings supporting the small size motivation were reported by Kierschnick (1998). This leads to:

H2: Small companies are more inclined to delist.

Within the 381 companies that from 2002 to 2008 were listed on the Italian market, we tested the motivations to delist. Data were supplemented by collecting accounting

information and the ownership structure from the Bvdep database called Osiris on a sample of 2,667 observations (381 companies for 7 years).

We analyzed the data by applying the General Linear Model which allows to model the values of multiple dependent scale variables measured at multiple time periods, based on their relationships to categorical and scale predictors and the time periods at which they were measured. The results indicate that H1 is confirmed (the number of shareholders is negatively related to the decision to go private) while H2 is not statistically supported (we didn't find a significant relationship between the PTP decision and company size).

**Keywords :** delisting, public to private, Italy

## Acknowledgement

The paper is part of a broader research project led by professor Danovi. As it is a work in progress comments are welcome.

## Subject and motivations

There have been a number of periods in various countries which have been characterized by companies opting for a transition from public to private. The first important wave of delisting took place in the United States in the 80s for a value of approximately USD 250 billion (Opler & Titman, 1993<sup>3</sup>). While the UK kept up with the US, if on a much smaller scale, continental European private-to-public transitions only emerged strongly in 1997 (Simons, Tomas, Renneboog & Luc, 2005<sup>4</sup>). These markets were thus in the early stages of their public-to-private transitions from the late 80s to the early years of the new century, whereas, for the more experienced UK and US, this era represented the second wave.

In terms of the topic of delisting, scholars investigate two major themes: its *motivations* (Renneboog, Simons & Wright, 2007<sup>5</sup>; Simons et al., 2005) and its *consequences* with a focus on delisting returns (Beaver, McNichols & Price, 2007<sup>6</sup>; Goetzmann, 1986<sup>7</sup>; Meera, Tripathy, & Redfearn, 2000<sup>8</sup>; Opler & Titman, 1993; Sanger & Peterson, 1990<sup>9</sup>; Renneboog et. al. 2005).

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<sup>3</sup> Opler, T., Titman, S., (1993), "The Determinants of Leveraged Buyout Activity: Free Cash Flow vs. Financial Distress Costs", *Journal of Finance*, Vol. 48: 1985-1999.

<sup>4</sup> Renneboog, L., Simons T., (2005), "Public-to-Private Transactions: LBOs, MBOs, MBIs and IBOs," *ECGI Working Paper*, No. 94/2005.

<sup>5</sup> Renneboog, L., Simons, T., Wright, M., (2007), "Why do public firms go private in the UK? The impact of private equity investors, incentive realignment and undervaluation", *Journal of Corporate Finance*, Vol. 13: 591-628.

<sup>6</sup> Beaver, W., McNichols, M., & Price, R. (2007), "Delisting returns and their effect on accounting-based market anomalies", *Journal of Accounting & Economics*, 43(2/3): 341-368.

<sup>7</sup> Goetzmann, W. N. (1986), "Does Delisting from the S&P 500 Affect Stock Price?", *Financial Analysts Journal*, 42(2): 64-69.

<sup>8</sup> Meera, A. K., Tripathy, N., Redfearn, M. R., (2000), "Wealth and liquidity effects of stock delistings: empirical evidence from the stock exchanges of Singapore and Malaysia", *Applied Financial Economics*, Vol. 10: 199-206.

Another variable that might be considered when approaching this topic is how the transformation is carried out: the most common methods are LBOs (leverage buy-outs), MBOs (management buy-outs) or MBIs (management buy-ins).

From an economic point of view, the motivations behind delisting can be divided into *micro* and *macro* ones. These reasons are not necessarily the same all over the world. For example, in the US, the macro motivations are related to a favorable tax-law, and also to the presence of a real market for corporate control. These macro motivations are not necessarily valid for the Continental European situation. Traditionally, legal and fiscal regulation in Europe is not as favorable for companies choosing to become private entities as in the US. The typical structure of European markets also differs from the Anglo-American ones (Simons et al., 2005).

Most of what is currently known about delisting comes from US studies that focused on US companies. There has hitherto been a dearth of literature on delisting in continental Europe and especially on the reasons that lead to such a decision.

### **Economic and managerial motivations**

From a *macro* point of view, the first important PTP transactions (which took place in the US) were motivated by deficiencies in corporate governance regulations and by the general lack of managerial incentives to focus on corporate value creation (Renneboog et al., 2007). The second wave of PTP transactions which took place both in the US and in Europe from the late 90s onwards were motivated by the downturn in the stock markets and the internet 'bubble bursting' which apparently made the cost of public equity too high for companies.

Moreover, specifically in the case of Europe, some countries undertook important law reforms on M&A (i.e. the introduction of minority 'squeeze out' provisions and fiscal reforms) which facilitated the management of PTP deals. An important macro motivation was also linked to the spreading of private equity funds and other types of financial intermediaries.

We focus now on the *micro* motivations for delisting retrieved from the present available literature. Scholars define them as "sources of wealth gains" (Renneboog et al., 2007: 595), these are: savings in tax, the reduction of agency costs (due to incentive realignment, control concentration or a reduction in free cash flow), the transfer of wealth from stakeholders to shareholders, a reduction in transaction costs, defenses against takeovers, and corporate undervaluation. In order to illuminate all the possible motivations, we consider as a point of reference the theoretical framework proposed by Renneboog and his colleagues and will combine it with further literature.

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9 Sanger, G. C. & Peterson, J. D. (1990), "An Empirical Analysis of Common Stock Delistings", *Journal of Financial & Quantitative Analysis*, Vol. 25: 261-272.

**Tax Benefits.** Tax benefits are enjoyed by companies that have high tax bills and decide to go private: going private is generally financed with a significant amount of debt which creates a considerable additional tax shield (i.e. possibility to deduct interests). It has been showed that, in the US, companies could, to some extent, gain tax benefits from going private (Kaplan, 1989)<sup>10</sup>. Results from another American sample confirmed this hypothesis (Lehn & Poulsen, 1989)<sup>11</sup>. Later, Kieschnick (1998)<sup>12</sup> re-examined Lehn and Poulsen's (1989) data with a more advanced analysis and found that accounting for the influence of the Lehn and Poulsen's sapling procedure and for outliers, the tax benefit hypothesis remains significantly proved. Recently this relationship in the US has been proved by Kosedag and Lane (2002)<sup>13</sup>. The tax benefit hypothesis, however, is not accepted everywhere. In the UK, for example, the tax advantages of using debt sources are smaller than in the US (Renneboog et al., 2007) (Weir, Laing and Wright 2003<sup>14</sup> and 2005a,b<sup>15</sup>).

To conclude, the tax benefit motivation is empirically proven in the US, not in the UK, as Ronnenboog (2005) note, even if firms that go private have higher tax benefits this doesn't mean that tax benefit represent the most important reason for delisting.

In Italy, although empirical study on the topic have not been carried out yet, this hypothesis seem not to be proved. Listed and private companies are ruled by the same tax law<sup>16</sup> and there is not a tax advantage in being private if we don't consider more aggressive fiscal policies that private companies could conduct because of their fewer transparencies needs.

Even the tax shield benefit hypothesis seem not to be consistent because target companies of a LBO in Italy usually don't go private. High leveraged companies prefer to stay public in order to have easier access to the stock market.

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10 Kaplan, S. (1989), "Management Buyouts: Evidence on Taxes as a Source of Value", *Journal of Finance*, Vol. 44: 611-632.

11 Lehn, K. & Poulsen, A. (1989), "Free Cash Flow and Stockholder Gains in Going Private Transactions", *Journal of Finance*, Vol. 44: 771-787.

12 Kieschnick, R. (1998), "Free cash flow and stockholder gains in going private transaction revisited", *Journal of Business Finance and Accounting*, 25, 187-202.

13 Kosedag A., Lane W. R. (2002), "Is it Free Cash Flow, Tax Savings, or Neither? An Empirical Confirmation of Two Leading Going-private Explanations: The Case of ReLBOs" *Journal of Business Finance & Accounting*, vol. 29, issue 1&2, 257-271.

14 Weir, C.M., Laing, D., Wright, M. (2003), "An empirical analysis of the agency characteristics of firms involved in public to private transactions in the UK", paper presented at the Academy of Management Conference Symposium, Seattle, August.

15 Weir, C., Laing, D., Wright, M., (2005a), "Incentive effects, monitoring mechanisms and the threat from the market for corporate control: an analysis of the factors affecting public to private transactions in the UK", *Journal of Business Finance and Accounting*, 32, 909-944.

Weir, C., Laing, D., Wright, M., (2005b), "Undervaluation, private information, agency costs and the decision to go private" *Applied Financial Economics*, 15, 947-961.

16 In 1998 by D. Lgs 466/1997, Italy introduced a tax benefit for going public companies but the law was eliminated after a few years because considered against EC competition rules.

*Incentive realignment, Monitoring managerial actions, free cash flow and leverage.* The Agency Theory suggests that going private could solve the incentive problem of having conflicts of interest between shareholders and managers (Jensen, 1986a,b; 1989<sup>17</sup>). *Incentive realignment* is a motivation for PTP transactions, especially for those companies that strongly feel the need to reunite ownership and control with the aim of realigning the incentives of managers and owners. US and UK Public companies have a lot of shareholders that generally own small portions of equity. This leads to low interest in *management monitoring* (Jensen & Meckling, 1976<sup>18</sup>). In such cases PTP transactions allow for a more concentrated ownership structure and hence for a higher interest in the control of management activities. The ownership structure of most Continental European companies is characterized by a large dominant shareholder who exercises significant control (Faccio & Lang, 2002<sup>19</sup>). For this reason the incentive realignment and management monitoring motivations might be weaker for the Continental European companies and especially for Italy where dominant shareholders often exceed 50%. Another implication of Agency Theory is that managers that generally act in conflict of interests with shareholders are also inclined to retain resources and grow the firm beyond its optimal size, this leads to a waste of *free cash flows* (FCF), Jensen (1986a,b). Moreover, managers actions are also disciplined by the presence of leverage. When the public company's debts are not high, it can be economically interesting to go private because the transaction is easily fundable with new debt. In such a case as debts tend to increase in PTP transactions, the risk of default tends to increase as well. This determines the free cash flow hypothesis: high leverage associated with PTPs forces managers to efficiently run the firm and avoid both *free cash flow* waste in suboptimal investments and default (Jensen 1986; Cotter & Peck, 2001<sup>20</sup>). As a consequence, one of the motivations of PTP can be described as the possibility to improve management efficiency, through an increase of debt. Nevertheless it also should be considered that high levels of debt might incentive managers to substitute low-risk assets for high-risk assets (an asset substitution problem: Renneboog et al, 2007). The free cash flow hypothesis has been supported empirically in the US by Opler and Titman (1993) and by Lehn and Poulsen (1989) while a different analysis conducted by Kieschinick (1998) on the same sample doesn't find any support to Lehn and Poulsen (1989) findings. In the UK Weir, Laing and Wright (2005a and 2005b) did not find any support to the

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<sup>17</sup> Jensen, M. (1986a), "Agency costs and free cash flow, corporate finance and take-overs", *American Review of Economics*, 76, 232-329.

Jensen, M. (1986b), "The take-over controversy: analysis and evidence", *Midland Corporate Finance Journal*, 4, 323-329.

Jensen, M. (1989), "The eclipse of the public corporation", *Harvard Business Review*, Sept/Oct, 61-75.

<sup>18</sup> Jensen, M., Meckling W. H., (1976), "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure", *Journal of Financial Economics*, 3 (4): 305-360.

<sup>19</sup> Faccio, M., Lang L.H.P., (2002), "The ultimate ownership of western European corporations" *Journal of Financial Economics*, 65: 365-395.

<sup>20</sup> Cotter, J. and S. Peck, (2001), "The structure of debt and active equity investors: The case of the buyout specialist", *Journal of Financial Economics*, 59, 101-147.



free cash flow hypothesis. In the same way Kosedag and Lane (2002) Kieschnich (1989 and 1998) and Halpern, Kieschnich and Rotenber (199921) found no support for it. When the public company's debts are high it can be economically interesting to go private because the fact of being not exposed to the public market assessment would allow for an increase of their leverage without effects on a public share price. For the said reasons, because of the coincidence of managers and dominant shareholders there is not convenience in Italy to go private for efficiency reasons and free cash flow hypothesis does not find support.

**Transaction costs.** As noted by DeAngelo et al. (1984)<sup>22</sup> the costs of maintaining a stock exchange listing are very high and going private represents a strategy to save money. This motivation has not found empirical support from the data analysis of Kieschnich (1998). In Italy transaction cost hypothesis has not been empirically tested even if costs are in percentage higher because of the small size of many companies. However it is difficult to imagine it as the main reason for delisting. Cost savings will probably be appreciated but can not lead to a going private decision.

**Characteristics of the company that decides to go private (Managerial Ownership).** The Jensen's (1986a) idea that PTP might be an opportunity for bringing more "discipline" to the management decisions applies only to firms with low levels of managerial equity. It has to be considered that public companies that decide to go private might have different ownership structures and motivations Halpern et al (1999). Halpern et al (1999) analysis on PTP transactions in the US over the period 1981-1986 reveals that leveraged going private transactions involve both companies with high managerial stock ownership and companies with low managerial stock ownership. High managerial stock ownership companies tend to go private voluntarily while low managerial companies typically go private because of a hostile takeover. Halpern also found that characteristics of high and low prior managerial equity LBO clusters differ significantly from one another. Low managerial stock ownership companies tend either to return to go public or to be acquired by another company, while the high managerial stock ownership companies tend to remain private. This finding is consistent with earlier research done by Maupin, Bidwell and Ortegren (1984)<sup>23</sup> who demonstrated that US companies with high managerial shareholdings in the 70s were more incline to engage in public to private transactions. Also this reason seems not to be consistent with the characteristics of Italian market for the same reasons shown about efficiency reasons and FCF theory.

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<sup>21</sup> Halpern, P., Kieschnich, R., Rotenberg, W., (1999), "On the heterogeneity of leveraged going private transactions", *Review of Financial Studies*, 12, 281-309.

<sup>22</sup> DeAngelo, H., DeAngelo, L., Rice, E. (1984), "Going private: minority freeze outs and stockholders' wealth", *Journal of Law and Economics*, n. 27, 367-402.

<sup>23</sup> Maupin, R., Bidwell, C. and Ortegren, A. (1984), "An empirical investigation of the characteristics of publicly quoted corporations which change to closely held ownership through management buyouts", *Journal of Business Finance and Accounting*, 11, 345-59.

**Undervaluation and small size** As Rennemboog et al (2007) explain, managers are insiders and know better than everybody what is the real firm's worth. Insiders indeed have information about the firm's strategic options and its potential value. This implies that if the firm is undervalued, managers might delist it to develop with higher freedom the firm potential (which is not understood by the financial markets) and create additional shareholder value once the firm is private. These situations occur especially among *small listed* companies which generally are not able to catch the attention of institutional shareholders and to fund growth, empirical findings supportive of the small size motivation were reported by Kieschnick (1998). Maupin et al (1984) studied a sample of US companies and found that those which went private had a lower price-to book ratio than the other companies, this implies that the undervaluation hypothesis is true for this sample. Research conducted in the US by Kieschnick (1989) reports that undervaluation is a motivation for delisting only when the PTP is done through a MBO. Uk research shows that undervaluation is one of the most important motivations for delisting Ronnemboog et.al. (2005 and 2007). In Italy, despite no completed analyses have been carried out, undervaluation and small size seem to be a possible cause of delisting even not the main one.

**Financial, Strategic, Managerial, and Public Market Influence motivations.** Geranio (2007)<sup>24</sup> stresses the idea that in general there are some other aims behind PTP transactions, those may be:

- Financial, if the buyer aims at owning the target company shares for a limited period of time (5 to 10 years) and then sell them to another investor or to the public market;
- Public Market influence-related, when the controlling shareholder desires to avoid the public market influence;
- Strategic, if the major objective of going private is to obtain synergies from the merging of the target public company and a private one.
- Managerial, if the public company is bought by its managers who have different views from the actual shareholders' ones.

**Speculation** Empirical research done in the US has showed that the likelihood of going private in the 80s was positively related to takeover speculation (Lehn and Poulsen 1989). This result is confirmed by Geranio (2004) who found that in Italy some companies decide to go public and to go private without having a clear long term perspective. This leads them to decide to go public when the public markets are in their positive trends and to delist when the market prices get lower.

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<sup>24</sup> Geranio M., Franzosi, A. (2007), "Gli investimenti azionari internazionali di portafoglio: quale ruolo per l'Italia?", *Bit Notes Borsa Italiana*, n.18/2007;

**Dividend policies** Geranio (2007) explains that shareholders tend to expect to receive constantly dividends from the public company that is going well. Profits reinvestment policies are more easily understood by investors in private companies. This implies that public companies need more liquidity to pay dividends than the private ones. Because of this, it might be that investors in public companies are less “patient” than investors in private companies; and short-term tasks may be their unique focus. The decision to go private can solve this situation by reducing the need to pay constant dividends and allowing the company to retain liquidity and finance growth. Maupin, Bidwell and Ortengren (1984) found that companies that went private paid (before the PTP operation) a significantly higher dividend whereas the cash dividends dropped to zero in a majority of ex-listed companies after the management buyout transaction.

**Restructuring needs** According to Geranio (2005) Growth strategies and companies shake-ups typically imply a reduction of short-term profits. For this reason public markets may not appreciate them and the shares value could decrease. Going private gives the company the opportunity to define growth actions and shake ups without being subject to the market judgments.

**The wealth transfer hypothesis** It has been hypothesized that PTP transactions could be done to transfer wealth from either employees or bondholders to shareholders (Ronnemboog et al. 2005). Shareholders’ gains of wealth to employees detriment are not empirically proven in the case of PTP transactions, (Weston et al. 1998<sup>25</sup>; Ronnemboog et al. 2005). It has to be considered that, even if Ippolito and James (1992<sup>26</sup>) observe that there is an important increase in pension terminations after PTP transactions, their data do not prove the wealth transfer hypothesis.

Finally, the hypothesis that seems to be the less applicable to the Italian case is related to **delisting cases motivated of takeover defense**. Going private can also be a strategy to defend the company against takeovers, (Lowenstein 1985)<sup>27</sup>, in such a case, managers might delist the company to avoid hostile takeovers and to protect themselves from losing their jobs . This concept was empirically proven in the past by Lehn and Poulsen (1989), Kieschnick (1998), Halpern, Kieschnick and Rotenberg (1999).

In the following sections we will provide some relevant descriptive data in order to shed some light on the PTP phenomenon in Italy.

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<sup>25</sup> Weston, J.F., Chung, K.S., Siu, J.A., (1998), *Takeovers, Restructuring and Corporate Governance*, second edition. Prentice- Hall, New York.

<sup>26</sup> Ippolito, R.A., and James, W.H., (1992), “LBOs, reversions, and implicit contracts”, *Journal of Finance*, 47, 139-167.

<sup>27</sup> Lowenstein, L., 1985, “Management buyouts”, *Columbia Law Review*, 85, 730-784.

## Italian law and rules of the delisting process

The requirements that cover delisting in Italy are mainly presented in the Rules of Italian Stock Exchange (Borsa Italiana)<sup>28</sup>. The Article number 2.5.1 asserts that Borsa Italiana may: **a) suspend** the listing of a financial instrument where the regularity of the market for the instrument is temporarily not guaranteed or risks not being guaranteed or where this is necessary to protect investors; **b) revoke** the listing of a financial instrument in the event of a prolonged lack of trading or where it deems that owing to special circumstances it is not possible to maintain a normal and regular market for such instrument.

The main causes of suspending (**case a**) are defined in the following elements: i) the dissemination or lack of dissemination of information that may affect the regular operation of the market; ii) the cancellation of the face value of the shares with the simultaneous resolution to reconstitute the capital; iii) the involvement of the issuer in insolvency proceedings; iv) the liquidation of the issuer; v) an adverse opinion or a disclaimer rendered by the auditor for two consecutive financial years. Suspending does not automatically mean delisting but suspended instruments are delisted if market conditions are not reestablished.

The main causes of delisting due to **case b** can be referred to: i) the average daily turnover in the market and the average number of securities traded over a period of at least eighteen months; ii) the frequency of trading in the same period; iii) the distribution among the public of the financial instruments in terms of value and number of holders; iv) the involvement of the issuer in insolvency proceedings; v) an adverse opinion or a disclaimer rendered by the auditor for two consecutive financial years. vi) the liquidation of the issuer. All these cases can be considered compulsory delisting i.e., delisting that occurs independently from the company or its shareholders willing.

Delistings occur also (and especially) voluntarily in the case of voluntary takeover bids or residual takeover bids. These are related to the abovementioned case b iii) when merger shareholders don't want (or are unable) to restore free floating.

Residual takeover bids (so called "Commitments to squeeze-out") are compulsory when, as a result of a global takeover bid, the bidder becomes holder of at least *ninety-five* per cent of the capital represented by securities in an Italian listed company and does not want to rebuild the free floating. In such a case the bidder shall be allowed to squeeze-out of the remaining securities should any other party so request (art 108 of the Consolidated Law on Finance) and the company is delisted.

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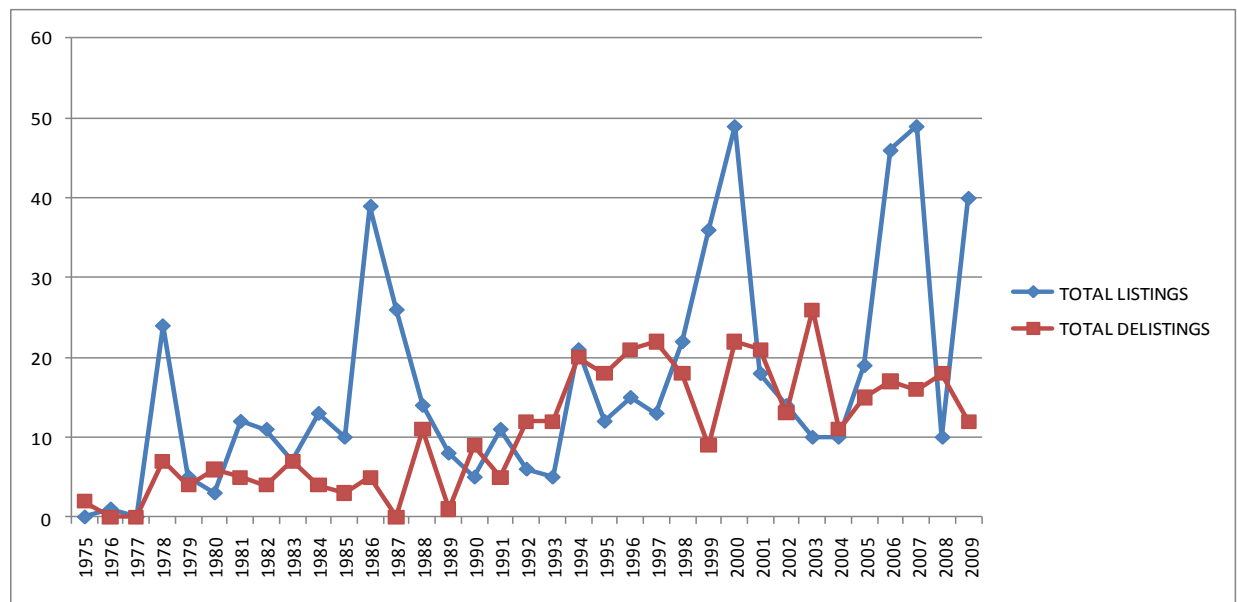
28 As Macey, O'Hara and Pompilio (2004) indicate, delisting rules can be designed to insure that the exchange's relationship with the listed company remains profitable or to protect the reputation of the trading venue where the shares list. Macey, J. R., O'Hara, M., Pompilio, D., "Down and Out in the Stock Market: The Law and Finance of the Delisting Process", (April 2005), Available at SSRN: <http://ssrn.com/abstract=583401>.

Voluntary takeover bids are referred to the case described in Article 111 of the same Law and are the most interesting for the purpose of our research. A bidder coming into possession following a global takeover bid of a holding of at least ninety-five per cent of the capital represented by securities in an Italian listed company shall have the right to squeeze-out on remaining securities within three months of expiry of the time limit for bid acceptance, if the intention to exercise said right was declared in the takeover bid document<sup>29</sup>.

### From public to private: the delisting phenomenon in Italy

Exhibit 1 represents Listings and PTP transactions over the past 35 years in Italy. As the graph shows, total listings waves per year tend to move symmetrically with total PTP transactions. So it is reasonable to assert that the Italian stock market agents' behavior might be in part the result of macro events that- over time- boost going public decisions and hinder going private choices or increase PTP transactions and hamper new listings.

Exhibit 1: Delistings and Listings from Italian Stock Exchange Market 1975-2009



Total is calculated by net figures of transfer between markets. 1994 listing includes 9 companies transferred from the minor exchanges to the national telematic system of Borsa Valori (i.e.: from Expandi to Borsa). 2009 listing includes 35 companies transferred from Expandi to MTA. This graph is based on the figures published on the Borsa Italiana website [www.borsaitaliana.it](http://www.borsaitaliana.it) under the section "Historical Statistics".

To investigate the characteristics of delisting, we focused on the period 2006-2009. We found that 63 delisting occurred over that period. We excluded 8 cases because we were unable to gather enough information about them and we focus on the remaining sample of 55 delisting.

As our interest is to describe the most recent wave of delisting in Italy we took three steps:

<sup>29</sup> Often residual takeover bids take place after voluntary ones.

- We analyzed the causes of delisting officially declared by the companies belonging to the entire sample;
- We selected the most frequent causes of delisting (i.e. delisting made following takeover bids);
- We then obtained qualitative information from takeover bids prospectus that were published by each company that delisted (we excluded bank and insurance companies and obtained 19 relevant cases) to better illustrate some aspects of the phenomenon.

### Declared causes of delisting

As shown in Exhibit 2, delisting can refer to diverse causes. The most rare over the analyzed period were bankruptcy, early dissolution of a partnership, and liquidation. The most frequent causes are related to following takeover bids. Mergers are strategic decisions that can imply also a PTP transaction. In particular, the merger cases indicated in Exhibit 2 implies that one of the companies involved in the merging operation goes private or delists in order to go public under another partners' name. On the total of PTP transactions *voluntary* takeover bids reached 25.5%, residual takeover bids reached 21.8% and mandatory takeover were 5.5%. Delisting due to merger operations are exquisitely a formal consequence of the merging of two or more companies. Takeover bids are instead the most frequent (52% of cases) and the most relevant in terms of delisting. Indeed they are referred to a PTP transaction that occurs explicitly as a consequence of a strategic decision.

*Exhibit 2: Declared Causes of Delisting 2006-2009*

						Total
		2006	2007	2008	2009	
<i>Bankruptcy</i>	<i>Count</i>	1	0	0	0	1
	<i>% within year</i>	6.2%	.0%	.0%	.0%	1.8%
<i>Early dissolution of a partnership</i>	<i>Count</i>	1	0	0	0	1
	<i>% within year</i>	6.2%	.0%	.0%	.0%	1.8%
<i>Following mandatory takeover bid</i>	<i>Count</i>	0	1	1	1	3
	<i>% within year</i>	.0%	7.1%	6.7%	10.0%	5.5%
<i>Following residual takeover bid</i>	<i>Count</i>	5	5	2	0	12
	<i>% within year</i>	31.2%	35.7%	13.3%	.0%	21.8%
<i>Following voluntary takeover bid</i>	<i>Count</i>	0	0	9	5	14
	<i>% within year</i>	.0%	.0%	60.0%	50.0%	25.5%
<i>Liquidation</i>	<i>Count</i>	0	1	0	0	1
	<i>% within year</i>	.0%	7.1%	.0%	.0%	1.8%

<i>Merger</i>	<i>Count</i>	9	7	3	4	23
	<i>% within year</i>	56.2%	50.0%	20.0%	40.0%	41.8%
<i>Total</i>	<i>Count</i>	16	14	15	10	55
	<i>% within year</i>	100.0%	100.0%	100.0%	100.0%	100.0%

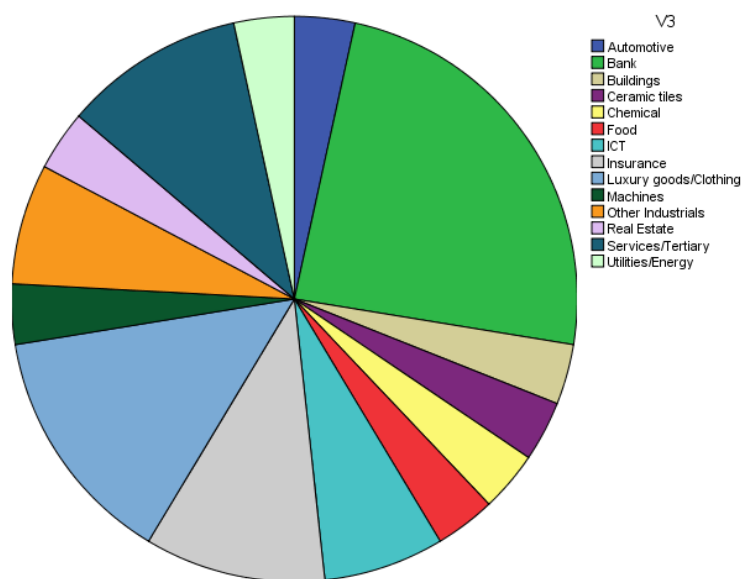
Source: Elaboration of the Authors

Let's now focus on the 19 selected cases related to delisting following takeover bids in industrial companies. As Exhibit 3 and 4 show a consistent part of PTP transactions occurred among banks (7), luxury goods/Clothing (4), insurance (3), and services/tertiary (3).

Exhibit 3: Selected Case studies Industries: Takeover Bids-Delisting 2006-2009

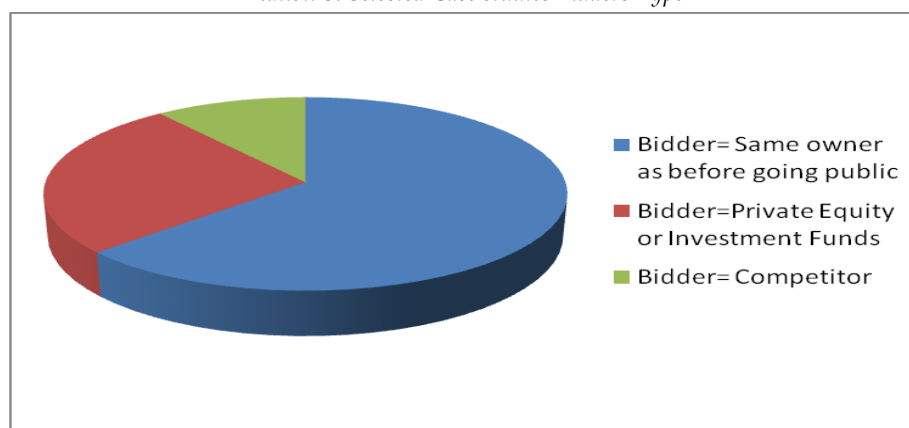
		<i>Frequency</i>	<i>Percent</i>	<i>Valid Percent</i>	<i>Cumulative Percent</i>
<i>Valid</i>	<i>Automotive</i>	1	3.4	3.4	3.4
	<i>Bank</i>	7	24.1	24.1	27.6
	<i>Buildings</i>	1	3.4	3.4	31.0
	<i>Ceramic tiles</i>	1	3.4	3.4	34.5
	<i>Chemical</i>	1	3.4	3.4	37.9
	<i>Food</i>	1	3.4	3.4	41.4
	<i>ICT</i>	2	6.9	6.9	48.3
	<i>Insurance</i>	3	10.3	10.3	58.6
	<i>Luxury goods/Clothing</i>	4	13.8	13.8	72.4
	<i>Machines</i>	1	3.4	3.4	75.9
	<i>Other Industrials</i>	2	6.9	6.9	82.8
	<i>Real Estate</i>	1	3.4	3.4	86.2
	<i>Services/Tertiary</i>	3	10.3	10.3	96.6
	<i>Utilities/Energy</i>	1	3.4	3.4	100.0
	<i>Total</i>	29	100.0	100.0	

Source: Elaboration of the Authors

*Exhibit 4: Selected Case studies Industries: Takeover Bids-Delisting 2006-2009**Source: Elaboration of the Authors*

Interestingly we found that, considering the bidders' nature, in 15 out of 19 cases they were the same owners as before going public. In 5 out of 19 cases they were private equity funds or investment funds and only in 2 cases they were competitors of the delisted company. This seem to be consistent with some theoretical hypothesis. The speculation hypothesis stated by Geranio (2004) seems to be proved considering that in the majority of cases:

- Companies management do not change;
- Owners directly run the company assuming managerial position;
- Owners and managers are insiders and dispose of the best set of information;
- Delisting occurs in period of low market.

*Exhibit 5: Selected Case studies Bidders Type**Source: Elaboration of the Authors*



We then considered the permanence on the Stock Market (i.e. the length of the period during which the company was listed on the stock market). Only 6 out of 19 companies staid on the market for more than 21 years, moreover, a relationship between bidder type and permanence on the stock market did not emerge.

*Exhibit 6: Selected Case studies Industries: Bidder vs Permanence on the Stock Market*

<i>Bidder Type * Permanence on the Stock Market</i>						
		<i>Per</i>				<i>Total</i>
		<i>0-4.9 y</i>	<i>5-9.9 y</i>	<i>10-21 y</i>	<i>&gt; 21 y</i>	
<i>Bidder Type</i>						
	<i>Bidder= Competitor</i>	0	1	1	0	2
	<i>Bidder= Same owner as before going public</i>	4	3	1	4	12
	<i>Bidder=Private Equity or Investment Funds</i>	1	1	1	2	5
<i>Total</i>		5	3	5	6	19

*Source: Elaboration of the Authors*

## A first essay of quantitative analysis

To complete the qualitative analysis we try to test statistically some hypothesis that seemed to be applicable to the Italian case<sup>30</sup>.

### Hp 1 Delisting strategy is related to Speculation

Delisting strategy was measured with a dummy that equals one when the company is listed and zero when it is delisted. We measured speculation considering the standardized values of the difference between the highest share price registered each year and the lowest share price registered each year.

### Hp 2 Delisting strategy is related to company characteristics

We measured the companies' book value per share, total assets value, number of employees and operating revenue (we used log values after having standardized each of these variables).

<sup>30</sup> Within the 381 companies that in the wave from 2002 to 2008 have been listed on the Italian market, we tested the motivations of the decision to delist. Data have been supplemented by collecting accounting information and the ownership structure from the Bvdep database called Osiris on a sample of 2,667 observations (381 companies for 7 years). After deleting missing values we obtained a sample of 888 observations and 267 companies.

We applied a mixed effects logistic regression model<sup>31</sup> to investigate the effects of the market speculation and company characteristics on the probability of going private.

None of the hypotheses tested was proved, no statistically significant relationship was found, neither between speculation and delisting nor between companies' characteristics and delisting. This first "non result" can be due to the characteristics of data. First of all, we have a high number of missing data. Second we were not able to retrieve data about each shares' average price per month. The use of such a variable could have helped to measure speculation before delisting. Indeed it is difficult to see speculation by considering only the highest and the lowest shares price over an entire year. Third, we used a dummy variable to measure the delisting strategic decision, while this strategic decision can be implemented with different objectives and for different reasons. For example at the moment we are not able, on this entire (and big) sample, to control for the diverse types of delisting (namely: delisting as a consequence of a takeover bid, delisting as a consequence of a merger or other). It is likely that these first non-results are due to the scarce capacity of the sample used to measure properly the variables considered in our hypotheses. Future research will improve the quality of this database by introducing variables to control for the various types of delisting and to consider shares prices in a more precise way.

## Conclusion

The aim of the paper was to focus on the characteristics and motivations of delisting in Italy.

We showed that in Italy the majority of PTP transactions are carried out by the same owner as the one before the company went public. So we found support to the idea that the going private decision is affected by concentrated institutional shareholdings. This finding is consistent with earlier researches (Maupin, Bidwell & Ortengren, 1984) which demonstrated that US companies with high managerial shareholdings in the 70s were more incline to engage in PTP transactions. One of the main differences between Italian market and the more developed ones is that often in Italy there is not a real separation between ownership and

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<sup>31</sup> The dependent variable  $Y_{it}$  is dichotomous and taking value 1 if in year  $t$  the company  $i$  goes private, 0 otherwise. Note that  $i$  ( $i = 1, \dots, N$ ) ranges over the companies in our data set, while  $t$  ranges over the  $T=7$  years from 2002 to 2008.

We model the probability  $\pi_{it} = \Pr(Y_{it} = 1 | \mathbf{x}_{it}, u_{it})$  where  $\mathbf{x}_{it}$  is a vector of explanatory variables and  $u_{it}$  are random effects. More specifically, we assume

$$\text{logit}(\pi_{it}) = \mathbf{x}_{it}\beta + u_{it}$$

where  $u_{it} \sim N(0, z_{it}\sigma^2)$  and  $z_{it}$  is the generic element of a  $NT \times NT$  matrix  $\mathbf{Z} = \mathbf{1}_T \otimes \mathbf{I}_N$ .

In point of fact, we have 7 observations for each company. As decisions taken by the same agent can be correlated over time, company-specific random effects are introduced to account for this potential effect.

management, so that in public companies the agency problem invest the conflict of interest within majority and minority shareholders. To conclude, our data tell us that the hypothesis according to which *characteristics of the company that decides to go private (Managerial Ownership) affect the decision to go private might be accepted for the Italian case.*

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## FROM NECESSITY TO BUSINESS ENTREPRENEURSHIP: THE CASE OF THE SONGHAI CENTER, PORTO NOVO, BENIN

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### Abstract

The “push theory maintains that individuals are pushed into entrepreneurship by negative external forces. The resulting activity is referred to as necessity entrepreneurship. The “pull theory” contends that individuals are attracted to entrepreneurial activities because they seek self-fulfillment, resulting in business or opportunity entrepreneurship. In the present study we discuss the preliminary criteria required to generate business/opportunity entrepreneurship using the terms of the McClelland typology: “need for achievement,” “need for affiliation,” and “need for power.”

We show that students at the Songhai Center, in Porto Novo, Benin have the intentions and interests needed to become entrepreneurs. We show further that Songhai's students exhibit the three levels of McClelland's business entrepreneurship: “need for achievement,” “need for affiliation,” and “need for power.”

**Keyword:** necessity entrepreneurship, business entrepreneurship, Africa, motivation, cooperation, leadership

### Introduction

The majority of small businesses in developing countries have been established by people who cannot find jobs otherwise (Rosa Wild, 1992). The businesses are necessity driven, and the entrepreneurs generally want to earn enough to make a living (Frese and De Kruif, 2000; Olomi, Nilsson P., & Jaenssoon 2002; Rutashobya, 1995; Toroka and Wenga, 1997). The greater the poverty, the larger is the number of necessity business (Reynolds Camp, Bygrave, Autio & Hay ., 2001). This reality is confirmed by Mitchel's research (2001) on entrepreneurship in South Africa. 38.7% of entrepreneurs open a business for purposes of survival and 20.2% because they were unemployed and were not able to find a job. As stressed by Kautonen and Palmroos (2010), necessity entrepreneurship is generally associated with a single motivation: unemployment.

Nearly all the poorest interviewed by Olomi et al (2002) in their research appeared to be “trapped” by their incapacity to find the time to earn sufficient surplus income to invest in a new business. Evolution from economic necessity appears to be rare. It is still unknown when and how entrepreneurs decide to grow and what triggers the desire to grow (Dunkelberg and

Cooper, 1982, Kolvereid, 1992, Kolvereid and Bullvag, 1996, Kurantko Hornsby & Naffziger, 1997)

Gilad and Levine (1986) and Verheul, Thurik, Hessels, Van der Zwan (2010) proposed two closely related explanations of entrepreneurial motivation, the “push theory” and the “pull theory.”

The push theory argues that individuals are pushed into entrepreneurship by negative external forces such as job dissatisfaction, difficulty finding employment, insufficient salary, or inflexible work schedule. This is necessity entrepreneurship. The pull theory contends that individuals are attracted into entrepreneurial activities in search of independence, self-fulfillment, wealth, and other desirable outcomes. This is business or opportunity entrepreneurship (Giacomin, Janssen, Guyot & Lohest, 2011).

Motivation for growth is a characteristic of business entrepreneurship rather than of necessity entrepreneurship (Davidsson, 1989, 1991). Reynolds et al. (2002) showed that opportunity entrepreneurs are older (35-44 years) than necessity entrepreneurs (18-24 years). Conversely, based on the 2002-2004 GEM data for Canada (Robichaud, LeBrasseur, Riverin & Zinger 2006) associate youth with opportunity entrepreneurship as do also Sandner (2009), Bhola, Verheul, Thurik & Grilo (2006), Block & Wagner (2006), and Wagner (2005). For Bergmann & Sternberg (2007), age does not seem to correlate with necessity entrepreneurship.

## **Research objectives**

The goal of the present research is to identify and analyze the main features conducive to the development of business entrepreneurship (Davidsson, 1989, 1991) in order to determine whether these are present in the students trained at the Songhai Center. Will these students emerge as necessity or business entrepreneurs?

## **Main generators of business entrepreneurship**

The main generators of entrepreneurship are motivation, will to cooperate, and capability to lead.

## **Motivation**

Without motivation to achieve personal and social goals, there is no interest in earning more than whatever is required for subsistence. Motivation is a fundamental requirement for entrepreneurship, and the absence of it blocks any initiative for development. Atkinson (1964) defined motivation as “the contemporary (immediate) influence on direction, vigor, and persistence of action”.

Campbell and Pritchard (1976) suggested that motivation has to do with a set of variables that explain the direction, amplitude, and persistence of an individual's behavior, holding constant the effects of aptitude, skill, and understanding of the task, and the constraints

operating in the environment. McDougall (1908) speaks about "an inherited or innate psychological predisposition that determines how its possessor perceives or pays attention to objects of a certain class, and experiences an emotional excitement of a particular quality upon perceiving such an object, and acts in regard to it in a particular manner".

Models based on drive or reinforcement suggested by drive theorists such as Thorndike (1911) and Hull, Bosley, & Udell, (1980) introduced the concept of learning through motivated behavior.

Reinforcement models continue to thrive today as explanatory vehicles for understanding work motivation and job performance, both in the workplace and in various performance management programs (Komaki, 2003).

The principal aim of content theories, such as Maslow's (1954) and McClelland's (1961, 1971) is to identify the factors associated with motivation. . Maslow (1954) proposed a steady progression upward a hypothetical hierarchy over time, as individuals grow and mature, from physical needs to safety and security needs, through social and self-esteem needs, and finally to self-actualization.

McClelland (1961, 1977) ignored the concept of the hierarchy and focused on the motivational potency of distinct levels of self- and social actualization. He called the first level of business entrepreneurship self-actualization objective "need for achievement." This level requires personal responsibility, calculated risks, performance feedback, and task accomplishment.

The entrepreneur determines his personal economic and professional objectives and the conditions required to achieve it: tasks to accomplish and monitoring of the required performance under conditions of calculated risks.

The second level is the self- and social actualization objective defined as "need for affiliation." The entrepreneur seeks the "approval" of the business and social community. He acts in conformity with the "wishes and norms," and is interested in the "feelings of others."

The third level of self- and social actualization objective is characterized by the entrepreneur's need for "power." He assumes leadership, exercises control, and maintains leader-follower relationships.

Motivation can be sustained by "intrasit" or "extrasit" orientation (Newstrom and Davis, 1993). Intrasit motivation or ambition is focused on direct relations between the individual and the task to perform. "Extrasit" motivation or ambition is related to the external environment around the task to be accomplished.

Herzberg's motivation-hygiene theory (1966) paved a way to strengthening both the intrasit and extrasit. He argued that work motivation is influenced by the extent to which a job is challenging and provides opportunities for recognition and reinforcement. Herzberg saw the

context of a job (which he referred to as *hygiene* factors) as leading to satisfaction and future motivation. He regarded also job enrichment as a key factor in work motivation.

From the point of view of the "objective to achieve," the motivation-hygiene theory is intrinsically because the objective to achieve is determined in advance and in turn it determines the task to be performed (Locke, 1968, 1996; Steers & Porter, 1974; Steer, Mowday & Shapiro, 2004, Crown & Rosse, 1995). This theory is frequently used at the individual or group level in industry (Ambrose & Kulik, 1999).

### **Cooperation in the entrepreneurial team**

Timmons (1999, 2004) defined two criteria required to determine the main functions of the entrepreneurial team. The first one refers to creativity, the second to management skills.

#### **Creativity vs. management skills**

Creativity requires curiosity, continuously updated knowledge, and the capability to identify and develop new ideas, more specifically the right idea at the right time. The microwave oven invented by Raytheon was a creative idea but it was developed in 1950, at a wrong time, when only a small percentage of women worked outside of home. By contrast, the iPod as a mobile music entertainment device was a creative idea developed at the right time, when both young and older customers were ready to use mobile entertainment applications downloaded from the Internet.

#### **Functional cooperation within the entrepreneurial team**

Timmons (1994, 2004) outlined the internal cooperation between the managerial, entrepreneurial, inventive, and promotional functions. The managerial function provides stability and continuous growth following the planned objectives, budget, timing, and performance requirements of each activity. Managers must possess a high level of management skills, but not creativity. Creative people think outside the box, and are therefore liable not to accept budget or time limitations. They can change their mind in the process of creative thinking. They would have to spend considerable time outside the firm meeting customers and specialists in search of new ideas. Their activities reflect the opposite of stability.

The entrepreneurial function must be creative in order to identify market opportunities. Entrepreneurs also need advanced management skills because they work in close cooperation with the manager.

The inventive function is in charge of improving existing products and processes and of developing new ones. Research center or representatives of international companies specializing in the relevant domains can function as inventors.



The promotional function understands the psychology of the customer and has the relevant networking relations to push the products into the market. Trading companies may be involved in the promotional process.

## Leadership

### Leadership style

Hersey and Blanchard (1982) distinguished between two attitudes of a leader: "directive behavior" and "supportive behavior." Directive behavior is defined as one-way communication, from the leader to the follower, with close supervision. Supportive behavior is defined as two-ways communication. The leader listens, provides support and encourages, facilitates interaction, and involves the follower in decision-making.

Hersey and Blanchard identified four distinct leadership styles:

*Style 1: High Directive/Low Supportive*– An autocratic "directing" leader leads the decision-making process and tells people what to do.

*Style 2: High Directive/High Supportive*– A democratic "coaching" leader transfers experience and knowledge to subordinates to improve their capabilities and initiate two-way communication by listening to ideas and suggestions. Eventually, the leader decides and the subordinates execute.

*Style 3: Low Directive/High Supportive*– A democratic "supporting" leader shares the decision-making process with others and provides knowledge to subordinates in order to delegate power.

*Style 4: Low Directive/Low Supportive*– A laissez-faire "delegating" leader transfers the decision-making process and control to others. He acts as a visionary and defines the rules and long-term objectives. The followers implement his philosophy and act as leaders or future leaders.

### Leadership philosophy

Leadership philosophy proposes an understanding of the essence of effective leadership based on the transactional or the transformational paradigm (Barling, Weber, & Kelloway, 1996; Bycio, Hackett, & Allen, 1995; Sosik, Avolio & Kahai, 1997; Bass, 1985).

The transactional leadership paradigm is based on conservative leader-follower relationships (Hsu, Bell, & Cheng, 2002) and on a "bargaining" relation between followers and leaders (Howell & Avolio, 1993). Transactional leadership differentiates between two basic attitudes:

- *Contingent reward leadership*: an active and positive exchange between the leader and followers (Bycio et al., 1995). Followers are monitored and controlled, and receive a reward as recognition of success.

- *Management-by-exception*: the leader monitors the followers' attitude and intervenes when it is necessary.

Transformational leadership provides vision (Howell and Avolio, 1993) and stimulates followers to improve their capabilities and achieve personal and developmental objectives (Barling et al., 1996). In a two-way communication, both developmental and individual orientation generate transformational leadership (Hsu et al., 2001).

Leadership behavior may change from transformational to transactional according to business conditions and objectives. Transformational behavior is needed for determining the business's vision, objectives, and rules, and for long-term planning. Transactional behavior is required during the implementation of the mission and for achieving its objectives.

The role of a transformational leader is to develop positive self-talk with the followers and to keep confidence high. The leader uses positive visual imagery to help people successfully deal with adversity, and speaks in a way that moves others to follow him and perform well. He inspires others to higher levels of performance, establishes trust, and fosters creativity in those he leads.

### **The Songhai Center**

Dr. Godfrey N'Zamujo, a Dominican priest from Nigeria, founded the Songhai Center in 1985 to train young agricultural entrepreneurs. In addition to its training activities, Songhai aims to develop a sustainable agricultural production system based on agrobiology.

At any given time more than 200 students attend 18-month training programs at sites in Porto-Novo, Savalou, Parakou, and Kinwédji. The first nine months are dedicated to general core courses (mathematics, economy, biology), and to training in various specializations such as poultry, pork, aquaculture, vegetables, and fruits. Each student selects a specialization in which he/she works during the last nine months and prepares a personal project.

### **The sample**

In 2010 I had the opportunity to train Songhai trainers, and I proposed to interview a random sample of students in order to analyze their motivation to become business entrepreneurs. I selected one third of the students (N=53) participating in the 18-month program.

Before the participants were asked to complete the questionnaire, I organized an open, one-hour discussion about their expectations before, during, and after the 18-month training program. My intention was to explain the concepts used in the questionnaire and to improve the quality of the answers. During the interviews my role was mainly passive, and I allowed them to express themselves freely.

## The questionnaire

The first part of the questionnaire contained a personal profile including age, family status, gender, parents' employment, level of education, and economic level of their family. In the second part, I asked students to indicate which subjects they found most interesting in the program and to explain the reasons why they chose those subjects. In the third part, students answered two questions about their level of motivation, leadership, and willingness to cooperate. The first question had to do with their personal interest in one or more of the following activities: production, research, management, training, and sales. Greater interest in areas other than production activity was scored as higher motivation.

The second question was related to the students' intentions after graduating from the program. Students were asked to indicate whether they wanted to work on a farm, on the family farm, continue their studies, build a farm and establish a family, build a house, and have an impact on their region. Students could provide more than one answer.

## Hypotheses

The hypotheses are based on the following levels of entrepreneurial necessity:

### Level of entrepreneurial necessity

Hypothesis 1: Intention to work in a farm (Intention 1) is related to interest in production activity only (Interest 1). *McClelland Level 1: "Need for achievement"*

Hypothesis 2: Intention to work in a farm (Intention 1) or in the family farm (Intention 3) and interest in production activity (Interest 1) only.

Hypothesis 3: Intention to continue to study (Interest 2) is related to interest in production (Interest 1) only.

### McClelland Level 2: "Need for affiliation"

Hypothesis 4: Intention to build a farm and establish a family (Interest 4) or to build a house (Interest 5) and interest in a wider range of activities than strictly production (Interest 1) research (Interest 2), management (Interest 3), training (Interest 4) and sales (Interest 5).

### McClelland Level 3: "Need for power"

Hypothesis 5: Intention to have an impact on the development of the region (Intention 6) and interest in a wider range of activities than production (Interest 1) research (Interest 2), management (Interest 3), training (Interest 4) and sales (Interest 5).

Based on the answers to these questions it is possible to determine whether the students were interested in necessity entrepreneurship or in business entrepreneurship. If they were business entrepreneurship-minded, it was possible to determine which of the McClelland levels was expected to be achieved by each student after completing the training program: the

first level (need for achievement), the second level (need for affiliation), or the third level (need for power).

## **Results and Discussion**

### **Descriptive statistics**

Below are the main results of the sample analysis of 53 questionnaires, representing around one third of the students participating in a yearly training program:

11% were under 20 years old, 58% between 21 and 25 years old, and 31% over 25 years old.

Parents' Employment was: 49% in agriculture, 22% bookkeeping, and 29% trade. Education level was: secondary school, 13% baccalaureate, and 14% primary school. 79% wants to specialize in production; 55% had a wider perspective in research; 51% in training, and 37% in management. Some of them express their interest for more than one specialization.

Expectations after the training: 23% intended to work as employees, 47% to continue studying, 24% to work on the family farm, 65% to create their own farm, and 50% to have an impact on economic development. Some of them had more than one expectation.

### **H1 and H2**

The dependent variable "work on a farm" (Intention 1) correlates strongly with training (Interest 4) and sales (Interest 5), but not with production. H1, concerning necessity entrepreneurship, was rejected. H2, referring to the first level of McClelland business entrepreneurship, "need for achievement," was supported.

The dependent variable "to work on the family farm (Intention 3) does not correlate with any of the parameters.

Students who want to work on a farm are not potential necessity entrepreneurs, but they are potential business entrepreneurs at McClelland's "need for achievement" level.

Table 1: Regression with "towork in a farm" (Intention1) as dependent variable (independent variables: training (Interest 4) and sales (Interest 5).

Coefficients<sup>a</sup>

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
1 (Constant)	-.776	.731		-1.062	.294
Interest 5	.383	.126	.443	3.029	.004
Interest 4	.256	.111	.296	2.301	.026

ANOVA<sup>b</sup>

Model	Sum of Squares	Df	Mean Square	F	Sig.
1 Regression	73.214	5	14.643	4.162	.003 <sup>a</sup>
Residual	154.786	44	3.518		
Total	228.000	49			

R	R Square	Adjusted R Square	Std. Error of the Estimate
.567 <sup>a</sup>	.321	.244	1.876

### H3

The regression based on the dependent variable "to continue to study" (Intention 2) correlates positively with management (Interest 3) and sales (Interest 5) activities (Table 2). H3 was therefore supported. Students who want to continue to study are potential business entrepreneurs at McClelland's "need for achievement" level.

Table 2: Regression with "tocontinue to study" (Intention 2) as dependent variable (independent variables: management (Interest 3), sales (Interest 5)

Coefficients<sup>a</sup>

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
1 (Constant)	3.835	1.495		2.566	.014
Interest 3	-.377	.176	-.361	-2.141	.038
Interest 5	.339	.160	.334	2.120	.040

ANOVA<sup>b</sup>

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	72.809	4	18.202	3.453	.016 <sup>a</sup>
Residual	226.671	43	5.271		
Total	299.479	47			

R	R Square	Adjusted R Square	Std. Error of the Estimate
.493 <sup>a</sup>	.243	.173	2.296

#### H4

The parametersexpressing the intention to build a farm and establish a family (Intention 4) and to build a house (Intention 5) correlate strongly with an interest in production (Interest 1), research (Interest 2), management (Interest 3), and training (Interest 4) (Table 4). This correlation expresses McClelland's second level of "self- and social actualization." H4 was therefore supported.

The regression between the dependent variable "to build his own farm and establish a family" (Intention 4) and the independent parameters confirms a positive correlation not only with production (Interest1) but also with management (Interest 3) (Table 3).

The regression between the dependent variable "to build a house" (Intention 5) and the independent parameters confirms the positive correlation with management (Interest 3) and training activities (Interest 4).Both results position the students at McClelland's level 2,business entrepreneurship, the "need for affiliation."

Table 3: Regression with "to build a farm and establish a family" (Intention 4) as dependent variable (independent variable: production (Interest 1), management (Interest 3))

Coefficients<sup>a</sup>

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	-1.056	1.764		-.598	.553
Interest 3	.297	.143	.297	2.070	.044
Interest 1	.414	.170	.338	2.442	.019

ANOVA<sup>b</sup>

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	72.484	3	24.161	5.263	.003 <sup>a</sup>
Residual	201.995	44	4.591		
Total	274.479	47			

	R Square	Adjusted R Square	Std. Error of the Estimate
.514 <sup>a</sup>	.264	.214	2.143

Table 4: Regression with "to build a house" (Intention 5) as dependent variable (independent variables management (Interest 3), training (Interest 4).

Coefficients<sup>a</sup>

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	-.051	.464		-.110	.913
Interest 4	.289	.112	.306	2.590	.013
Interest 3	.459	.114	.478	4.045	.000

a. Dependent Variable: After5

ANOVA<sup>b</sup>

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	94.049	2	47.025	12.475	.000 <sup>a</sup>
Residual	177.171	47	3.770		
Total	271.220	49			

R	R Square	Adjusted R Square	Std. Error of the Estimate
.589 <sup>a</sup>	.347	.319	1.942

## H5

The dependent variable "to have an impact on the development of the region (Intention 6), expressing MacClelland's level 3 of "need for power," correlates positively with management (Interest 3) and sales (Interest P5). H5 was therefore supported but with a low adjusted R square of 9%.



Table 5: Regression with "to have an impact on the development of the region" (Intention 6) as a dependent variable and independent variables: management (Interest 3), Sales (Interest 5)

Coefficients<sup>a</sup>

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.931	1.054		1.833	.074
Interest 5	.382	.173	.379	2.215	.032
Interest 3	-.503	.190	-.484	-2.652	.011

a. Dependent Variable: After6

ANOVA<sup>b</sup>

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	54.236	5	10.847	1.866	.121 <sup>a</sup>
	Residual	238.317	41	5.813		
	Total	292.553	46			

R	R Square	Adjusted R Square	Std. Error of the Estimate
.431 <sup>a</sup>	.185	.086	2.411

Students who want to "to have an impact on the development of agriculture are potential business entrepreneurs at McClelland's "need for power" level.

## Conclusion

Songhai center succeeded in attracting students who are beyond necessity entrepreneurship. They are mainly potential business entrepreneurs, interested in developing not only their own business but also in having an impact on business development in their region. Even students who want to work on a farm are not potential necessity entrepreneurs but potential business entrepreneurs at McClelland's "need for achievement" level.

To become business entrepreneurs, Songhai students must acquire entrepreneurial experience during the 18 months of their training in more activities than production. Necessity and business entrepreneurship are driven by different mechanisms (Hechavarria & Reynolds, 2009). According to Gabrielsson and Politis (2009), the motivations of individuals affect their decision-making processes and reactions. In the present paper we identified the entrepreneurial intentions and interests required to differentiate between entrepreneurs at the necessity level and those at McClelland's "need for achievement," "need for affiliation," or "need for power" levels of business entrepreneurship. Using these distinctions, we proved that Songhai students are potential business entrepreneurs.

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## SUB SAHARAN AFRICAN (ASS) COUNTRIES TOWARDS ECONOMIC DEVELOPMENT: THE PROCESS MODEL

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### Abstract

In sub-Saharan African (SSA) countries, economic growth has very little impact on economic development. Based on international models, the study suggest a process model starting with open incubators, generating the formalization of the informal economy, followed by industrial districts, organizing the knowledge, know how and finance infrastructure relevant to the development of the formal economy into clusters. The feasibility of the process model was checked in Cote d'Ivoire, in three sectors that is, processed fruits and vegetables, processed wood and textiles.

**Keywords:** SSA countries, regional development, incubators, industrial districts, clusters, agribusiness.

### Introduction

#### Growth versus economic development in SSA countries

GNP annual growth rate of sub-Saharan African (SSA) countries enjoyed higher prices of crude petroleum, minerals and agricultural products and grew from 2.4% in 1999 - 2001 to 3.9% in 2001 - 2004 (World Bank, 2001, 2006).

But this economic growth has not had any impact on economic development and poverty. The income poverty indicator of Millennium Development Goal No. 1 (MDG1), the number of people living on less than US\$1 per day (purchasing power parity, or PPP), did not change from 1990 to 2004 (UNECA, 2006). While the total number of people worldwide living on less than US\$1 per day from 1981 to 2001 declined from 1.45 to 1.1 billion , the number in SSA countries increased from 164 to 314 million (World Bank, 2004). Poverty is expected to decrease in Asia and Latin America, but to increase in Africa and the Middle East.

According to analyses initiated by the International Labour Organization (ILO, 1999, 2007), growth in the extractive mineral and fuel sectors has generated very few jobs across economies.

From 2008 onwards, the world economic crisis generates a slowdown of demand for oil and minerals and cut the revenues of several SSA countries, worsening their economic situation. From an overall current account surplus position of 2.9% of GDP in 2008, the continent will face a deficit of -4%. of GDP in 2009. The large surplus of 8.8% of GDP for the group of oil

exporters will turn into a deficit of -4% of GDP (ADB, 2009). This is a direct result of the expected decline in oil revenue.

SSA countries will not be spared from the pessimistic world trade outlook for 2009. Exports and imports growth rates are forecast at 3.6% and 10.5% in 2009, respectively compared to 10.6% and 15.2% in 2008. As a result, the impact of the crisis on foreign exchange is expected to be negative. Having benefited from the recent primary commodity boom, Africa will experience a loss of 45.4% of its exports value in 2009 (ADB, 2009). Losses in export growth rates are not compensated for by decreasing import growth rates in value terms, implying that the trade balance may deteriorate.

Exports growth or external support cannot be the only solution.

The main objective of this paper is to discuss and suggest a model able to generate sustainable growth of local demand and supply in the local informal and formal economy.

### **Models of regional development**

The main models of development discussed in the literature are the Incubator, the Industrial District and the Cluster.

#### **The incubator model**

The United States National Business Incubation Association (NBIA) (see website) defines the business incubator as “a dynamic process of business enterprise development, providing, under one roof shared office services, access to equipment, flexible leases, and expandable space”. Its main task is to create a dynamic of development in the supported small and medium-sized enterprises (SMEs) by providing management and consulting services as well as relevant material and financial resources. Its wider task is to support macro-economic-related (employment) or micro-economic-related (implementation of technologies) objectives.

In 1956, Massey-Ferguson, the largest industry in Batavia, New York, United States of America, closed down, leaving vacant an 850,000 ft<sup>2</sup> complex of multi-story buildings. The Mancuso family purchased the complex and gave Joe Mancuso the responsibility of creating jobs and making money. Mancuso decided to divide the building in smaller units and rent them to individual businesses that he would nurture by providing shared office services, assistance with raising funds and business consulting.

One of his first tenants was a chicken processing company, thus, the origin of the name “incubator” and of a new model of promoting SME development. The first business incubator, Batavia Industrial Park (BIP), was thus, created. BIP reached capacity after five years and created thousands of jobs for the area and appreciable earnings for its owners, its tenants and the city of Batavia.

The incubator model supports the development of SMEs as a source of local economic development. In 1979, June Lavelle, in her capacity as Executive Director of the Industrial

Council of Northwest Chicago, developed the incubator concept as a model for neighborhood revitalization programs.

In a vacant 350,000 ft<sup>2</sup> facility in northwest Chicago, the Fulton-Carroll Center for Industry (FCCI) became the headquarters for the revitalization of an abandoned industrial neighborhood.

As a result of the work of FCCI's support team of successful business people, the vacancy rate of the surrounding neighborhood's commercial property dropped sharply and real estate values have risen. The FCCI incubator fosters local development by creating job opportunities initiated by new entrepreneurs.

The United Nations Industrial Development Organization (UNIDO) adopted the incubator model in order to "create a favorable environment for entrepreneurship and the expansion of SMEs in developing countries" (UNIDO, 2002). It has been implemented with many difficulties in SSA countries such as Angola with the INEFOP-PEA Business Incubator in Luanda, in Kenya with the Jomo Kenyatta University of Agriculture and Technology Center for Business Innovation (JKUAT-CBI), and the private incubators Kountry Business Incubator (KeKoBI) and SACOMA. (See website busynet)

Nigeria is quite representative of the difficulties encountered by SSA countries in order to implement the incubator model. The Nigerian Incubator System Foundation (TBI) founded in 1993 as a cooperation with UNFSTD, the private sector, the states and the federal government, decided to create three incubators, in Lagos, Nara and Kano. But due to corruption, the Federal government nationalized it in 1995.

The Lagos incubator started only with 11 tenants.

South Africa only differs from the other SSA countries and succeeded in implementing the incubator model (Giddings, 2009).

South Africa has 21 incubators supporting entrepreneurs in various sectors.: Nine technology incubators (one biotech; one bio-medical; two chemical and five Information and Communication Technologies-ICT, six manufacturing incubators (automotive, wood, stainless steel, base metals, aluminum, platinum), one mining incubator, three agricultural incubators (flowers, biodiesel, essential oils), one construction incubator and one fully private sector. Most are supported by the national government and to a lesser extent by provincial and local governments. The South African Business and Technology Incubator Association (SABTIA) was created by incubator professionals and has since become an organization representing incubators in South Africa. The few hundred entrepreneurs supported by those incubators have a small impact on economic development in South Africa.

## **The industrial district model**

Becattini (1990) conceptualizes the industrial district, defining it as: “a socio-territorial entity which is characterized by the active presence of both a community of people and a population of firms in one naturally and historically bounded area”. In the district, community and firms tend to merge. In Italy, the industrial district model first appeared in the 1970s. Industrial districts in the textile industry in Carpi and Prato, the furniture industry in Brianza and Cascina, and the footwear industry in Vigevano opened new markets in Europe and Japan for the Italian industry (Brusco, 1982).

National and local authorities built a network of support centers specialized in research, technological transfer, management or international marketing.

Today, industrial districts in textiles, ceramic tiles, food processing, furniture and agricultural machinery tools are concentrated in northern and central Italy (Paniccia, 1998).

The industrial district model requires flexible specialization, deepening division of labor between firms, differentiation of enterprises by process or products (Rabellotti, 1995; Schmitz, 1995; Rabellotti and Schmitz, 1999), inter-firm cooperation and mutual trust, as well as a positive industrial atmosphere (European Commission, 2002).

The main driver of an industrial district is the local and national support policy which can be defined as “a set of humanly devised behavioral rules that govern and shape the interaction of human beings, in part by helping them form expectations of what other people will do” (Nugent and Lin, 1996).

## **The cluster model**

The cluster model (Porter, 1998) is a “geographic concentration of an array of linked, competitive firms that have close buy-sell relationships, utilize common technologies, share customers, or share a labor pool that provides them with a competitive advantage”.

The cluster model gains competitive strength due to its better access to trained and experienced employees, suppliers, specialized information and public goods, as well as from motivating forces of local competition and customer demand (Rosenfeld, 1996; Enright, 2000; Saxenian, 1994).

In their research on successful cluster development practices in the United States and Italy, Christensen, McIntyre and Pikhoid (2002) emphasize the business generator aspect of the cluster.

Lissoni (2001) argues that authorities and institutions should facilitate collaboration and networking, but Porter does not endorse this view on the grounds that such networking would lead to a reduction in competition.

An example of bottom-up development is the Silicon Valley, the first United States cluster model, which was initiated by private parties. Frederick Terman, Professor and Provost of



Stanford University, proposed the leasing of Stanford's lands for use as an office park, the Stanford Industrial Park (SIP).

Leases were limited to high-tech companies. Its first tenant was Varian Associates, founded by Stanford alumni in the 1930s to build military radar components. Terman also found venture capital for civilian technology start-ups. One of the major success stories was Hewlett Packard, which was founded by Stanford graduates William Hewlett and David Packard. Networks were generated autonomously in both regions, Silicon Valley and SIP (Saxenian, 1994; Segel, 1985).

In most European Union (EU) countries, the clustering process was the initiative of governments. The EU Expert Group's final report *Enterprise Clusters and Networks* surveyed 59 traditional clusters and 25 science-based clusters (European Commission, 2007). According to the report, in the member states, policies towards cluster development are generally issued by national governments with the co-operation of regional or local governments. National authorities focus on designing and coordinating cluster policies to create the general framework conditions and developing R and D programs. In certain countries such as Belgium and Spain, cluster policy is strictly a regional government initiative.

Regions in these two countries enjoy autonomous authority in this field and develop their own approaches and instruments.

In Germany, projects such as EXIST and BioRegio are the result of the Federal Government's cluster policy, a top-down approach (Colovic-Lamotte and Tayanagi, 2004). Regional governments have been required to share with the Federal Government the provision of financial support to spin-off companies from universities. The Finnish Government also encourages the development of industrial clusters. Finland's best-known cluster, "Networking", located at Turku and Oulu, specialized in telecommunications and involves companies such as Nokia and ABB (TEKES, 2005).

The best examples of functioning clusters in SSA countries are in South Africa. The South African Petro Chemical cluster around Sasol near Witbank,

is one of the most successful clusters. In this cluster various supporting industries and downstream linkages were created, manufacturing products like: solvents such as alcohol, ketones, tar products, sulphur, ammonia, krypton/xenon, nitrogen and oxygen, feedstock, fuels like petrol, diesel, gas and paraffin (Nortjé, 1998). These and other by-products are used in the production of paint, fertilizers, plastics and plastic products, washing detergents and feedstock.

The cluster's motor vehicle industry around East London and Uitenhage in the Eastern Cape already produces 40 percent of the country's output of vehicles, components, like motor

spares and platinum exhausts, services and ten per cent of the chemical, pharmaceutical and petroleum industries (Nortjé, 1998).

McCormick (1999,) differentiates between “groundwork clusters”, “industrializing clusters” and “complex industrial clusters”. Based on this classification, Kleynhans (2003) thinks that even those successful clusters cannot be classified as complex industrial clusters. They tend to be smaller and less developed than their counterparts in Western countries.

In the 80s and early 90s, the government of Uganda ran a number of state enterprises and projects including those engaged in the production of fish nets (Uganda Fishnet Manufacturers), fish trawling (the Sino-Ugandan Fisheries Joint Venture with the Chinese), fish processing, three fish distribution centers, and a fleet of fish trucks (Uganda Fisheries Industries Limited) and the supply of fishing inputs (EEC funded Artisanal Fisheries Rehabilitation Project). Many of these state outfits ran into management and financial trouble prior to their closure or privatization (Kiggundu , 2007). According to Kiggundu, the key point is that despite this long history of public investments in the fisheries, no attention was paid to the need to build and support local systems for learning and innovation.

This role is not limited to enforcing regulation and standards of performance. It includes funding research, facilitating innovation, and arranging the provision of technical assistance.

The Ugandan case underlines the vital role of public efforts in providing overall leadership and co-ordination of systemic learning, institutional change and continued interaction with the various players in order to ensure that combined efforts bring about the required knowledge flows.

The production of leather shoes in Ethiopia dates from the late 1930s when Armenian merchants founded two shoe factories in Addis Ababa. These factories nurtured a number of shoemakers, who opened their own factories in Addis Ababa and trained their workers. Today, the neighbourhood of Merkato, a huge marketplace in the city, swarms with shoemakers, wholesale shops dealing in leather, soles, and shoe accessories, and shoe retail stores (Adeya 2006). Sonobe, Akoten and Otsuka (2007) selected randomly a sample of 100 large, medium and small firms in this cluster in order to analyze its development.

Eighteen enterprises only in the sample were managed by second-generation entrepreneurs. The fact that the majority of the enterprises were new also indicates that only a small number of enterprises could survive in the face of intense market competition.

Van der Loop,(2003) selected also in Merkato 42 enterprises composed of different footwear manufacturers and shops, such as large, medium and small-scale footwear producers, as well as shoe shops. He found that horizontal linkages, or cooperation among similar types of enterprises, are rather weakly developed among footwear enterprises.

Seventy percent of the sampled firms do not undertake any joint purchase of raw materials with similar firms. In general terms, footwear enterprises have rather weak vertical linkages.

A minority of enterprises (29%) sometimes works jointly with other footwear enterprises in the form of receiving contracts or giving contracts, in particular capacity.

The remaining enterprises do not work jointly at all, due to various reasons: they want to operate independently (47%), they do not have the trust (23%), there is no need for it (18%), or they are not aware of the possibility of joint work (12%). The first two reasons given (totalling 70%) are both pointing to a lack of trust in each other. The lack of trust among entrepreneurs seems to be an overriding argument.

In Kenya, McCormick (2001) found that firms belonging to the textiles cluster undertake “production process”, while other activities such as design, procurement, and marketing are undertaken by firms located in developed countries. Those firms operate at the lower level of the garment chain.

### **Adaptation of the Models to the Economic Environment of SSA Countries**

Within any SSA country, three parallel economies live side by side, the informal, the formal and the international oriented economy. (Exhibit1).

The informal economy, employs more than 80% of the manpower in thousands of SMEs supplying basic products and services to the local market, from farming products, food, furniture, shoes, clothes, to transportation or trade.

The majority of those small businesses have been launched by people that cannot find jobs otherwise (Rosa, 2006).

They are poverty and subsistence driven and mainly want to earn just enough to live (Frese and De Kruif, 2000) (Olomi, 2001; Rutashobya, 1995; Toroka and Wenga, 1997). The greater the poverty, the more necessity business there is (Reynolds et al., 2001) (Rosa, 2009).

This is confirmed by Mitchell's research (2001) on entrepreneurship in South Africa: 38.7% open a business for survival purposes and 20.2% because they were unemployed and did not find any other job.

Nearly all of the poorest interviewed by Olomi (2001) in his research appeared “trapped” by their incapacity to find the time to earn a sufficient surplus to invest in a new business. Evolution from economic necessity appears to be rare (Olomi 2001). It is still unknown when and how entrepreneurs decide to grow and what triggers the desire to grow (Dunkelberg and Cooper (1982), Kolvereid (1992), Kolvereid and Bullvag (1996) and Kurantko et al. (1997).

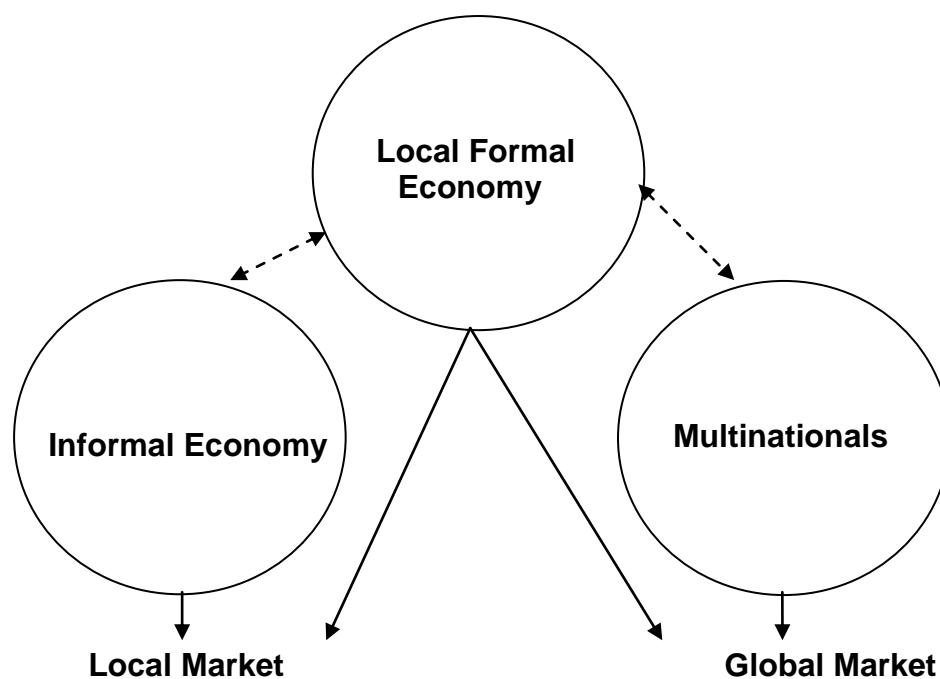
The issue is how to support those thousands of SMEs in order to achieve motivation which characterizes business entrepreneurship (Schumpeter, 1934; Davidsson, 1989, 1991).

The formal local economy consists of firms of different size working in agriculture, industry, trade and many other services, such as banking, construction and telecommunications.

Formal local firms mainly supply the needs of the local wealthier population and partially supply the needs of the international customer (mainly exporters of agribusiness products). They are beyond the level of subsistence, but they require infrastructural support such as relevant research, technological transfer, education and training services in order to grow.

The multinationals and the international firms, supply the needs of the local and the international market. Some firms produce and sell mass products to local customers (soft drinks, ice cream) or high-end products to the wealthier population (cell phones, computers). Others buy coffee, cocoa, crude oil, minerals or rubber in SSA countries.

*Exhibit 1: The Current and Potential Links between the Three Economies in SSA Countries.*



### **The incubator versus the open incubator and SMEs in the informal and formal economy**

The management and the experts in an incubator support 20 to 30 SMEs. A SSA country has a limited number of experts and so, can open very few incubators.

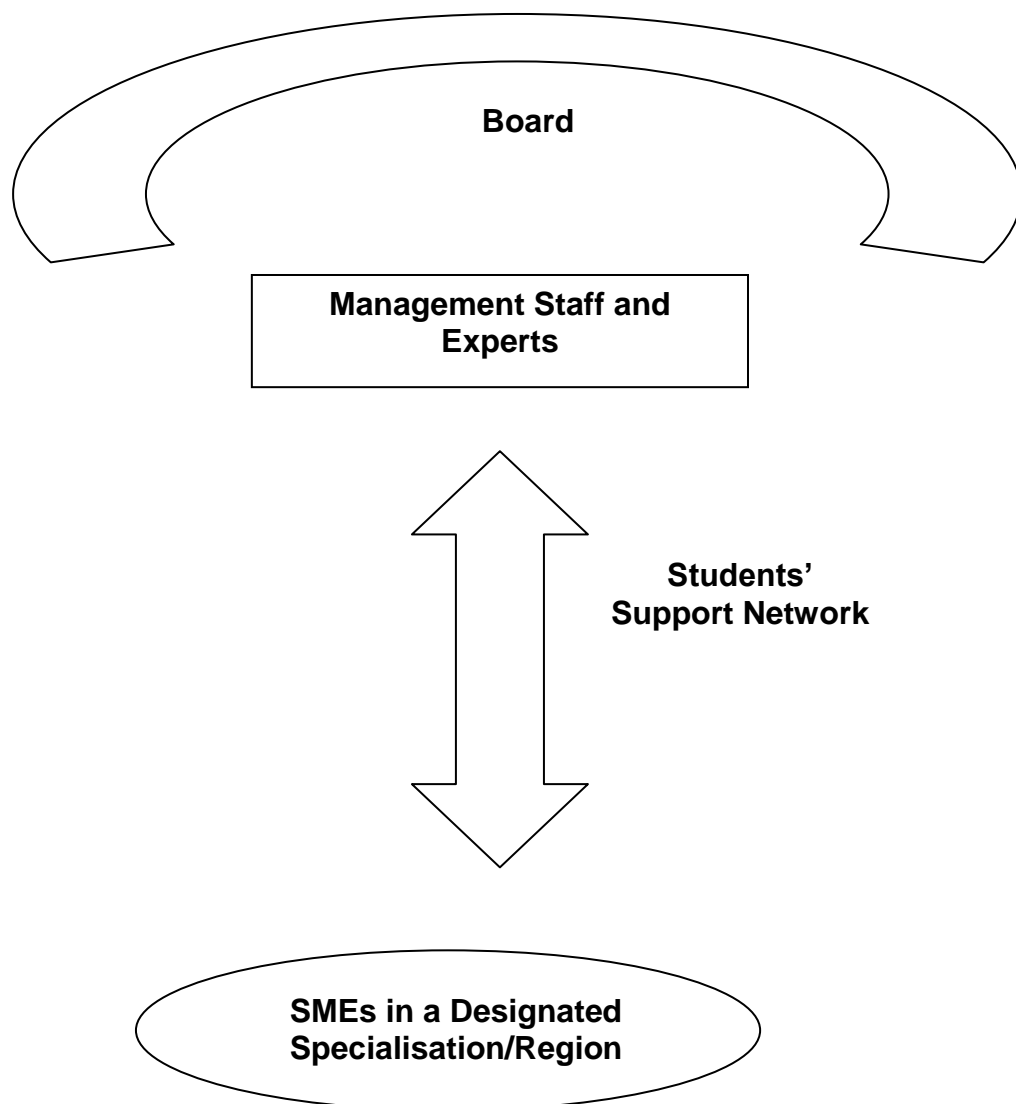
Support to thousands of SMEs from the informal and the formal economy is required in order to generate economic development of sectors or regions. The "closed" incubator cannot support thousands of SME's but the "Open" incubator can.

The study propose make available the services of incubators to thousands of scattered SMEs in the informal and formal economy in a specific region and creating regional open

incubators (Exhibit 2). In this way, the limited number of experts will serve a larger number of SMEs.

In order to overcome both problems, that is, the lack of business knowledge of informal SMEs on the one hand and the limited available number of experts, on the other, the study propose to establish a network of students who would be responsible for presenting the SMEs' requests and reporting on their business progress to the managers and experts of the open incubator as the final project of their studies. One student can support 5 SMEs, and 100 students, 500 SMEs.

*Exhibit 2: The Open Incubator Model*



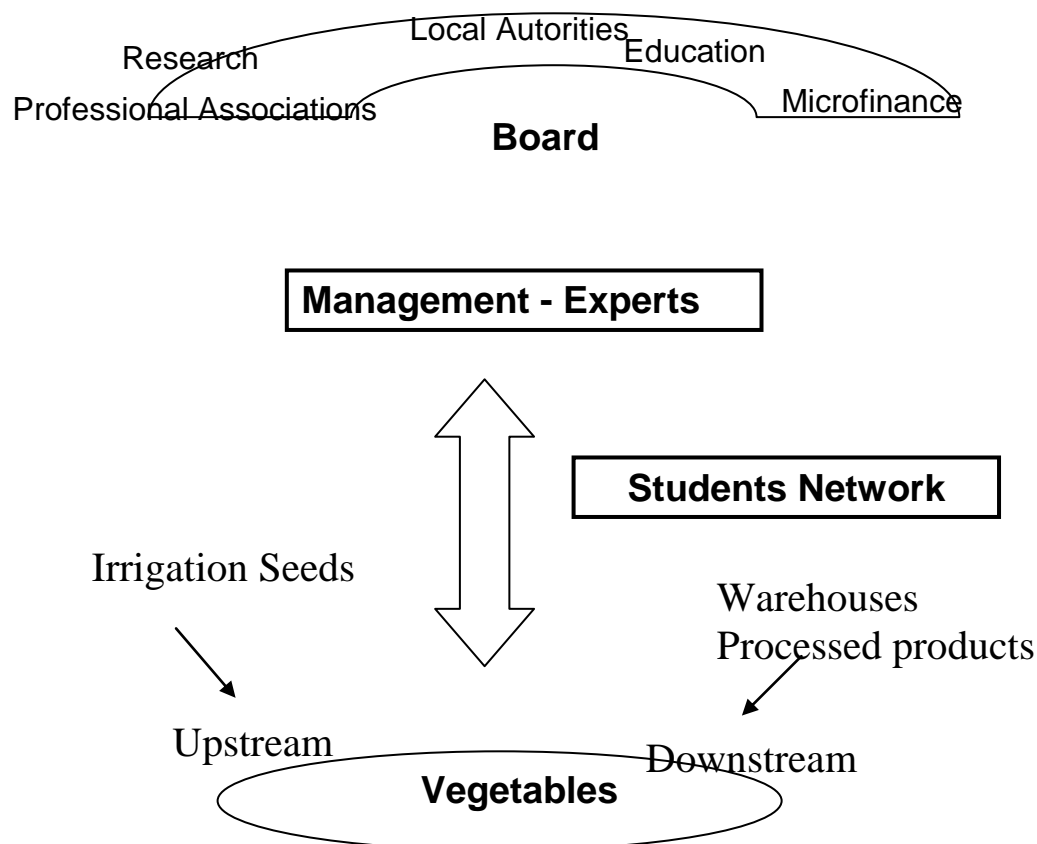
The students would thus acquire experience; some might even become employees or partners in the SME they support. Students specializing in business management, agriculture or any technical field could be a part of this supporting student network. Their task would be to support the SMEs in improving their business efficiency and pass subsistence level.

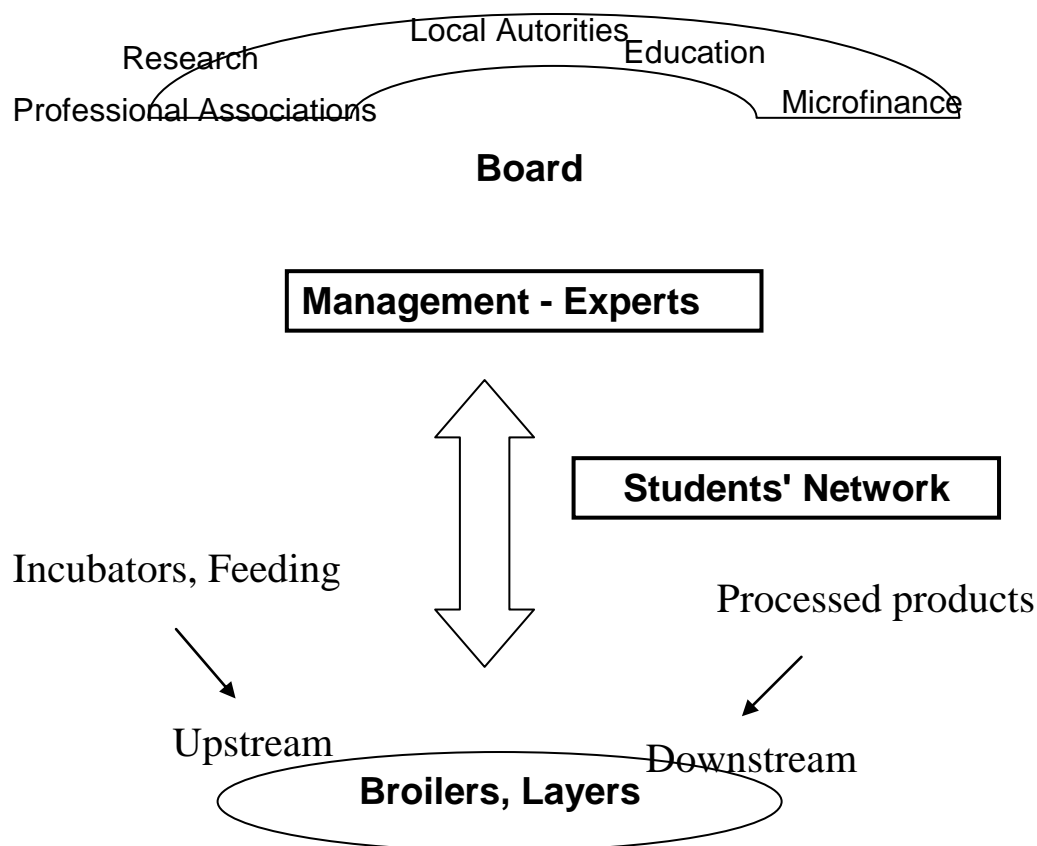
Each incubator will have its own specialization and will support SMEs related to it. The objective will be to create the critical mass of SMEs required in order to generate economic growth in the different economic sectors.

The proposed Open Incubator model can support the formalization process of thousands of firms. The board of the open incubators, in order to be integrated in the sector and the region, will represent the different economic forces, local authorities' suppliers of research, education, technological transfer, finance, management and marketing services.

Hereafter is presented ( Exhibit 3,4) the case of poultry and vegetable sectors in which SMEs could be supported by the open incubator upstream and downstream of the production of chicken , eggs and vegetables. .

*Exhibit 3:Open Incubator in vegetables*



*Exhibit 4: Open Incubator in Poultry*

### The Progressive model, from Open Incubators to Industrial Districts and Clusters

Specialized open incubators will open the ground for the development of existing and new institutions and organizations, supplying technological and managerial knowledge. In such a way, the open incubators could be transformed into industrial districts

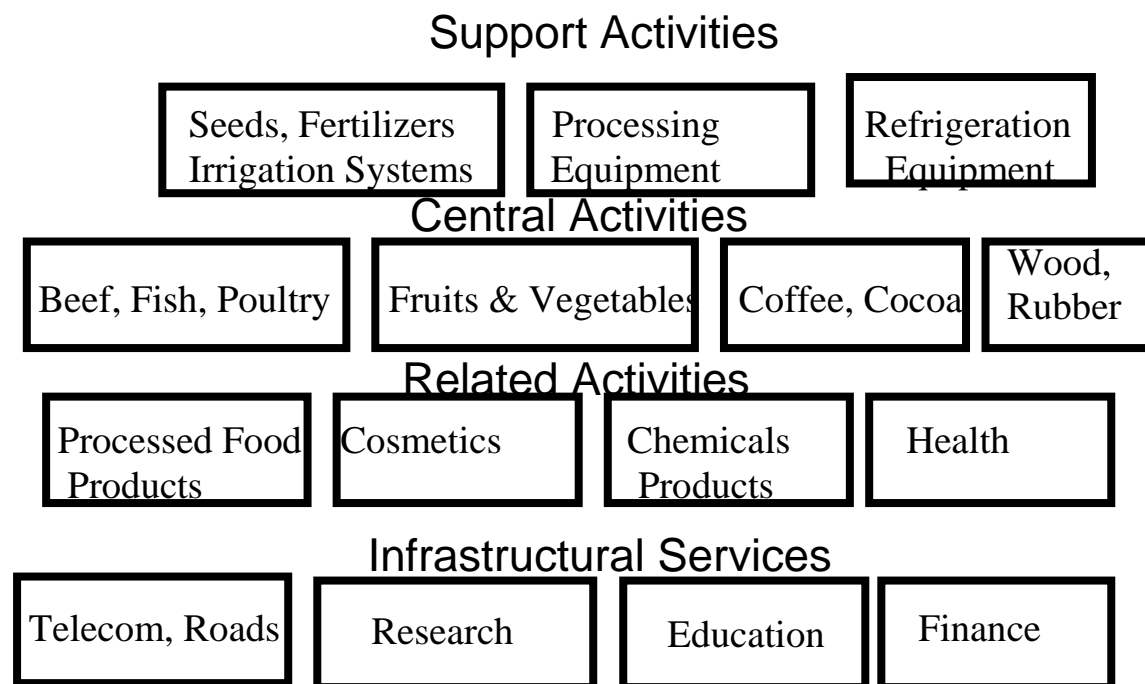
In order to become a cluster, an industrial district needs, an economic driver able to generate synergic development. National or local authorities can be the economic driver and decide to generate for example an agricultural cluster around main activities such as meat, fish, crops, wood, rubber, and minerals (Exhibit 5). Upstream, they will promote support activities such as seeds, feeding, processing equipment, post harvest and refrigerating equipment. Specializations downstream such as processed food, cosmetics and chemicals will be generated.

The infrastructural activities such as research, education and finance will grow according to the evolution of the cluster.

Large local and international firms, working in the SSA countries could be the co-partner of national authorities and also play the role of economic driver.

Nestlé, as a basic philosophy decentralizes its production in order to adapt the products to customer taste in each country (see website). Nestlé has 95 plants in Europe, 74 in North America, and five only in Africa. Its production is limited to basic Nescafé, Maggi soups using starch from cassava. The other products are imported. Nestlé don't invest more in Africa because of better business opportunities in other regions. Nestlé has the relevant technologies in order to process cassava, coconuts or maize and to sell to the local market in SSA countries. But the market is limited due to low level of income of consumers.

*Exhibit 5: SSA Cluster in Agribusiness*





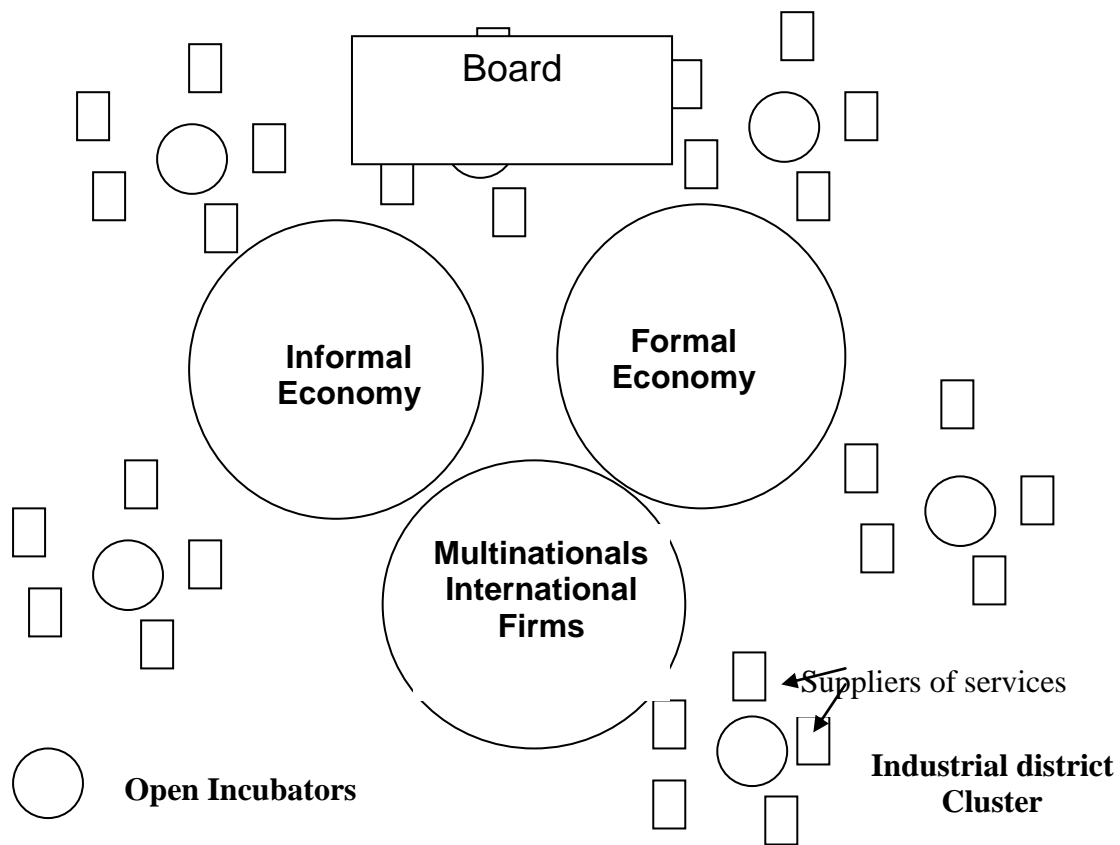
Coca Cola has also plants in SSA countries and sells soft drinks, but produces no local drinks based on coconuts, coffee or cocoa for similar reasons as Nestlé.

Michelin imports from SSA countries rubber but does not produce tires in any SSA country. The reasons are that most customers are in developed countries and that the industry is capital intensive. But if it is feasible to produce tires in China and even in a small country like Israel, it should be possible to do so in SSA countries. Better business opportunities exist in other countries than SSA countries.

In order to convince companies as Nestlé, Coca Cola or Michelin to be an economic driver in the development of clusters, the economy of SSA countries has to be more attractive than others.

The economic development of SSA countries requires a progressive approach (Exhibit 6).

Open incubators help to formalize a part of the informal economy and to strengthen the SMEs in the formal economy. Support services initiated by local authorities around each open incubator transfer the relevant knowledge to SMEs in order to achieve sustainable economic growth. This positive development in the economy will attract large local and international companies to invest in a growing economy and to be economic drivers in the development of clusters.

*Exhibit 6: The Process Model towards SSA Industrialization*

Hereafter, the study presents the results of a research it launched in three sectors in Cote d'Ivoire, in order to check the feasibility of the Progressive model starting from open incubators to clusters initiated and generated by national authorities and large local firms.

### **Implementation of the Process model in Cote d'Ivoire**

The IMF last report (IMF, 2009) suggests a Poverty Reduction Strategy for Cote d'Ivoire. But 0.07% of the financial support only is allocated to SMEs, 0.7% to the private sector and 0.8% to human capital.

This report is based on secondary official Ivorian information sources such as, the national planning committee, CNPRA (Comité National de Pilotage du Redéploiement de l'Administration), the Ministry of Agriculture and Animal Resources, or Ministry of Economy and Finance, or international sources such as UNDP or UEMOA.

The report uses a macro economic top down approach and does not deal with the basic problem of the integration of the informal economy, mainly composed by SMEs. The progressive model discussed and proposed here is bottom up oriented and based on a cooperation between the national and international authorities and the economic forces:

farmers, growers, cooperatives, traders, large and small local or international firms, service suppliers, professional associations and research centers.

The interviewed representatives of national authorities, the Ministry of Industry and SMEs and of the Ministry of Planning requested us to concentrate our research on the sectors contributing to both agriculture and the industry.

The study selected the following sectors in order to check the feasibility of the Progressive Model:

- Fruit and vegetable processing (pineapple, mango, and other exotic fruits): southeast region. Main city – Abidjan
- Textiles (cotton, jute, silk): northeast region. Main city - Bouaké
- Wood processing and products (plywood, peeled veneers, windows, doors, furniture): southwest region. Main city - San Pedro

In each sector, the study interviewed large local and international firms, local authorities, and professional organizations in order to ascertain their capabilities for contributing to the development of the open incubators, the industrial districts and the clusters.

The study used a questionnaire divided into three sections:

- Section I: Firm's / organization's activities
- Section II: Present and planned activities with SMEs
- Section III: Barriers to the development of SMEs

### **Support infrastructure**

The study interviewed organizations offering three kinds of support—technical, financial, and marketing.

They included FDFP (Fonds de Développement et de Formation Professionnelle), the Chamber of Commerce and Industry and FIDI (a fund for SMEs). The study collected information also about the research centers (CNRA).

### **Fonds de Développement et de Formation Professionnelle (FDFP)**

The FDFP is a public training organization funded by the employees in the public and private sector. Membership is compulsory for the public sector and state owned industries: the membership fee amounts to 0.5 percent of the total wage bill plus an additional tax for on-going vocational training (1.5 percent) (AfDB/OECD, 2008).

The FDFP also administers other funding earmarked for vocational training entrusted to it. Its tasks relate to financing, monitoring and evaluation of in-service training plans and projects. The FDFP provides in-service training with the support of partners.

The FDFP hardly works with the informal economy and SMEs because they are not able to pay for their membership fee. But it is able and ready to launch training programs for SMEs if initiated by national or local authorities.

### **FIDI ( Fonds ivoirien de développement et d'investissement)**

The FIDI is a fund for the development of and investment in SMEs. This fund works mainly with very small enterprises.

The main bottleneck of its activities is the lack of business knowledge of its potential beneficiaries and the difficulty they encounter to invest the loan into the planned direction. Oftentimes, the survival needs are stronger and loans fund current basic needs and even the marriage of relatives.

### **Chamber of Commerce and Industry**

All the firms in the formal sector are members of the Chamber of Commerce and Industry. Today the chamber supports its members through international exhibitions, training programs and specialized services such as warehousing and the weighing of coffee at the port of Abidjan. But this organization is capable and ready to launch, in cooperation with the local and national authorities any development program supporting the different economic sectors. They can contact at any time all the few thousand formal companies in Côte d'Ivoire.

### **CNRA**

CNRA, Centre National de Recherche Agronomique de Côte d'Ivoire (see website) support the agriculture related research activities in Côte d'Ivoire. Created in 1998, CNRA has representations all around the country. The cotton research center is in Bouaké, close to the selected textile firms and employs 9 research workers. The fruit research center in Bimberesso employs 10 research workers. Its main activity is on banana and pineapple. The forest and environment research center in Abidjan employs 8 people and is mainly working of the management of forest and forest seedlings production.

The firms we interviewed in the three selected sectors did not benefit of any of the research work implemented by their respective research center. The researchers work in a closed environment and have very few contacts with growers or firms.

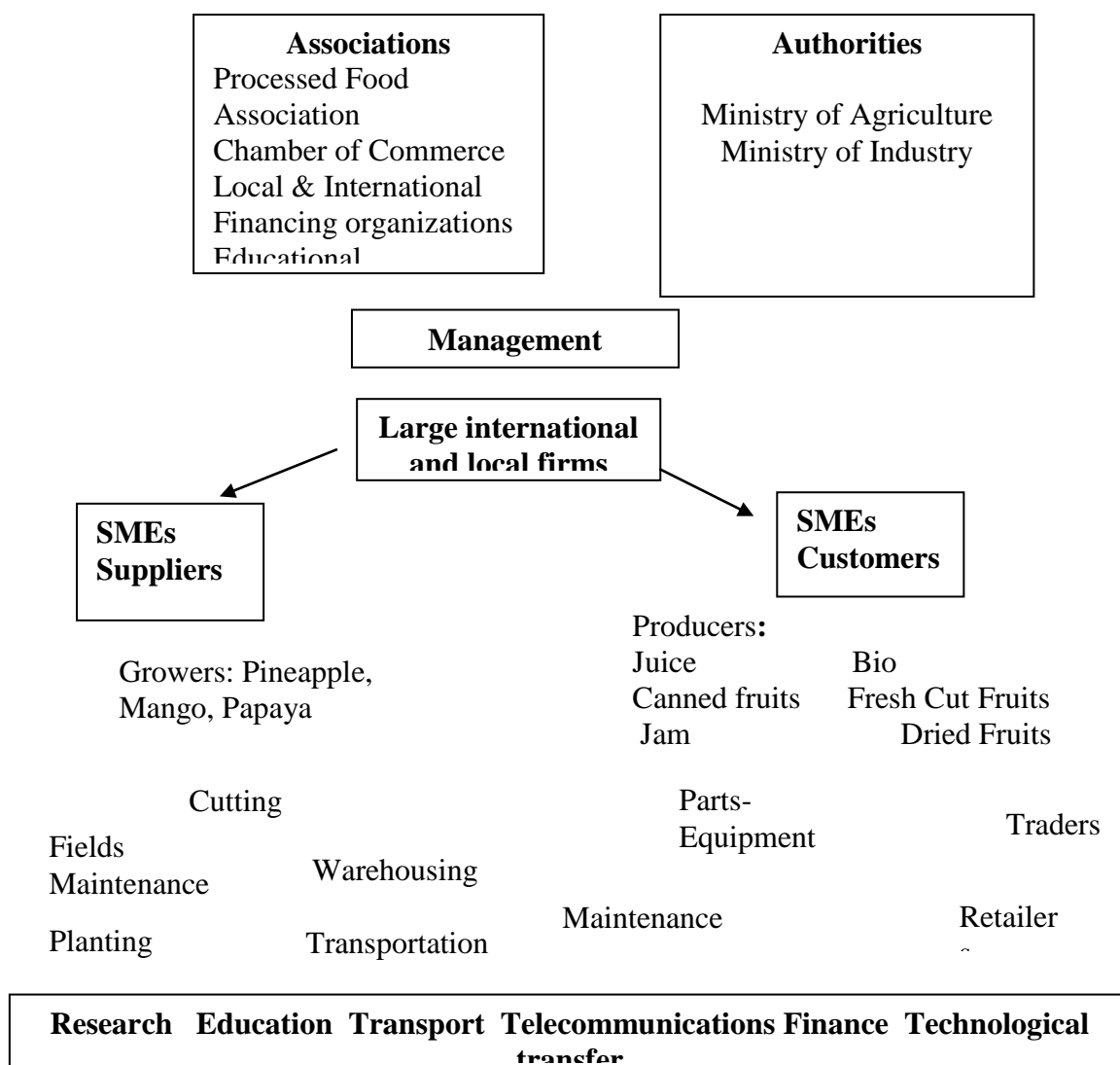
### **Process model in Abidjan-Thiassalé (Southeast) – Fruit and vegetable processing (see Exhibit 7)**

In this area, we interviewed, one dominant international company, SAFCO (juices) at Thiassalé and one medium-sized company, Confipral (juices and jam) at Abidjan. SAFCO, a leader in pineapple juice, is owned by foreign investors, who have production units in other developing countries and lead the marketing process using their own marketing infrastructure, mainly in Europe. SAFCO exports pineapple juice in bulk (thousands of liters), because there are no packaging services in the region.

This company utilizes only 50 percent of its production capacity. The reason is the lack of efficient and reliable supply networks of raw materials. In parallel, at the growers' level, more than 50 percent of the fruit is wasted and the rest sold or processed. This situation opens opportunities for SMEs, able to supply upstream fruits and vegetables to processing companies, and downstream if able to transport and sell the processed fruit.

SAFCO expressed its interest in cooperating and even in creating joint ventures with SMEs specialized in the supply of fruits and vegetables, transportation, packaging, and processing based on fruit juice/fruit extracts (jam, ice cream).

*Exhibit 6: Process model in Abidjan District - Fruit and Vegetable Processing*



SAFCO cannot improve the range of its products in order to enter the second generation with bio products and fresh cut packaged products. The main reasons are a lack of growers able to produce bio fruits and the large investment required for a "clean" room

The second generation of products requires SMEs or joint ventures between existing companies specialized in the construction of "clean" rooms and aseptic packaging (for fresh cut products) and SME growers specialized in bio fruits (bio products).

CONFIPRAL, a family-owned company emphasized the importance of the local and regional markets that can be developed, if a network of SMEs supports it upstream by providing transportation of raw materials; and downstream by providing marketing services in order to supply the local and sub regional demand.

Research centers (ITT), educational and training programs (FDFP), transfer of technologies and extension services (ANADER, Agence Nationale d'Appui au Développement Rural) exist in this agribusiness sector, but they have to improve their knowledge in bio culture for example in order to transform the open incubator in fruit and vegetable processing into an Industrial District and a cluster.

### **Process model in Bouaké District - Textiles (Exhibit 7)**

The study interviewed the dominant state-owned producer of cotton fabric, Ivoire Coton; the largest international private producer of cotton spinning and fabric, Cotivo and CIDI (Compagnie Ivoirienne pour le Développement des Textiles); two medium-sized private producers of cotton and silk spinning, and two cooperatives specializing in textile products, Women's Clothing Cooperative and Printed Arts Cooperative.

Knowledge regarding local and international markets is very limited in both private and state-owned firms. In privately owned firms, market knowledge is in the hands of the owners and not the managers. In state-owned companies, the business focus is on production, and the managers depend on the marketing experience of large traders. Diversification has occurred in four main spheres: cotton spinning, printed textiles, jute bags, and silk spinning.

Export is mainly oriented to Asian markets (Taiwan, Thailand, and Indonesia). The competitive advantage based on local raw materials and low-cost labor is eroded by international competition from other developing countries from Asia and North Africa. Unbleached textiles are no longer profitable.

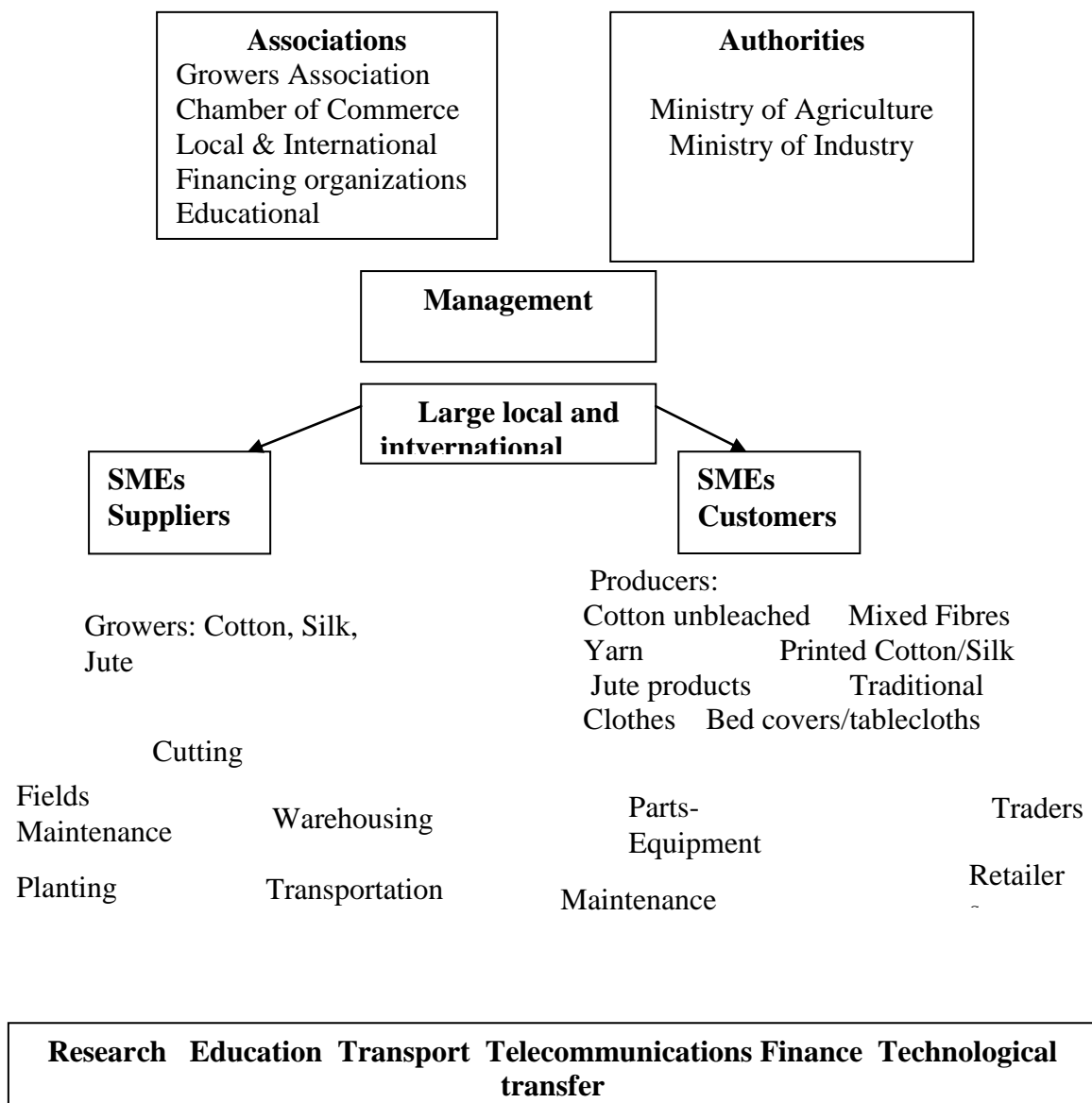
North African countries compete not only on the European market but also in the Ivorian market. At the beginning of the season, North African companies concentrate their activity in the European markets. At the end of the season, they cut their prices and sell their product in the Ivorian market below even the cost of production of local companies. Challenger, a local producer of clothing (jeans), puts pressure on Cotivo to reduce the price of its cotton fabric, which in turn pushes down Cotivo's profits (that today have become losses).

SMEs can develop new design for the local and sub regional markets of clothes (traditional clothing) and textile products (bed covers, tablecloths, curtains). In addition, jute products have a large domestic market in the packaging sector (coffee, cocoa), as well as potential markets in neighboring countries. Numerous SMEs could derive economic advantages in these two fields.

SMEs could produce or repair spare parts for textiles equipment

The interviewed firms expressed their interest to train and support SMEs willing to enter the textiles products market.

*Exhibit 7: Process Model in Bouaké in the Textile Sector*



In the textile sector, there is no similar support infrastructure as in agro business. They have to be created by local and national authorities in order to develop the open incubators into Industrial Districts and Clusters.

### **Process model in San Pedro district: Wood processing (Exhibit 8)**

The study interviewed Thanry, the dominant private producer of plywood and sliced veneers, and IGD, a medium-sized firm.

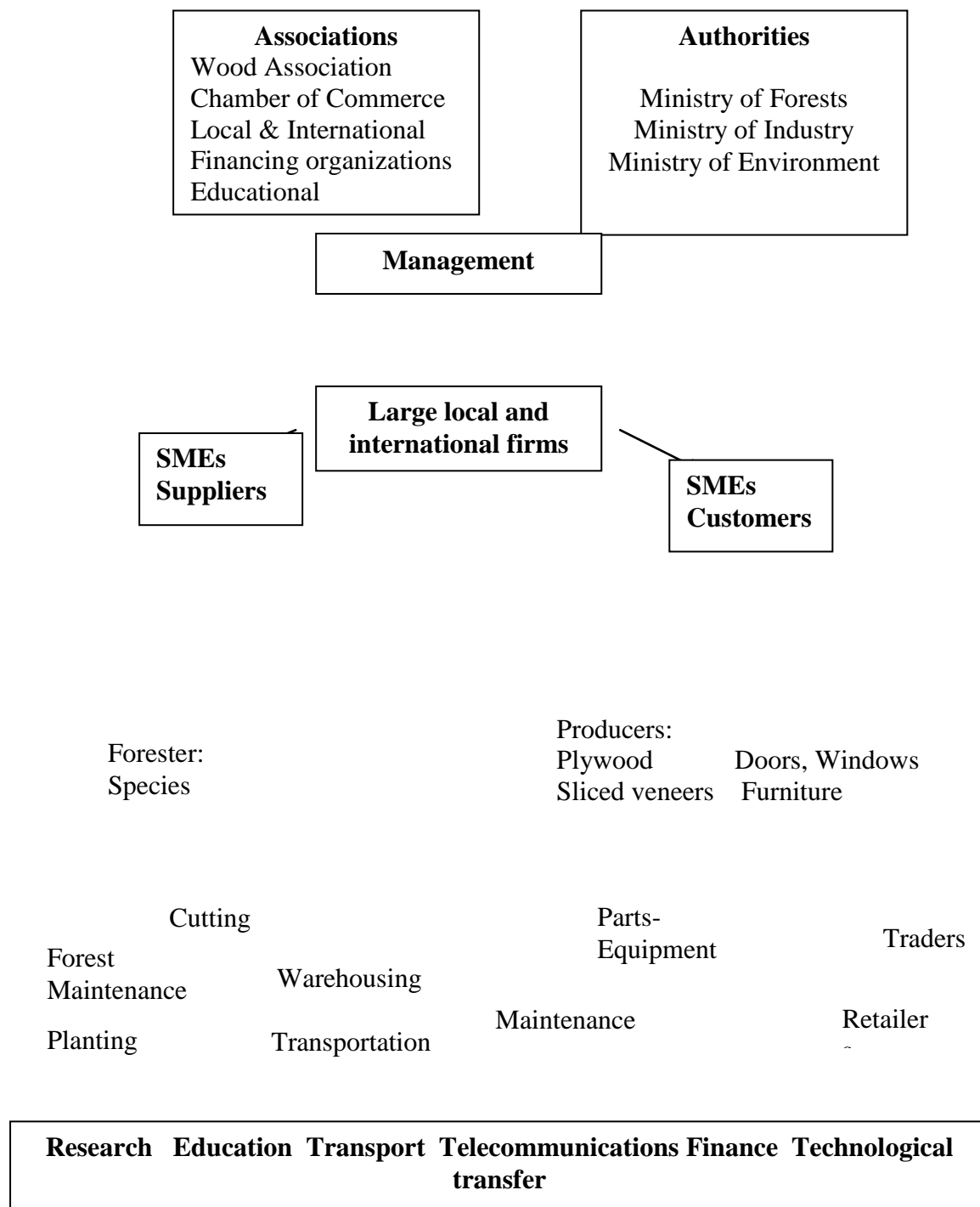
Villagers cut trees in order to clear arable land and plant corn for their own consumption. Large timber companies cut trees in order to supply raw material for the international market. The deforestation process creates environmental and economic problems. Wood is more expensive due to higher local taxes. There is room for the creation of SMEs that would maintain forests through planning and cutting trees at the right time.

Both companies interviewed produce peeled veneer, sliced veneer, plywood and basic wood products, all at a low level of added value. The end customers are unknown to the companies. They use traders to sell the products.

The few tentative attempts at diversification—such as the production of curtains and wooden swimming pool and sauna appliances—have failed. Few SMEs cooperate with these companies downstream, because the local customer cannot afford dried wood products.

The wood sector is threatened by the prospect of de-industrialization due to the limited wood supply and the high taxes levied in Cote d'Ivoire as compared to countries such as Guinea. However, large firms such as Thanry or IGD are willing to support the development of SMEs by providing them with their experience and even the opportunity to use their equipment to produce new products based on dried wood such as doors, windows or furniture. These products are mainly made today of wood, which is not dried enough and therefore, have a shorter shelf life.



*Exhibit 8: Process Model in San Pedro District in the Wood Sector*

While the wood sector needs to diversify, the fact that the market knowledge available to the large companies is limited hampers the identification of business potential.

As in agro business, the wood sector has no similar support infrastructure. It has to be created by local and national authorities in order to develop open incubators into Industrial Districts and Clusters.

A process model starting with an open incubator in San Pedro will act as a bridge between large companies and SMEs by improving the transfer of technical and marketing knowledge between the large firms and themselves and between local, sub-regional and international markets.

## Conclusion

In the three selected sectors of Côte d'Ivoire, the large local and international companies interviewed expressed their willingness to cooperate with national and local authorities, in order to create open incubators supporting SMEs upstream and downstream of their business activities. This attitude is positive for their long term business interest and for the economic development of the sector. Those open incubators could improve the contribution of the informal economy to the development of the selected sectors.

\*The proposed process model starting with numerous specialized and regional open incubators can be the starting point for the development of a critical mass of SMEs in each sector, thereby ensuring sustainable growth. Local and national authorities could use part of the IMF support and taxes collected from this new economy, in order to invest in infrastructural services and develop industrial districts which will attract large local and international enterprises to joint efforts in order to generate clusters.

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## THE EFFICIENCY OF ITALIAN BANKRUPTCY PROCEDURES: AN EMPIRICAL ANALYSIS

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### Abstract

The importance of efficient bankruptcy procedures is widely recognized and the consciousness of the possible costs due to inefficient procedures has induced several European countries to introduce reforms of their systems in order to improve the efficiency.

The early Italian bankruptcy act was promulgated in 1942; its main goal was the punishment of the inefficient debtor and the protection of interests of creditors. In this context, the interests of the debtor were not taken into account and the creditors were merely participants in a compulsory proceeding in which they played a marginal role. Recently, the Italian bankruptcy act was modified in order to avoid inopportune liquidation of firms, trying to safeguard the value of firms, and to reduce time of liquidation as well as costs of bankruptcy procedures.

The focus of the paper is the analysis of ex post and ex ante efficiency of the Italian bankruptcy procedures.

The analysis of ex post efficiency is based on official statistical data annually published by the ISTAT (the Italian Office of Statistics), investigating: direct and indirect costs of bankruptcy procedures; average ratio of claims reimbursed to the creditors; length of bankruptcy procedures. The period investigated is 2000-2007.

The analysis of ex ante efficiency is based on two non-paired samples of failed and non-failed firms, investigating their financial statements of 2003-2008.

The main expected result is that the Italian bankruptcy procedures are not efficient both in an ex post and in ex ante perspectives.

**Keywords:** Bankruptcy procedures; ex ante efficiency; ex post efficiency; costs of bankruptcy; length of bankruptcy; failed and non-failed firms.

### Introduction

The importance of efficient bankruptcy procedures is widely recognized. The consciousness of the possible costs due to inefficient procedures has induced several European countries to consider reforms of their systems in order to improve their efficiency and effectiveness.

The early Italian bankruptcy act was promulgated in 1942 and only recently (2005) the Italian parliament introduced some innovations. The demand for reform arises from the

perceived inefficiency of previous bankruptcy procedures, the main limits being the following (Marcucci, 2000):

- a) Limited protection of the value of the firm;
- b) Excessive punishment for debtors, reducing the incentives to initiate the procedure in good time;
- c) Complexity, excessive length and high costs of the procedures.

Most of these limitations were a consequence of the limited scope of previous bankruptcy legislation, essentially intended as a mean to expel firms from the market.

Coherently, the main objective of the bankruptcy procedure was the punishment of the inefficient debtor and the protection of interests of creditors (respecting the absolute priority rule). In this context, the interests of the debtor were not taken into account; moreover, the creditors were merely participants in a compulsory proceeding in which they played a marginal role. Nevertheless, procedures were generally characterized to a small average rate, because only a small percentage of claims of creditors were reimbursed.

In 2005 (and in other decrees of 2006 and 2008), different innovations were introduced; their main aims are commented below.

1. Bankruptcy procedures should avoid inopportune liquidation of firms, trying to safeguard the value of firms. As a consequence, bankruptcy law lose its initial punitive aspect, considering insolvency as a physiological stage in the life cycle of entrepreneurship; then, if there is a concrete possibility of re-starting the activity, legislation should help firms to manage this phase, considering liquidation as an extreme solution.

2. Bankruptcy procedures should reduce time of liquidation: if a firm is insolvent, it is important to sell rapidly its assets in order to pay debts, because if the procedure takes on more time, the value of assets could reduce.

3. Bankruptcy procedures should reduce costs of bankruptcy procedures, in order to avoid that a great percentage of money derived from the liquidation of assets could be absorbed by the procedure itself, reducing the average ratio of claims reimbursed to the creditors. Moreover, Italian legislation should exempt or prescribe simplified procedures for small debtors.

Moving from these aspects, the focus of the paper is the analysis of the efficiency of the Italian bankruptcy procedures by comparing empirical data before and after the introduction of the above-mentioned reforms; more specifically, the paper analyses ex post and ex ante efficiency (Cornelli and Felli, 1996):

– The analysis of ex post efficiency will be based on official statistical data annually published by the ISTAT (the Italian Office of Statistics); the variables investigated will be: direct and indirect costs of bankruptcy procedures; average ratio of claims reimbursed to the

creditors; length of bankruptcy procedures. The period investigated is 2000-2005 and 2006-2007 (i.e. before and after amendments of Italian bankruptcy act);

– The analysis of *ex ante* efficiency will be based on two non-paired samples of failed and non-failed firms, considering their financial statements of 2003-2008.

The paper is articulated as follows. After a brief review of the literature (see Section 2) and the specification of the research questions, Section 3 introduces empirical analysis, while Section 4 analyzes results and draws some conclusions, also clarifying the limitations of the study and suggesting improvements for future researches.

## Literature Review and Research Questions

Literature concerning efficiency of bankruptcy procedure distinguishes two profiles.

The first one concerns *ex post efficiency*: in this case, the legislation should provide tools which affect variables such as costs of bankruptcy procedures, average rate of claims reimbursed to the creditors and length of bankruptcy procedures.

Costs can be articulated in direct and indirect.

While direct cost are relatively easy to calculate, concerning all the expenses originated during the procedure, indirect costs are very hard to estimate: a possible methodological approach could take into account the ratio between the average rate of claims reimbursed to the creditors and the total amount of debts of failed firms. There are numerous papers which investigated the costs of bankruptcy and reorganization procedures; these studies prevalently were based on samples of US firms, analysing direct and indirect costs of Chapter 7 and Chapter 11 (see: Warner, 1977; Ang *et al*, 1982; Altman, 1984; Lawless *et al*, 1994; Anderson and Betker, 1995; Betker, 1995; Lawless and Ferris, 1998; Bris *et al*, 2006; Hotchkiss, 1995; Lubben, 2000). Unfortunately, the evidences are contradictory: some authors consider the costs of procedures to be high; others consider costs to be low.

Anyhow, the main aim of bankruptcy (and reorganization) legislations should be the reduction of both direct and indirect costs, in order to avoid that procedures absorb a lot of resources that are subtracted to their natural destination: the payment of all debts. As a consequence, the average rate of claims reimbursed to the creditors represents another important variables in analyzing *ex post* efficiency.

Another classical parameter used in estimating *ex post* efficiency is the length of bankruptcy and reorganization procedures, which represent the main “Achille’s heel” of the Italian legislation.

Obviously, the variables mentioned above (direct and indirect costs; rate of claims reimbursed to the creditors; length of procedures) are mutually connected (for example, if the time of a procedure increases, the relative costs should also increase and *vice versa*); as a

consequence, they will be jointly analyzed in order to gain a better understanding of ex post efficiency of the Italian procedures.

The research questions concerning the analysis of ex post efficiency are:

*Does the Italian legislation (before and after its modification) minimize direct and indirect costs of bankruptcy procedures, ensuring a great rate of claims reimbursed to the creditors?*

*Does the Italian legislation (before and after its modification) guarantee rapidity of bankruptcy and reorganization procedures?*

The second profile of the investigation concerns *ex ante efficiency*. While there are different studies which analyses ex post efficiency of Italian bankruptcy procedures (see, for example, Barontini, 1997), there are few researches that investigate ex ante efficiency.

This paper tries to study ex ante efficiency by adopting a peculiar approach which benefits from methodological approaches adopted in forecasting models for default risks (even if the goal of the paper is not to discriminate between healthy and unhealthy firms but also to demonstrate the substantial delay in commencement of a bankruptcy procedures).

The methodological approach used in this paper is based on an empirical analysis of two non-paired sample of failed and non-failed firms; more specifically, firms for which a bankruptcy petition has been submitted compose the latter sub sample but the court did not order relief, rejecting the petition. The aim is to understand if these non-failed firms were or not in a state of insolvency. In more detail, we think that the economic and financial conditions of these firms are substantially equivalent to those of failed firms; as a consequence, court should order relief (i.e. the failure of firms should be declared).

The research questions concerning ex ante efficiency is: *if non-failed firms have the same negative performance and the same liquidity and financial problems of failed firms, why court does not order relief? (In other words, if these firms were insolvent, why a court does not declare their failure?)*

If the Italian legislation provides incentives for managers and/or creditors, one of the main implications could be a timely commencement of a reorganization or liquidation procedure, with the aim of protecting the value of the firm (or maximizing the proceeds for creditors).

On the contrary, if the Italian legislation does not provide for any incentives, the debtor does not have any stimulus for a timely commencement. As a consequence, court could not promptly order relief, with the effect of postponing a bankruptcy procedures and reducing the value of the firm.

We expect that there are not significant differences between failed and non-failed firms. If this is the case, we can infer that the bankruptcy procedures prescribed by the Italian legislation are not efficient in an ex ante perspectives. In addition, if the Italian legislation does not provided for any form of incentives for management (who should try to delay the



bankruptcy), the main consequence is also a reduction of ex post efficiency: bankruptcy procedures take on long time, are expensive and the rate of claims reimbursed are very low.

### **Empirical Analysis**

The empirical analysis is divided in two parts.

The first part (see par. 3.1) concerns the investigation of ex post efficiency and it is mainly based on official statistical data annually published by the ISTAT (the Italian Institute of Statistics). The aim of this step of the empirical analysis is to show some basic aspects of Italian bankruptcy procedures in order to understand the degree of ex post efficiency.

The second step (see par. 3.2) concerns ex ante efficiency and it is based on empirical analysis of two non paired sample of failed and non failed firms; as mentioned above, the latter sub sample is composed by firms for which a bankruptcy petition has been submitted but the court did not order relief. The aim is to understand if these non-failed firms were or were not in a state of insolvency.

#### **Ex post efficiency**

Ex post efficiency consists in maximizing the value of an insolvent firm; this objective can be reached by reducing time and costs of a bankruptcy procedure and by maximizing the percentage of claims reimbursed to the creditors.

As a consequence, the empirical analysis concerning ex post efficiency is based on the following variables:

- a)* Direct costs of bankruptcy procedures;
- b)* Indirect costs of bankruptcy procedures;
- c)* Average rate of claims reimbursed to the creditors;
- d)* Length of bankruptcy procedures.

The analysis concerns two periods; from 2000 to 2005 and from 2006 to 2007 that is before and after the introduction of new bankruptcy act, in order to compare the results.

Table 1 illustrates descriptive statistics of direct costs of bankruptcy procedures expressed in percentage of total assets.

Table 1: Direct costs of bankruptcy procedures

	Period (years)	
	2000-2005	2006-2007
<i>Mean</i>	0,2103	0,2295
<i>Std Error</i>	0,0042	0,0035
<i>Median</i>	0,2085	0,2295
<i>Std. Dev.</i>	0,0104	0,0049
<i>Variance</i>	0,0001	0,00002
<i>Min</i>	0,198	0,226
<i>Max</i>	0,226	0,233

The incidence of these costs does not change in the two periods examined (the average ratio is about 21% and 22% respectively).

Indirect costs are very difficult to calculate and in literature, authors adopted different approaches; in this paper, we express indirect costs by considering the percentage of claims reimbursed to the creditors and by calculating the ratio between this percentage and the total amount of debts of failed firms. Table 2 shows that the values of this ratio are substantially similar in the two periods we analyzed.

Table 2: Indirect costs of bankruptcy procedures

	Period (years)	
	2000-2005	2006-2007
<i>Mean</i>	0,8556	0,8545
<i>Std Error</i>	0,0052	0,0025
<i>Median</i>	0,858	0,8545
<i>Std. Dev.</i>	0,0128	0,0035
<i>Variance</i>	0,00016	0,00001
<i>Min</i>	0,838	0,852
<i>Max</i>	0,87	0,857

In addition, we can express the average rate of claims reimbursed to the creditors by comparing bankruptcy procedures characterized from a full payment of all debts and those showing only a partial reimbursement of debts (see Table 3). Italian legislation prescribes also other hypothesis (for example, a bankruptcy procedure could be substituted by a reorganization procedure), but they are not illustrated in the table because of their limited impact and their irrelevance with the aim of this study.

Table 3: Full vs. partial pay off of debts

	Period (years)			
	2000-2005		2006-2007	
	Full reimbursement	Partial reimbursement	Full reimbursement	Partial reimbursement
Mean	0,0315	0,4321	0,029	0,413
Std Error	0,0006	0,0062	0,002	0,01
Median	0,0315	0,434	0,029	0,413
Std. Dev.	0,0015	0,0152	0,0028	0,0141
Variance	0,000002	0,0002321	0,000008	0,0002
Min	0,03	0,414	0,027	0,403
Max	0,034	0,454	0,031	0,423

It is clear that creditors gain a full reimbursement of their claims in a small percentage of cases, showing a very low ex post efficiency of bankruptcy procedures before and after the modification of Italian bankruptcy act.

Finally, Table 4 shows the length of bankruptcy procedures; it is clear that the Italian procedures take on very long time (on average about 2.800 days). In addition, there are no substantial differences between the first and the second period we analyzed, even if the second period evidences a small increase.

Table 4: The length of bankruptcy procedures

	Period (year)	
	2000-2005	2006-2007
Mean	2722,8333	2999,5
Std Error	77,6103	35,5
Median	2754,5	2999,5
Std. Dev.	190,1056	50,2045
Min	2431	2964
Max	2923	3035

The results shows a limited ex post efficiency; however, if the results concerning costs of procedures and the average ratio of claims reimbursed to the creditors are substantially comparable with those of other countries, the result concerning the length of procedures are worse than those of other countries (see Caprio, 1997, p. 30; other comparative studies are: Franks *et al*, 1996; Blazy *et al*, 2010). Moreover, the new bankruptcy act of 2007 has not produced any improvements (even if a conclusive judgment requires the availability of data for a longer period of time).

### Ex ante efficiency

Ex ante efficiency consists in maximizing the proceeds to creditors from the reorganization of firms and providing incentives for the creditors to monitor the firm (Cornelli and Felli,

1996) as well as providing incentives to management to not delay a request for a reorganization or a liquidation procedure.

The analysis of ex ante efficiency is a very difficult task and it is not easy to understand the methodological approach suitable in a specific context.

In this paper, we propose a specific approach founding the analysis of ex ante efficiency on two non-paired sample of Italian failed and non-failed firms.

Firms whose bankruptcy procedures started in October 2009 compose the first sample. We choose this month because, in an explorative step of the research, we notice that the highest number of bankruptcy procedures characterizes October.

Firms for which a bankruptcy petition has been submitted compose the second sample but the court did not order relief (rejecting the petition) in October 2009.

The samples of failed and non-failed firms were formed using a database of the Italian “Osservatorio sulle crisi d’impresa” (see: [www.osservatorio-oci.org](http://www.osservatorio-oci.org)), a research team composed by university researchers and professionals as well as judges involved in bankruptcy procedures. This team organized a vast research involving 65 Italian courts (a representative sample of the population of all Italian courts; see Ferro and Di Carlo, 2010); we used this database by analyzing financial statements of all failed and non-failed firms (in the sense clarified above). More specifically, the analysis was based on the financial statements of failed and non-failed firms concerning five years before October 2009 (i.e. from 2003 to 2008).

Although many authors have highlighted (Lincoln 1984; McDonald and Morris 1984; Mensah 1984; McGurr and DeVaney 1998) that the analysis of a specific sector of activity leads to better results, in this case this distinction is not necessary, the aim being the understanding of the efficiency of bankruptcy procedures.

For each year investigated, we selected a limited number of ratios without taking into account their reciprocal links (in other words, we adopted an approach similar to univariate analysis; see Beaver, 1966). The ratios adopted are: Current assets to Current Liabilities (CA/CL); Quick ratio; Return on Equity (ROE); Return on Investment (ROI), because they are frequently used in forecasting model for default risks, to which we implicitly refer. We do not calculate leverage ratio because a great proportion of Italian firms have a high degree of leverage (as pointed out by different empirical researches; see, for example: Paoloni and Demartini, 1997; Aureli *et al*, 2004; Mussolino, 2006; Viganò, 2010); as a consequence, this ratio is not explicative in differentiating failed and non failed firms.

The tables presented below show the descriptive statistics concerning failed (F) and non-failed (NF) firms (the number in brackets indicates the number of observations for each year investigated).

*Table 5: Ratios of failed and non-failed firms: year 2004*

Year 2004		CA/CL		Quick ratio		ROE		ROI	
(F = 167)	(NF = 131)	F	NF	F	NF	F	NF	F	NF
Mean		24,787	1,524	0,730	0,919	-0,078	-0,232	0,029	0,022
Std error		10,674	0,224	0,037	0,093	0,086	0,105	0,011	0,018
Median		1,008	0,999	0,722	0,724	0,029	0,022	0,041	0,035
Std. Dev.		137,940	2,565	0,480	1,068	1,115	1,207	0,141	0,208
Kurtosis		35,436	58,855	26,899	23,012	39,955	36,683	19,131	33,641
Asymmetry		5,955	6,947	3,783	4,370	1,446	-5,464	-2,803	-3,797
Min		0,034	0,055	0,015	0,039	-7,190	-9,656	-1,006	-1,622
Max		1041,121	25,342	4,560	8,192	9,281	0,998	0,458	0,838

Table 6: Ratios of failed and non-failed firms: year 2005

Year 2005		CA/CL		Quick ratio		ROE		ROI	
(F = 182)	(NF = 138)	F	NF	F	NF	F	NF	F	NF
Mean		508,091	2,100	81,952	1,017	-0,657	-0,833	0,000	-0,028
Std error		506,806	0,857	81,155	0,188	0,271	0,622	0,028	0,020
Median		1,013	0,997	0,740	0,669	0,040	0,015	0,041	0,025
Std. Dev.		6837,189	10,068	1094,840	2,212	3,652	7,305	0,372	0,240
Kurtosis		182,000	129,682	182,000	54,587	90,027	123,904	139,814	29,432
Asymmetry		13,491	11,256	13,491	7,035	-8,767	-10,799	-11,168	-4,801
Min		0,149	0,000	0,010	-0,555	-41,412	-83,797	-4,681	-1,710
Max		92240,00	117,735	14771,00	20,417	0,980	12,965	0,512	0,413

Table 7: Ratios of failed and non-failed firms: year 2006

Year 2006		CA/CL		Quick ratio		ROE		ROI	
(F = 196)	(NF = 149)	F	NF	F	NF	F	NF	F	NF
Mean		10,842	2,167	1,655	0,961	-0,425	-0,755	0,010	-0,294
Std error		6,894	1,026	0,890	0,222	0,107	0,267	0,014	0,214
Median		1,012	0,991	0,711	0,677	0,018	0,002	0,033	0,022
Std. Dev.		96,510	12,527	12,458	2,708	1,502	3,256	0,201	2,617
Kurtosis		100,830	145,243	195,308	132,790	70,067	64,556	51,733	137,732
Asymmetry		10,025	11,987	13,963	11,253	-7,042	-7,344	-5,202	-11,548
Min		0,024	0,014	0,027	-0,006	-16,621	-32,449	-1,993	-31,417
Max		1063,737	153,104	175,025	32,882	0,705	3,158	0,637	0,723

Table 8: Ratios of failed and non-failed firms: year 2007

Year 2007		CA/CL		Quick ratio		ROE		ROI	
(F = 155)	(NF = 141)	F	NF	F	NF	F	NF	F	NF
Mean		0,999	3,521	0,674	1,201	-99,653	-45,925	-0,052	-0,050
Std error		0,058	2,393	0,037	0,451	98,219	44,992	0,020	0,025
Median		0,965	0,969	0,648	0,643	-0,045	-0,011	0,013	0,012
Std. Dev.		0,719	28,418	0,460	5,361	1222,817	534,246	0,248	0,303
Kurtosis		39,684	140,557	5,745	135,915	154,990	140,992	5,628	18,727
Asymmetry		4,949	11,847	1,752	11,564	-12,449	-11,874	-1,576	-2,871
Min		0,005	0,000	0,001	0,000	-15225,12	-6344,667	-1,327	-2,172
Max		7,346	338,318	2,963	63,838	30,323	1,124	0,686	1,000

Table 9: Ratios of failed and non-failed firms: year 2008

Year 2008		CA/CL		Quick ratio		ROE		ROI	
(F = 67)	(NF = 73)	F	NF	F	NF	F	NF	F	NF
Mean		0,912	1,186	0,561	0,822	-1,099	-0,770	-1,501	-0,231
Std error		0,144	0,210	0,074	0,094	0,161	0,184	0,809	0,086
Median		0,660	0,950	0,429	0,584	-1,027	-0,319	-0,246	-0,002
Std. Dev.		1,177	1,794	0,605	0,806	1,316	1,568	6,621	0,737
Kurtosis		23,021	48,459	15,134	10,604	11,788	22,259	62,245	33,304
Asymmetry		4,405	6,500	3,477	2,824	-3,085	-3,977	-7,769	-5,248
Min		0,002	0,013	0,002	0,013	-7,364	-10,713	-53,960	-5,345
Max		8,065	14,880	3,509	4,938	0,192	0,783	0,112	0,328

Tables show different results concerning the first and the second ratio of failed and non-failed firms in each year investigated, while ROE and ROI do not present relevant differentiation.

In order of understanding if the differences between failed and non-failed firms are significant, we implement a t test, comparing means of two samples.

We expect that there are no significant differences between the two samples, because the Italian legislation does not provide incentives for managers and/or creditors; as a consequence, the debtor does not have any stimulus for a timely commencement and, in addition, court could not order relief, with the effect of postponing a bankruptcy procedures and reducing the value of the firms. If this is the case, we can infer that the bankruptcy procedures prescribed by the Italian legislation are not efficient in an ex ante perspectives.

The null hypothesis ( $H_0$ ) is that there is no difference between means ( $\mu_1$  = means of failed firms;  $\mu_2$  = means of non failed firms) of two samples; the alternative hypothesis ( $H_1$ ) is that means are significantly different:

$$H_0 = \mu_1 = \mu_2$$

$$H_1 = \mu_1 \neq \mu_2$$

For each year and for each ratio, we compare means of failed and non-failed firms; the Stat *t* has been compared with the critical value and the *p-value* has been calculated.

We accept the null hypothesis ( $H_0$ ) if *p-value* > 0,05; this result implies that means of two samples are not different: as a consequence, non-failed firms are not different from failed firms and we can infer that the Italian procedure are not efficient (in an ex ante perspective).

We reject the null hypothesis ( $H_0$ ) if *p-value* ≤ 0,05; this result implies that means of two samples are different: as a consequence, non-failed firms are different from failed firms and we cannot infer that the Italian procedures are not efficient (in an ex ante perspective).

Tables 10 to 14 show the results of the test.

Table 10: Test *t* (year 2004)

Year 2004	CA/CL		Quick ratio		ROE		ROI	
	F	NF	F	NF	F	NF	F	NF
Mean	24,78247	1,523783	0,725611	0,919254	-0,077516	-0,232147	0,029453	0,02166
Variance	19027,6	6,579758	0,23369	1,140790	1,244256	1,457692	0,019929	0,043061
N. Observations	167	131	167	131	167	131	167	131
Stat <i>t</i>	2,178487698		-1,926079932		1,134475351		0,368035446	
<i>p-value</i>	0,030779919		0,055743405		0,257608896		0,713202274	
Critical value	1,974357726		1,97385213		1,968855114		1,970855317	

The results concerning 2004 show that *p-value* > 0,05 in three cases, being ≤ 0,05 only in one case. As a consequence, in the first three situations, we accept the null hypothesis.

Table 11: Test *t* (year 2005)

Year 2005	CA/CL		Quick ratio		ROE		ROI	
	F	NF	F	NF	F	NF	F	NF
Mean	508,0913	2,099513	81,95200	1,016693	-0,656938	-0,832771	0,000496	-0,028474
Variance	46747149	101,3735	1198675	4,891019	13,33380	53,36606	0,138666	0,057773
N. Observations	182	138	182	138	182	138	182	138
Stat <i>t</i>	0,998391814		0,997290666		0,259258364		0,843176149	
<i>p-value</i>	0,319422261		0,319954831		0,795718068		0,399777954	
Critical value	1,973157001		1,973157001		1,972595036		1,967621068	

The results concerning 2005 show that *p-value* > 0,05 in all cases; as a consequence we accept the null hypothesis.

Table 12: Table 10: Test *t* (year 2006)

Year 2006	CA/CL		Quick ratio		ROE		ROI	
	F	NF	F	NF	F	NF	F	NF
Mean	10,83951	2,167205	1,652618	0,961307	-0,424748	-0,755294	0,009827	-0,293886
Variance	9314,216	156,9277	155,2073	7,335183	2,256064	10,60360	0,040482	6,848858
N. Observations	196	149	196	149	196	149	196	149
Stat <i>t</i>	1,244313174		0,753787311		1,149590452		1,413437084	
<i>p</i> -value	0,214812065		0,451786607		0,251713407		0,159613008	
Critical value	1,971660843		1,970855317		1,972141177		1,976013145	

The results concerning 2006 lead to the same conclusion (we accept the null hypothesis).

Table 13: Table 10: Test *t* (year 2007)

Year 2007	CA/CL		Quick ratio		ROE		ROI	
	F	NF	F	NF	F	NF	F	NF
Mean	0,999006	3,520916	0,673843	1,200501	-99,65327	-45,92533	-0,051538	-0,050211
Variance	0,517498	807,5968	0,211317	28,73744	1495280,	285419,1	0,061515	0,091634
N. Observations	155	141	155	141	155	141	155	141
Stat <i>t</i>	-1,053453212		-1,162698505		-0,497326969		-0,041029958	
<i>p</i> -value	0,293948077		0,246902123		0,619466709		0,967302225	
Critical value	1,977053689		1,976810963		1,971059073		1,968756254	

Also the results concerning 2007 lead to the same conclusion (we accept the null hypothesis).

Table 14: Test *t* (year 2008)

Year 2008	CA/CL		Quick ratio		ROE		ROI	
	F	NF	F	NF	F	NF	F	NF
Mean	0,911643	1,186456	0,561009	0,8218725	-1,099406	-0,770413	-1,501214	-0,231057
Variance	1,385641	3,219373	0,365870	0,6490848	1,733112	2,458400	43,84108	0,542673
N. Observations	67	73	67	73	67	73	67	73
Stat <i>t</i>	-1,079715722		-2,17746843		-1,348240665		-1,561352416	
<i>p</i> -value	0,28234771		0,031209867		0,179805843		0,123082914	
Critical value	1,979124084		1,977961236		1,977431183		1,995468907	

The results concerning 2008 imply that we accept the null hypothesis in three cases.

Finally, we conclude that non failed firms (i.e. firms for which a bankruptcy petition has been submitted but the court did not order relief, rejecting the petition) are not different from failed firms; in more details, considering the results of *t* test, we conclude that non failed firms were substantially insolvent, being the economic and financial conditions of these firms to a large extent equivalent to those of failed firms; as a consequence, court should declare the failure of these firms and a bankruptcy procedure should start as soon as possible. If the court did not order relief, it means that the Italian legislation does not provide any incentives for



either the debtor or the creditors. The result is a delay in bankruptcy, minimizing the value of the firm and the rate of claims reimbursed to the creditors.

## Conclusions

The paper analyses ex post and ex ante efficiency of Italian bankruptcy procedures.

The investigation concerning ex post efficiency is based on a database annually published by the Italian Institute of Statistics (ISTAT). The variables analyzed are: costs and length of bankruptcy procedures and average rate of claims reimbursed to the creditors. If costs of Italian procedures are substantially comparable with those of other countries, the length is too high. In addition, there are no significant differences between years before and after the amendments of Italian Bankruptcy act (even if a conclusive judgment requires the availability of data for a longer period of time).

The investigation of ex ante efficiency is based on the analysis of two non paired samples of Italian failed and non failed firms; the methodological approach adopted is based on ratios frequently used in the analysis of financial statements as well as in forecasting models for default risks. After a descriptive statistics, we implement a *t test* comparing means of two samples, in order to understand if non failed firms are (or are not) in the same conditions of failed (insolvent) firms. The empirical analysis shows that there are not significant differences between failed and non-failed firms so we conclude that the Italian legislation does not provide enough incentives for debtor and creditors and bankruptcy procedures are not efficient (in an ex ante perspective).

The methodological approach used in the empirical analysis concerning ex ante efficiency represents a first attempt to join approaches used in forecasting models for default risks and methods of investigation of efficiency of bankruptcy procedures. Therefore, we are aware of the incompleteness of the research that requires further investigation and additional efforts, especially in the selection of ratios that calls for more robust statistical procedures.

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## THE LINK BETWEEN FAMILY BUSINESS AND INNOVATION: EVIDENCE FROM AN ITALIAN SAMPLE.

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### Abstract

Family businesses are an alternative organizational typology that crosses all segments, in terms of size and sectors. They are a primary organizational type all over the world and innovation has long been considered vital for their growth and survival. However, research on the linkages between family firms and innovation is scant and lacking empirical investigation.

This research begins to fill this scientific gap in knowledge by studying the influence of family characteristics, in the context of family owned firms, on business innovation capacity. The research identifies the differences in innovative behaviour between family and non-family firms; and empirically proves that family firms, contrary to conventional thinking, are more innovative than non-family. The research investigates the matter particularly with reference to the resource perspective, that is measured in terms of the human, social and marketing capitals.

Methodologically, the paper combines the knowledge drawn from an extensive literature review with the primary research results of a structured questionnaire survey on Italian firms. The Llach Pagès and Nordqvist (2009) analysis model was employed in the process, and to identify family firms, the AIDA database was utilised, in conjunction with the Chua et al. (1999) principle: that a family firm must also perceive itself to be one.

**Keywords:** family business, family firm, innovation, resource perspective, Italy

### Introduction

The competitive scene of recent years has been characterized by structural change, consequent to many factors, but mostly two forces: globalization and technology. It is now increasingly recognized in scientific literature that the new economy is the result of these changes (Tardivo et al., 2011), which ultimately determine the reformation of the drivers of competitiveness. A significant transformation is in fact noticeable in the drive to maintain, even improve, on the economic development of territories/localities and enterprises, in parallel to developing strategies that improve performance. These factors are critical to Italian

businesses, which are characterized by the presence of numerous small and medium-sized enterprises, often family-controlled (AIDAF, 2011; Prencipe et al., 2008; Cappuyns et al., 2003; IFERA, 2003, La Porta et al., 1999).

Family firms compete in a dynamic market with unique resources, which differentiate them from non-family firms. A family business, is an organization in which one or several families exert their influence on the properties and/or the management of the business itself (Demattè et al., 1993). More specifically, family firms differ in terms of goals (Tagiuri et al., 1992), size and financial structure (Romano et al., 2000), international structure and strategies (Zahra et al., 2004), corporate governance (Golinelli, 2000; Montemerlo, 2000) and entrepreneurial behaviour (Zahra et al., 2004).

Three main elements further characterizing family businesses are: (a) the influence of the family on the firm, justified by the legal ownership of all (or part) of the risk capital; (b) the entrepreneurial activity intimately identified with one (or several) families for one or more generations; and (c) the relatives who work in the family firm and run and own (jointly or separately) the family assets in a complex environment, that is often marked by family conflicts (Devecchi, 2007).

In this context, innovation arises as an important strategic resource that family-run firms use to achieve competitive advantage. Innovation is inevitably also an element that researchers can use to determine whether family and non-family businesses differ in their strategic marketing processes. Innovation is ultimately a crucial point in the effort to understand the capabilities of family firms, their procedural capacities and their potential in terms of surviving and competing in the global economy (Tanewski et al., 2003).

Innovation and (consequently) entrepreneurship are of fundamental importance to our economy as they spur economic growth and wealth creation (Barringer et al., 2008). Innovation, in fact, stimulates firm growth and this growth occurs almost regardless of the condition of the larger economy. The role of innovation has been widely studied in large and publicly traded firms and high-tech ventures. However, those firms that have remained family owned have been largely ignored by innovation researchers.

The paper studies the relationship of family owned firms with innovation capacity, largely through an investigation into the differences in innovative behaviour between family and non-family firms. The structure of the paper follows this methodological approach. The next section undertakes an extensive literature review towards defining the terminological context of 'family business' and its contextual framework. The following section, studies innovation and family business and concepts to ultimately develop the hypotheses of the section after that. Subsequently, the research methodology is presented, followed, finally, by the research results and conclusions, along with some discussion and directions towards further research.

## Family Business - Terminological Definition and Contextual Framework

Family businesses represent the oldest form of economic organizations. Until the '70s, studies on family business, conducted mainly in the Anglo-Saxon world, were characterized by their focus on the transition from small business to large Fordist organization. These studies mostly relate to the separation between ownership and management (Marris, 1964; Galbraith, 1971; Chandler, 1977), the generational change at the top of the organization (Donelley, 1964; Megivern, 1978) and the links between the various elements of the business system (Zappa, 1946). The '80s and '90s, however, gradually shifted focus to emphasize more on the relationship between life-cycle of the family and the firm (Danco, 1982; Churshill et al., 1983 and 1986, Peiser et al., 1983; Lansberg, 1988 ). Specifically in Italy, some authors dealt in detail with small and medium-sized family firms (Lorenzoni, 1987; Beccatini, 1989; Nanut et al., 1989; Marchini, 1989), while others studied family firms regardless of size, but focusing on the operating conditions (Corbetta, 1995), the generational shift (Boldizzoni, 1988; Piantoni, 1990; Demattè et al., 1993; Bertella, 1995), and corporate governance (Demattè, 1988; Caffrey, 1988; Schillaci, 1990; Demattè et al., 1993).

In the 2000s, scholars have expanded their analysis to study the relationship between family firms and performance, governance and internationalization (Chrisman et al., 2003; Thrassou and Vrontis, 2008a). In particular, Tardivo et al. (2011) highlight the studies on organizational structures and decision making (Gubitta et al., 2002; Compagno et al., 2003; Songini et al., 2006; Songini, 2007), on corporate governance (Compagno, 2000; Montemerlo, 2000; Corbetta et al., 2002a, 2003 and 2007; Gnan et al., 2007; Pittino et al., 2007; N. Miglietta, 2009; Carminati, 2010), on strategies and growth processes (Ansell, 1999; Compagno, 2003, Compagno et al., 2005, 2006 and 2007; Lassini et al., 2006; Thrassou and Vrontis, 2008b), on leadership and the continuity of generations (Corbetta et al., 2002b, Compagno et al., 2004; Zocchi, 2004; Mezzadri, 2005, Montemerlo, 2010), on value creation (Tischer, 2001; Mussolino, 2005; Mussolino et al., 2005; Viganò, 2006; Thrassou and Vrontis, 2006), on international development (Cerrato et al., 2007; Belussi et al., 2008; Stampacchia et al., 2008) and on the prospects for development in specific sectors (Franch et al., 2008; Thrassou and Vrontis, 2008a) or in particular geographical areas (Zocchi, 2003, 2007 and 2008).

Though the variety of foci and the subject spectra covered by the different researchers allow for some useful secondary data, they do not presently offer a consistent generally acceptable definition of family business. Existing literature does indeed present a 'sharing' of general parameters utilized towards the formation of a single definition (Astrachan et al., 2002; Klein et al., 2005). This is inadequate though, at least for the purposes of this research, while also leading to the false identification of family businesses with small and medium-sized enterprises. While it is true that small and medium-sized enterprises are often managed at the household level, what constitutes a family business is much more than size. Family firms are in fact sometimes big and multinational ones e.g. Armani, Cargill, Estée Lauder, Fidelity,

Home Depot, Ikea, JP Morgan, Michelin, Motorola, Nordstrom, Tetra Pack SC Johnson, Wal-Mart, Ford Motor Company, Carrefour, Samsung, PSA Peugeot, Fiat, Ferrero, Benetton, Luxottica..

Predictably, researchers have come up, diachronically with many definitions of ‘family business’, some more generic and others more fit for specific contexts (see Table 1).

Table 1: the evolution of the family business definition.

Authors	Years	Definition
Donnelley	1964	<i>A business in which can be identified at least two generations of the same family whose ties should influence both the strategy of the enterprise and the interests/objectives of the family.</i>
Bernard	1975	<i>A company controlled by members of one family through shares.</i>
Codice Civile art. 230 bis (L 151/75)	1975	<i>The company in which the collaborating spouse, relatives within the third degree and kin to the second, unless it constitutes a different relationship, the family that pays its activities on an ongoing work has a right to the aristocracy to hold according to condition sheet the family and the right to profit sharing and / or increases the company, in proportion to the quantity and quality of the work.</i>
Barnes, Hershon	1976	<i>A company in which an individual or members of one family have a controlling interest.</i>
Alcorn	1982	<i>A company in which the family, even if the property is held by external actors, must manage the business and participate in equity.</i>
Davis	1983	<i>They are family businesses in which the strategic and managerial aspects are subject to significant influence of one or more families. The influence is exerted through the property and, upstream, the contribution of family management.</i>
Rosenblatt	1985	<i>A company in which the majority of the capital (or control) is in the hands of a single family and at least two family members are or have been directly involved in management.</i>
Pratt, Davis	1986	<i>A business in which two or more family influence management through the exercise of family ties, of managerial roles or rights of ownership.</i>
Stern	1986	<i>A business owned and operated by members of one or more families.</i>
Ferrero	1989	<i>A family enterprise is an enterprise where, in fact, they establish relations of mutual conditioning between the company and the company's production, consumption of one or a few families linked by kinship or affinity, to retain ownership of the capital provided by the lien of the full risk.</i>
Churchill, Hatten	1987	<i>An enterprise is considered the family business in which it is proposed or in case of sale of control by a family elder to a younger family.</i>
Babicky	1987	<i>Is a type of small business, started by one or a few people who have a business, working hard to ensure their development and that, often with the help of limited resources, fail to ensure their growth, keeping the majority of the capital .</i>
Lansberg	1988	<i>A business in which members of a family have the legal control of the firm.</i>
Handler	1989	<i>An organization in which the major operational decisions and succession planning are influenced by family members in the management or the board of directors.</i>
Dreux	1990	<i>There are companies that appear to be controlled by one or more families, who have a level of incidence in organizational governance sufficient to substantially affect business decisions.</i>
Leach et al.	1990	<i>A company in which more than 50% of the votes are controlled by a family or a family actually controls the company and / or a significant proportion of managers are members of one family.</i>
Donkels, Frohlick	1991	<i>A company in which family members have at least 60% of the capital.</i>
Gallo, Sveen	1991	<i>A company in which a single family owns a majority stake and has total control.</i>
Lyman	1991	<i>A company in which a single family owns a majority stake and has total control.</i>

Holland, Olivier	1992	<i>Any business in which decisions concerning the ownership or management are influenced by relations between members of one or more families.</i>
Demattè, Corbetta	1993	<i>We are in the presence of a family business where one or several families linked by close ties of kinship or affinity, will put at the disposal of financial capital in full risk or low risk, real or personal guarantees and managerial skills.</i>
Welsch	1993	<i>A company concentrated ownership, with the owners or relatives of owners involved in management.</i>
Carsrud	1994	<i>A company owned by a limited number of subjects, in which the property and the decision process are dominated by a group of persons linked by affective relations of kinship.</i>
Litz	1995	<i>Is family that business in which ownership and management are concentrated in the hands of a single family unit whose members are committed to maintaining an organization that focuses on the ties of kinship.</i>
Tagiuri, Davis	1996	<i>A business in which two or more family influence management.</i>
Astrachan, Schanker	1996, 2003	<i>Broad definition: is family that business in which the family has control over strategic activities and participate in various ways and levels to the business. Definition media: is that family businesses in which the owner intends to pass the company to the heirs and the founder or his heirs should be involved in management. Narrow definition: That is family business for generations Which are undertaking and controlling at least one family member must be involved in management.</i>
Sharma, Chrisman, Chua	1997	<i>The business enterprise which is managed with the intention to train, develop and sustain over time, a vision shared by a dominant coalition controlled by a member of the same family or a small group of families.</i>
Smyrniotis, Romano, Tanewski	1997	<i>The business to be considered family has to be characterized by at least one of the criteria identified: more than 50% of the property is held by a single family; more than 50% of the property is held by more than one family; a single family group holds the effective control of the business.</i>
Chua, Chrisman, Sharma	1999	<i>Is family a run business with the aim to model and pursue the vision of the business that distinguishes the ruling family, not necessarily the largest shareholder, to make it sustainable in the intergenerational level.</i>
Angiola	2000	<i>The family business is that enterprise consists of a household or by two or more nuclei linked by close ties of kinship or affinity, which provide the financial capital of the full-risk or low risk, real or personal guarantees or managerial skills.</i>
Habbershon, Williams, MacMillan	2003	<i>The concept of family business is tied to the desire to convey the property to the next generation and the trans-generational commitment to create value.</i>
Villalonga, Amit	2006	<i>Is family that businesses in which one or more family members holding 5% of capital or are directors or managers, there is at least a family member as an administrator and as a manager, the family is the main shareholder voting, one or more family members of generations after first having at least 5% of capital or are managers or directors, the family is the major shareholder and has at least one family as a manager and at least one as an administrator, the family owns at least 20% of the capital and is the main shareholder. One or more family members possess at least 5% of capital or are administrators but there is no family among the managers, the family is the largest shareholder, owning at least 20% of the voting capital, at least one family member is an administrator and manager, the family is a second generation or later.</i>
Di Mascio	2007	<i>The family business firm which is characterized by: the interplay of familiar figures in the various private and managerial roles and the close relationship of interdependence between the family business and the family business itself, by a strong grounding in economic and political territory; by a strong institutional overlap between family, business, property that generates critical especially during the generational</i>

		<i>transition of the company and the family property.</i>
Zocchi	2007	<i>The family business is that enterprise is characterized by two main factors: the feelings of family members and the patrimonial assets of the family. This affects the appearance and transmission of capital, income, investment, corporate boards and management.</i>
Aidaf	2008	<i>Family firms are the business enterprises in which one or more families, linked by family ties and strong alliances, have the power to appoint the governing bodies.</i>

Source: Tardivo G., Cugno M. (2011), *Il sistema family business. Un patrimonio da valorizzare*, Franco Angeli, pp. 74-78.

## Determinants of Innovation in Family Businesses - the Resources Perspective

It is a challenge to find a single generic definition of either the ‘family business’ or ‘innovation’. It is exponentially more difficult though, to find a definition of the link between these two, especially in view of the varying use of the terms depending on the context. As it is not this research’s aim to invent a universal definition of the above, and much in line therefore with past researchers’ approach, Chua’s et al (1999) perspective is accepted as the one that best fits this research’s scientific context. Specifically, family business is being defined for this research’s purposes as “a business governed and/or managed with the intention to shape and pursue the vision of the business held by a dominant coalition controlled by members of the same family or a small number of families in a manner that is potentially sustainable across generations of the family or families” (Chua et al., 1999, p.25). In the same spirit, Lumpkin and Dess’s (1996) definition is accepted regarding ‘innovation’ i.e. that it is “a firm’s tendency to engage in and support new ideas, novelty, experimentation, and creative processes that may result in new products, services, or technological processes. Although innovations can vary in their degree of radicalness, innovativeness represents a basic willingness to depart from existing technologies or practices and venture beyond the current state of the art” (Lumpkin et al., 1996, p.142).

Initial studies regarding innovation in family firms found that they were less innovative than non-family ones (Donckels et al., 1991, Morck et al., 2003). In fact, family businesses were found to present aversion to risk, resisting change to invest in new ventures, and lacking innovative capacity, since they are more likely to maximize their profits by investing in political rent-seeking behaviour rather than in innovation. That is the reason why the literature often criticizes family firms for their lack of innovation (Carney, 2005).

From a strategic point of view, family business is considered a business that develops across generations. It follows that innovation is family-based if and only spontaneous interaction between family members across generations takes place and it is relevant to the process’s outcome. It’s difficult for innovation in family business to take place without both



generations being involved. The secret of innovation in family business lies with the capacity of dynamically balancing power and trust, and control and freedom in the developmental process of a senior-junior relationship. Both roles contribute to the quality of this relationship. On the one hand, the older generation should be able to set the newer free to follow its path, but at the same time it is also the former's responsibility to ensure that the latter will have developed the necessary competencies to continue the family business. Moreover, the younger generation should willingly and with vision be ready to take full responsibility for their choices regarding the family business. Intergeneration innovation does not take place in a context where each party is simply set free to follow their own interest and career (Litz et al., 2001).

Family firms, especially larger and older ones, are in fact characterized by generational evolutionary stages, three of which are visibly identifiable in the businesses' evolution path: the controlling-owner stage, in which the founder exercises the control rights; the sibling partnership stage, in which several members of a single generation (sibling team) control the firm, and the cousin consortium stage, in which several family branches represent ownership (Lubatkin et al., 2005). This evolution nonetheless, may be detrimental to the long term investment perspective and the pursuit of more innovative strategies. In addition, Westhead and Howorth (2006) argue that multi-generation family firms also have a lower entrepreneurial drive than first-generation family firms.

Moreover, referring to managerial determinants of innovation, several authors on entrepreneurship, strategy and management literature, have emphasized the importance of managerial characteristics in explaining performance differences in terms of innovation (Hoffman et al., 1993; Wu et al., 2005; Elenkov, Judge et al., 2005). The hypotheses formulated in these studies are based on top managers' capacity to influence or challenge strategic decisions with certain personality attributes, or the influence of executives' experience on strategic firm choices, known as CEO locus of control, CEO-tenure, and top management heterogeneity (Van Gils et al., 2008). They all have a positive influence on the innovation process.

Additional to the managerial determinants, several studies also suggest that specific family-related variables may explain variation in innovative output (e.g. Sirmon et al., 2003; Le Breton-Miller et al., 2006; Kellermanns et al., 2008). The theoretical arguments behind this rationale are mainly resource and agency based. In fact empirical evidence of the relationship between innovation and family characteristics is scant.

In literature, family determinants of innovation are often built on the resource-based view. The patient financial capital is one of the main resources that provide family firms with potential advantages over non-family firms. Family firms have a longer investment time horizon and can focus more on long term results. The effective management of this financial capital is especially important given the primary objective of continuing the firm as a family

firm. Hence, patient capital creates the necessary conditions for pursuing more creative and innovative strategies (Sirmon et al., 2003).

Regarding family management, and more specifically family CEOs, it is often argued that the presence of family members in the board team may reduce agency costs and increase stewardship attitudes. In addition, family CEOs are expected to perform better than non-family CEOs (Bennedsen et al., 2007). The distinction between a family and a non-family CEO and its relationship with innovation has been recently investigated, with results that portray family CEOs as negatively influencing organizational innovation (Van Gils et al., 2008).

The aim of this research is to extend the knowledge on how family businesses compete through innovation, taking into account their specific characteristics and their differences with non-family firms; particularly, the “familiness” of firms: their human, social and marketing capital (Sirmon et al., 2003; Miller et al., 2005; Llach Pagès et al., 2009). The focus is on these resources, with the underlying reasoning that family firms have a potential advantage which should positively affect their innovative behaviour; with a difference from non-family firms; and against the conventional wisdom that holds family firms as less innovative than non-family ones.

“Familiness” is described as the unique bundle of resources created by the interaction of family and business (Habberson et al., 1999). Familiness can be a point of difference that contributes to competitive advantage. One of the main advantages for example, is the use of a unique language, which allows members to communicate more efficiently and to exchange more information. It is a resource with a firm and deep linkage with the human, social and marketing capitals.

## **Developing the Hypotheses**

The research subsequently expands the knowledge on family businesses’ innovation-based competition, through the above-defined concept of firm “familiness” i.e. their human, social and marketing capitals.

Human capital can be defined as “the knowledge and skills embodied in people” (Hatch et al., 2004). Human capital is an important family firm resource, because it can bestow the firm with a competitive advantage through skills, abilities or attitudes (Sirmon et al., 2003). However, most related literature suggests that family firms are constrained by their limited pool of human capital, which often lacks qualified employees. The explanation for the latter phenomenon lies in the difficulty of attracting and retaining non-family qualified employees into the firm, due to certain long-term barriers (Donnelley, 1964). For these reasons, it is possible to formulate the following hypotheses:

- Hp1: To support innovation, family firms devote a lower proportion of human capital than non-family firms.

Following Adam (2006) and Pagès and Nordqvist (2009) models, we can consequently and naturally hypothesize that:

- Hp1a: The percentage of qualified employees is lower in family firms than in non-family ones.
- Hp1b: The percentage of employees devoted to R&D activities is lower in family firms than in non-family ones.

In line with Putnam's (1993) work, this research defines 'social capital' as the resources that exist in relationships among people. Keeping a high social capital is important to gain access to other forms of capital (e.g., intellectual, human, financial capital) that are critical to a firm's survival (Sirmon et al., 2003). Social capital provides information, technological knowledge, access to markets, and complementary resources; it can reduce transaction costs, facilitate information flows, knowledge creation, creativity and alliance success (Nahapiet et al., 1998).

Family firms may gain specific advantages by developing social capital, especially with customers who can sustain the business in times of trouble. They can further enjoy long-term relationships with external stakeholders; and through them develop and accumulate even greater social capital. As a result, social capital is potentially a primary contributor to high family firm performance. Cooperation in fact, is often a means of compensating for the lack of internal resources: firms find solutions in their immediate environment, as provided by competitors, suppliers, customers, and other elements of the external and macro-environments, including research centres and/or universities. Consequently, the following hypotheses are investigated:

- Hp2: The use of cooperation agreements to support innovation is higher in family firms than in non-family ones.

In order to more deeply analyze the degree of cooperation, the sample is split into three sub-samples, which permit the research to formulate the following sub-hypotheses:

- Hp2a: Family firms have a higher number of cooperations than non-family ones in production.
- Hp2b: Family firms have a higher number of cooperations than non-family ones in purchasing.
- Hp2c: Family firms have a higher number of cooperations than non-family ones in services/sales/distribution.

While the human capital is important for the initial and developing stages of the innovation process, at the stage of launching and implementation, other capabilities gain importance such as market investigation, market testing and promotion. Family firms, due to their high social capital, have access to different resources such as information, technology, knowledge, financial capital and distribution networks (Arregle et al., 2007). These resources also permit

them to communicate closer with the customers, and build marketing capital. This has potential direct effects on the firm's innovativeness or more indirect effects, such as facilitating the development of innovation. Lastly, the flexibility/adaptability of family firms, especially of small and medium sized ones, is enhanced through product and service customisation advantages. This, in its turn, restructures demand and of course firm product marketing; from mass production to high quality 'individualized' products. Family firms, from this point of view, are likely to be closer to customers and their needs/wants/demands, rather than non family firms. This phenomenon adds to the competitiveness potential of family firms since, as Adams et al. (2006) support (and business researchers generally accept), one of the most important factors for the success of a company is its capacity to successfully introduce new products and services into the market. From the above flows the final hypothesis to be tested, as follows:

- Hp3: The proportion of new products launched into the market is higher in family firms than in non-family ones.

## **Research Methodology**

The research was conducted in two interlinked but separate phases: in the first, a sample of 400 Italian firms was selected from AIDA; a database of company accounts, ratios, activities of more than 700,000 Italian companies; in the second phase, a structured questionnaire was mailed to the 400 firms of the sample. 127 firms answered the questionnaire successfully and satisfactorily (in the methodological sense of the terms), which corresponded to a successful response rate of 32 per cent.

The model of analysis applied by this research is the one used by Llach Pagès and Nordqvist (2009). Importantly though, an additional constricting factor was adopted by this research, in line with Chua's et al. (1999) philosophy i.e. that a family firm must also perceive itself to be one. Though this factor may instinctively be viewed as scientifically superfluous, the research partly rests on and investigates social elements of the family firm. This parameter alone therefore, demands that family firms are not termed as such simply because they conform to certain numerical/legal/factual criteria; but also because they socially and consciously view themselves as family firms.

Table 2 shows some basic descriptive statistics of the responding companies (sample). Family firms are more than non-family ones (59.8% vs 40.2%), with the majority belonging to the manufacturing sector (41 firms, i.e. 53.9%).

<i>Main activity</i>	<i>Family</i>	<i>Non-family</i>	<i>% Family firms</i>	<i>Total</i>
<i>Manufacturing</i>	41	26	61.2%	67
<i>Services</i>	12	9	57.1%	21
<i>Finance</i>	4	9	30.8%	13
<i>Food&amp;Beverage</i>	17	5	77.3%	22
<i>Pharma</i>	2	2	50.0%	4
<i>TOTAL</i>	76	51	59.8%	127

Table 2: number of firms by economic activity and family vs. non-family.

In order to verify that the items of each stream only load on a single factor and the discriminant validity; and also to validate the convergent validity of the measures detected in the literature, a principal component analysis was performed.

Factor analysis is a statistical method used to describe variability among observed variables, in terms of fewer unobserved variables, called factors. The observed variables are modelled as linear combination of the factors, plus “error” terms. The information gained on the interdependencies is subsequently used to reduce the set of variables in the dataset. Company size is related to size and “family”, so it was necessary to verify its potential effect.

We have verified the possibility of using the factor analysis model through two different tests: Barlett’s sphericity test and the Kaiser-Meyer-Olkin (KMO) index. The Barlett statistic puts in evidence a value  $\chi^2=1433.96$  (p value 0.0001); the KMO (0.550) also confirms the analysis.

Table 3 presents in evidence the results of the factor analysis. A varimax rotation was applied in order to better analyze the components. The analysis extracted four factors, choosing those which presented eigen values greater than one. These four factors explained 89.24% of the total variance.

It is evident from Table 3, that there is a strong relation between:

- the two measures defining human capital; showing that firms with qualified employees devote a high number of them to R&D;
- the measures defining social capital; showing that the co-operations in production, purchasing, and services/sales/distribution are strongly linked;
- the measures defining marketing capital; showing that many new firm products are new for the market too; and
- the two control variables; showing that there is no effect on the other variables.

	<i>Component</i>			
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
<i>Human capital</i>				
<i>Qualified employees</i>	0.933	-0.042	0.022	0.111
<i>Employee in R&amp;D</i>	0.925	-0.005	0.030	0.220
<i>Social capital</i>				
<i>Co-operation in production</i>	0.051	0.909	0.005	0.060
<i>Co-operation in purchasing</i>	0.087	0.927	0.027	0.120
<i>Co-operation in services/sales/distribution</i>	-0.050	0.805	0.008	0.070
<i>Marketing capital</i>				
<i>Proportion of new product into the market</i>	0.048	0.045	0.997	0.210
<i>Proportion of new market products into the market</i>	0.033	-0.010	0.998	0.098
<i>Company size</i>				
<i>Employees</i>	0.170	0.055	0.078	0.843
<i>Turnover (log)</i>	0.230	0.072	-0.013	0.793

Table 3: Rotated Component Matrix

Extraction Method: Principal Component Analysis

Rotation Method: Varimax with Kaiser Normalization

a. Rotation converged in 4 iterations.

## Research Results

This section presents the results of the comparison between family and non-family firms, using the constructed analysis based on human capital, social capital and marketing capital. Using the Mann-Whitney U-test it is possible to compare family and non-family firms.

Table 4 shows that family firms outperform non-family firms in all the variables considered. Moreover, five out of eight measures are statistically significant.

These results are in line with those of Llach Pagès and Nordqvist (2009), but in contrast with other literature. As described in previous sections in fact, most literature states that family firms are less innovative than non-family firms. The evidence of this research nonetheless is very clear and can be summarized as follows.

For human capital, family firms have a higher average value both in qualified employee and in employees devoted to R&D. So, the first hypothesis (1) has to be rejected.

	<i>Non-family firm</i>		<i>Family firm</i>		
	<i>Mean</i>	<i>St.Desv.</i>	<i>Mean</i>	<i>St.Desv.</i>	<i>Signif.</i>
<i>Human capital</i>					
<i>Qualified employees</i>	127.02	368.38	247.23	553.11	0.0200*
<i>Employee in R&amp;D</i>	20.32	58.94	61.81	138.28	0.0001**
<i>Social capital</i>					
<i>Co-operation in production</i>	0.65	0.84	1.25	0.87	0.0001**
<i>Co-operation in purchasing</i>	0.29	0.50	1.30	0.73	0.0001**
<i>Co-operation in services/sales/distribution</i>	0.69	0.88	1.38	0.80	0.0001**
<i>Marketing capital</i>					
<i>Proportion of new products into the market</i>	0.17	0.04	0.19	0.06	0.3250
<i>Proportion of new market products into the market</i>	0.12	0.04	0.13	0.06	0.6680

Table 4: Summary of basic descriptive statistics and Mann-Whitney U test

\* indicate that the Mann-Whitney U-test is significant ( $p < 0.05$ )\*\* indicate that the Mann-Whitney U- test is significant ( $p < 0.0005$ )

For social capital, family firms outperform non-family in every area considered, with the highest difference found in purchasing. So, cooperation and relationship are key competitive advantage factors of family firms in comparison to non-family ones. Hypothesis 2 is therefore accepted.

Finally, for marketing capital there is no statistically significant difference. The average data is very similar between family and non-family firms, with a very slight prevalence of family firms.

## Conclusions and Further Research

The primary aim of the research was to study the influence of family characteristics, in the context of family businesses, on innovation capacity. The focus hence was on the differences in innovative behaviour between family and non family firms.

Although innovation is widely accepted as a key competitive advantage, studies on innovation in family firms, is scarce. This research's work with secondary data and literature review nonetheless, has uncovered past research (see literature review) on the link between innovation and aversion to risk in family firms. This past research portrayed family firms as unused to taking risks, with an apparent hasty conclusion that their level of innovation is consequently lower. However, this research's more specific work on the subject analyzes the innovative behaviour of family firms in terms of the three resources of human, social and marketing capitals and concludes differently.

Llach Pagès and Nordqvist (2009) on the other hand, working on a Spanish sample of companies, contradicted past research to support that family firms are in fact more innovative than non-family firms. Their significantly different results and conclusions challenged this

research to apply their model to an Italian sample. The results were essentially the same: family firms outperform non-family firms in human and social capital.

Additionally, it was found that family firms have the need to attract and utilise qualified employees (see hypotheses 1) and that the high number of collaborations of family firms (see hypotheses 2) indicates their heavy connection with their locality. These findings are also naturally anticipated in marketing capital (see hypotheses 3) owing to the fact that family firms largely rest their competitive advantages on this strong connection they have with their geographical domain.

These findings are even more relevant in the Italian case, where clusters are based on the flexible specialization between a large number of SMEs sharing a complementary technological specialization in a territorial network of common norms and values. This competitive framework has been, until recently, a source of advantages both for the firms belonging to this network and for the regions where these networks have emerged. However, the main source of this competitive advantage, the possibility to share the costs of learning and innovation in a territorial network, is close to being exhausted. The main reason is that the extension of the network is insufficient to metabolize the degree of complexity generated by the global process of interaction between people, institutions and firms. The local network of shared norms and values has become a barrier to local knowledge creation because it constrains interaction rather than leveraging it across geographical boundaries.

This research has taken a significant step both towards closing the gap in knowledge on family firm innovation and towards changing some commonly held beliefs on the subject. Beliefs formed largely through projections of past research and which may need reinvestigation or reinterpretation. Unavoidably, this calls for further research on both sides. From the past research's point of view, to test the projections; and from the present research's point of view, to further verify the findings. Regarding the latter, which this research supports to be the wisest methodological path, it is recommended that further research:

- Performs similar research in other geographical contexts (i.e. not Italy or Spain)
- Performs similar research using different but scientifically relevant models
- Performs similar research which is sector specific.
- Performs similar research which is also size-focused

On a catalectic note, this research calls for a re-evaluation or at least reinterpretation of some commonly held beliefs on family firms, not just in relation to innovation, but other aspects as well. The fundamental principle that should be established is that family firms are not ordinary firms, which just happen to have a different ownership structure. They are firms whose family aspect affects many of its other aspects, but most of all those of a social nature. This entails that their differences are not only deep, but also of a less tangible and less visible nature. Projections therefore that lead to conclusions are unscientific at the very least. Family



businesses have a unique culture and a complex nature that demands respect; respect that should be portrayed through research that is specific, focused and bears into consideration exactly those factors that make family firms unique.

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## CHALLENGE TO THE SUSTAINABILITY OF MICROFINANCE INSTITUTIONS IN CHINA

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### Abstract

Based on the development of China's Microfinance Industry the paper first gives an overview on China's Microfinance Institutions. It shows the main regulations and challenges in the legal environment and investigates and analyzes challenges in corporate governance, competition and management capacity

**Keywords:** Microfinance, China, sustainability

### Introduction

There are two related terms in international microfinance field: microfinance and microcredit. **Microfinance** is the provision of financial services to low-income clients who traditionally lack access to banking and related services. The financial services here include not just credit but also savings, insurance, and fund transfers. **Microcredit** is provision of credit services to poor clients. In this sense, microfinance is a broad category of services, which includes microcredit.

To understand microfinance in China better, we think there are two special points to be addressed. First, microcredit has been the main scope of business in the development of microfinance institutions (MFIs) in China. Only recently village banks are allowed to extend their business to the other financial services. Meanwhile, microcredits provided by the existing financial institutions are widely considered a part of the microfinance. Second, due to the imparity of distribution of financial resources, there is larger demand for credit besides from the poor or near-poor population. Small and medium private enterprises are notable entities among such demand. In many cases, the credits going to SMEs are also treated as microfinance. However, the credit line can be as much as several hundred thousand RMB.

Tracing down the history, Du Xiaoshan (2008), He Guanwen (2009) defined the phases of development of China's microfinance industry. For our purpose of analysis, we outlined the key factors in the following table 1.

Now the role of the microfinance has been recognized by the Chinese government. And with its supporting policies, new forms of microfinance institutions such as MCC, VTB, RMCC came into being, meantime traditional commercial banks downscaled their operations to microfinance. However, during the development of microfinance, sustainability has been

the biggest concern of all stakeholders. **Sustainability** refers to the ability of a MFI to cover its operating costs from its operating revenues, so that the MFI is able to survive and prosper in the long run.

Table 1: Development Phases of China's Microfinance Industry

<i>Driving Force</i>	<i>Fund Resources</i>	<i>Operating Organizations</i>	<i>Subsidized Interest Y/N</i>
<i>Phase 1: (1994 – 1999) Experimental Phase</i>			
<i>multilateral and bilateral development projects<sup>[1]</sup></i>	<i>international grants soft loans</i>	<i>project office quasi-official Organization NGOs</i>	<i>some Yes / some No</i>
<i>Phase 2: (1999 – 2005) Expansionary Phase</i>			
<i>government through: PBOC (People's Bank of China), and Other governmental agencies</i>	<i>government funds</i>	<i>Cooperation between gov- ernment and: ABC (Agriculture Bank of China) RCC (Rural Credit Coop- eratives) commercial banks (for urban laid-off)</i>	<i>normally Yes</i>
<i>Phase 3: (2005 – present) Breakthrough Phase</i>			
<i>government through: PBOC (People's Bank of China), and CBRC (China Banking Regulatory Commission)</i>	<i>non-government funds overseas funds traditional commercial banks' funds government funds grants and soft loans</i>	<i>MCCs (microcredit companies) VTBs (village/township banks) NGO MFIs (from previous development projects) RMCCs (rural mutual credit cooperatives) lending companies of commercial banks traditional commercial banks</i>	<i>normally No / a few Yes</i>

Source: extracted by the authors from relevant references

In this article, we don't intend to assess the operation performance of certain MIFs, but focus more on the overall situations which would negatively affect the sustainability of MIFs. Since by nature subsidized microcredits can not be sustainable, we exclude such business in our discussion. We also exclude the downscaling of traditional commercial banks because we think traditional commercial banks (including their lending companies) are doing microcredits within their general scope of operation thus it is more difficult to assess separately. Therefore, we'll mainly discuss the challenge to the sustainability of NGO MFIs, MCCs, VTBs, and RMCCs in China thereafter.

## Overview of China's MFIs

NGO MFIs originate from the project offices of the development projects in 1990s. For more independency and better governance, many microfinance project offices took the reform in

early 2000s to register as Social Organizations or Non-business Entities both of which are generally categorized as NGOs. Du Xiaoshan (2008) showed only around 100 NGO MFIs remain in operation out of approximately 300 such microcredit projects or organizations.

MCCs (since 2005), VTBs (since 2006) and RMCCs (since 2006) are all pilot projects initiated by PBOC and CBRC. The purpose is to encourage private capital to invest in the finance business in rural or less-developed areas where the traditional banks would not like to go, thus there is a broader aim of promoting the economic growth in those areas. Among these three forms, only MCCs are not subject to the strict requirement for prudential regulations. MCCs developed very fast especially since May 2008 when PBOC and CBRC issued the *Guideline for Pilot Microloan Companies*. Latest statistics from the PBOC show that there were 2614 MCCs with total loan balance of 197.5 billion RMB by the end of 2010<sup>[2]</sup>. Table 2 below gives an overview of China's MFIs on their business.

Table 2 Overview of China's MFIs (Traditional Commercial Banks Excluded)

MFIs	Incentives aligned with development	Fund Resources		Credit Business			Non-credit Business	
		Capital Sources	Liability Sources	Traditional Collateral	Average Loan Size	Annual Interest Rate	Savings	Remittances
NGO MFIs	Yes	Grants from multilateral and bilateral aid institutions international NGOs Chinese government	Soft loans from international organizations such as Grameen Trust, KfW, etc. Wholesale loans from banks such as the CDB	No	Several thousand	no clear regulation, actual 3-18%	No	No
MCCs	Yes + No	Private capital from: individual investors institutional investors	Loans from no more than 2 banks and amount no more than 50% of its net capital	Yes	Several thousand – hundred thousand	0.9-4.0 times basic rate in law, actual around 20%	No	No
VTBs	Yes + No	Domestic or foreign commercial banks as: sole proprietorship, or joint stock partnership with individual and/or institutional investors	savings from depositors	Yes	Several thousand – hundred thousand	0.9-2.3 times basic rate	Yes	Allowed in law, but currently No
RMCCs	Yes + No	Capital from: Member farmer, citizens and enterprises donations from other organizations	voluntary savings from members bank loans allowed by law but difficult to get	No	Several thousand	0.9-2.3 times basic rate	Yes but only from members	Allowed for members in law, but currently No

Source: extracted by the authors from relevant references

## Challenges in Legal Environment

### Main Regulations Issued by the PBOC and the CBRC on MFIs

So far the main regulations/guidelines issued on MFIs include:

- CBRC, *the Opinions Regarding Easing Market Access for Banking Financial Institutions in Rural Areas in order to Better Support the Construction of a Socialist New Countryside*, Dec., 2006. → **Overall guideline**
- CBRC, *the Provisional Regulations on the Management of VTBs*, Jan., 2007. → **VTBs**
- CBRC, *the Provisional Regulations on the Management of RMCCs*, Jan., 2007. → **RMCCs**
- CBRC, *the Provisional Regulations on the Management of Lending Companies*, Jan., 2007. → **Lending companies**
- CBRC, *the Guideline on How to Greatly Develop Rural Microloan Business by Banking Financial Institutions*, Aug., 2007. → **Microloans Business**
- PBOC and CBRC, *the Notice of Relevant Policies about VTBs, Lending Companies, RMCCs and Microloan Companies*, Apr., 2008. → **All the new MFIs**
- PBOC and CBRC, *the Guideline for Pilot Microloan Companies*, May, 2008. → **MCCs**

These regulations set up a framework for the establishment and operation of MFIs. It promotes microfinance development especially by encouraging private capital entering into the business. But in this framework, there are also challenges to the sustainable development of MFIs in the long run, and we will discuss them in detail later.

### Instable Legal Status of MFIs

By scope of business, NGO MFIs, MCCs, VTBs, and RMCCs should all be treated as financial institutions and subject to the supervision of the PBOC and the CBRC. However, currently NGO MFIs are supervised by the Bureau of Civil Affairs in the sense of NGO. In addition, among them only a few obtained the permission from the PBOC, while the others are operated mainly based on informal business agreement between fund donors and the local governments.(He Guanwen, 2009) There is no official regulation related to the establishment of such NGO MFIs, nor for the supervision of their business. This leads NGO MFIs to an instable legal status and an uncertain future.

Although MCCs are promoted by the PBOC and the CBRC, the supervision is entrusted to the local governments. So far it involved in such governmental department as Financial Management Office or SME Management Bureau. The MCC regulation only stipulates that MCC should be registered as a limited company, but not clearly says that it is a financial institution.



VTBs and RMCCs are recognized as financial institution and supervised by the CBRC. But the CBRC adopts nearly the same prudential supervision as in traditional commercial banks such as the requirements for at least 8% of Capital Adequacy Ratio (CAR), 100% of Loan Loss Provisions, etc. it also specified the qualification of the top managements. All these are thought too strict for the small institutions, especially for RMCCs where the capital is rather small<sup>[3]</sup> and the clients are limited to the shareholders.

The uncertain future of MFI's legal status affects the confidence of both the present and the potential investors. It may make MFIs difficult to attract investments and may also lead MFIs focusing too much on the short-term benefit.

### **Limited Sources of Funds**

For all MFIs, fund constraint is a common problem that restrains their expansion. So far, credit is the only business for most of the MFIs. So their operating revenues totally depend on the interest income from loans, i.e. on the total volume of loan and the interest rate. The implication is with the same interest rate loan volume is the key factor for higher profit; and for covering certain operating cost, there is a need of certain capital.

Not like banks which can mobilize more funds by deposit creation, MCCs and RMCCs are strictly forbidden from attracting public deposit in any forms. Although RMCCs are allowed to attract voluntary savings from their members, it is more difficult to realize it since the interest rate for savings shall not be higher than the national basic interest rate according to the regulation and thus it can not be attractive even for RMCC members. The same situation happened in VTBs where the saving is allowed but VTBs found it very difficult to collect deposit due to the same reason. We can understand the prudent attitude of the PBOC and the CBRC towards saving permission, worrying about the default risk and the associated social unrest. But this regulation would result in the constant fund restriction for these new types of MFIs.

Donation is mentioned as one of the fund sources for MFIs in the regulation. Both international and national grants and soft loans for microfinance are with the purpose of poverty alleviation. It is still not clear whether MCCs, VTBs and RMCCs can align this goal with their development as expected by the government. In this sense, no matter from their origin or their current operations, NGO MFIs have better access. Actually grants and soft loans have always been the main source of fund for NGO MFIs.

For taking commercial loans, current policy allows MCCs to take from no more than 2 commercial banks and with the amount not exceeding 50% of the net capital. While due to the nature, RMCCs find it difficult to get loans although it is allowed by the policy. Meantime CDB, the policy bank, is trying to promote microfinance by wholesale loans. That would be a new source of fund for MFIs.

### Restrictions on Business and Expansion

In order to control risk, it is regulated not only for the fund resource, but also for the other business aspects such as the range of the interest rate, the cap on the single loan amount, and the cap on the leaving loan balance of single client, etc. And normally the business areas are limited to the county where MFIs are registered. RMCCs' business is limited to their members (i.e. shareholders).

### Challenges in Corporate Governance

Like other business organizations, ownership and governance structure are the essential factors that determine whether MFIs succeed or fail. Based on the current legal environment and the operating practice, we find there are challenges and problems in corporate governance in China's MFIs as reflected in the following table 3.

Table 3: Challenges and Problems in Corporate Governance in China's MFIs

MFIs	Ownership	Governance Structure	Main Problems
NGO MFIs	Grants providers are not the true owners in the sense of ownership Local governments have factual control over the funds of grants especially after the ending of projects Local government normally has contributed to office place, office equipments, etc.	Board → Top Management By law a NGO needs to be registered under a certain government department Normally chairman of the Board is the chief officer of the affiliated government department <sup>[4]</sup> Normally the top management is designated by the government directly or through the Board Top management members normally have status of government employees and enjoy the affiliated welfares	No real ownership No real functional Board Not independent from local government No real incentives for top management to increase efficiency
MCCs	Registered Capital of: RMB 5 million for limited liability company; RMB 10 million for shareholding company; however the standard is raised by at least 4 times in provincial regulations <sup>[5]</sup> Private investors (individual or institutional) No single founder > 10% principal ownership (raised in provincial regulations for the principal founder <sup>[6]</sup> )	Comply to the Corporate Act of China: Shareholders → Board → Top Management Vote by capital shares Requirement on banking experience for top management (normally in provincial regulations)	Conflicts among shareholders More interested in short-term profits Reluctant to adopt social missions Doubtful management capacity
VTBs	Registered Capital of: RMB 3 million in county; RMB 1 million in township Sole ownership or controlling ownership by a traditional	Shareholders (?) → Board → Top Management President of Board and the top management require 5 years' experience in banking or 8 years'	Control by traditional commercial banks or large shareholders More interested in short-term profits Reluctant to adopt social missions Difficult to attract qualified directors

	<i>commercial bank</i> <i>Controlling shareholder bank &gt; 20% principal ownership</i> <i>Any other non-bank shareholders &lt; 10%</i> <i>Any shareholder &gt; 5% needs advance approval of CBRC local office</i>	<i>related experience (including 2 years' banking)</i> <i>Candidate for directors and top management needs qualification check of CBRC local office</i> <i>Branch director to get certificate from local CBRC exam</i>	<i>and top management</i>
RMCCs	<i>Registered Capital of: RMB 300 thousand in township; RMB 100 thousand in village</i> <i>At least 10 qualified initiators</i> <i>No single founder &gt; 10% principal ownership</i> <i>Any shareholder &gt; 5% needs advance approval of CBRC local office</i>	<i>Shareholders / members → Top Management, or</i> <i>Shareholders / members → Board → Top Management</i> <i>If members &gt; 100, then to elect representatives consist of &gt; 31 members</i> <i>Each member has one basic vote</i> <i>Large shareholders can have additional votes, but total additional vote should &lt; 20%</i> <i>Directors and general manager need qualification check of CBRC local office</i> <i>Supervision committee by the stakeholders</i>	<i>High possibility of being controlled by a few influential leaders</i> <i>Low internal cohesion</i> <i>Weak internal control mechanisms</i> <i>Generally poor management capacity and staff quality</i> <i>Ineffective external supervision</i>

Source: prepared by the authors

Our research shows it is not easy to combine commercial operation with social expectation of serving the poor. The NGO MFIs supported by grants can fulfill social missions better, but have less incentive for high efficiency due to lack of real ownership. So they can not be sustainable in the long run. While the other type of MFIs, which involve in private investment, tend to ignore social missions and go for profit only, especially for the short-term benefit. They intend to charge higher interest rate and disburse large loan sizes. The risk may accumulate and finally affect the sustainability of the MFIs, Not to mention the other aspect that such behaviors already move away from the initial aim of microfinance.

## Challenges in Competition Context

### The Competition from the Traditional Commercial Banks

As we showed in the table 1, the traditional commercial banks are also encouraged to downscale their products. Now the Agricultural Bank of China, the Rural Credit Cooperatives, and the Postal Savings Banks are very active in the rural areas, while urban commercial banks and the other traditional commercial banks are rather active in the urban areas. Compared to the internal competition among MFIs, we think the threat from the traditional banks is more serious.

Banks have many competitive advantages. They have easier access to the good clients and can provide better services beside credit; they can monitor the fund use better; they have better financial condition both on capital and on attracting savings; they have better staff and management capacity; they have better experience on developing new products and conducting marketing; and so on. So if they go into the same business sector, the present MFIs can hardly compete.

Besides the good clients may be taken away by banks, in reality the interest rate offered by banks is actually the interest rate cap for MFIs for transactions at the same condition. Lacking of their own remittances channel, MCCs need to cooperate with banks for the relevant services. Traditional state-owned banks had retreated from poor and rural areas during their reform of efficiency improvement; therefore there is the room for MFIs especially VTBs to grow. But so far remittances channel still needs to be settled for VTBs to broaden their business.

### **Higher Operating Cost and Risk**

Theoretically MFIs will go to the poor or low-income clients who are normally considered unqualified clients by traditional banks. Generally the traditional collateral is not feasible for such clients, and this leads MFIs to higher default risk. This is especially true for NGO MFIs.

To solve this problem, NGO MFIs tried Grameen Model of group guarantee and repayment in installment. Normally a loan group consists of 3–5 clients, and 2–5 groups constitute a loan center. The disbursement of loans and the collection of repayments are organized in the regular center meeting (weekly, biweekly, or monthly) by the credit officers of MFIs. The individual loan size normally is several thousand. It is very costly to manage a large number of clients with small loan size<sup>[7]</sup>. It also costs to maintain the regular center meeting system, especially when the clients are remote<sup>[8]</sup>. That is why some NGO MFIs reduced the frequency of center meeting from weekly gradually to biweekly and then to monthly. However, regular center meeting enable MFIs to keep close monitoring on the clients and to guarantee repayment rate. Reduction in meeting frequency may have a negative impact on the repayment risk.

Du Xiaoshan (2008), Cheng Enjiang (2006) both mentioned there were once approximately 300 microcredit organizations or projects in China, and only around 100 MFIs still remain operation. Among them, only about 10 MFIs have managed to become operationally self-sufficient, means the operating revenues (mainly from interest) can cover the operating costs and the subsidized capital cost (the grants and the soft loans). They are still far from financially self-sufficient, means the operating revenues can over not only the operating costs, but also the market capital cost (capital cost calculated in the market interest rate).

Actually it is widely believed that there is a trade-off between outreach<sup>[9]</sup> and sustainability due to the high transaction costs, high risk and lower expected returns for providing microfinance services to the poor. This explains exactly why the newly established MCCs and

VTBs, operating on a business approach, are reluctant to adopt social missions and incline to issue large loan size and server the non-poor.

As another means of guarantee, some NGO MFIs required up-front group funds or compulsory savings. But this policy now encounters the legal risk when MCCs are strictly forbidden by the regulation from attracting savings in any form. We noticed that some NGO MFIs have given up this practice due to this reason.

### **Challenges in Management Capacity**

Management capacity is another key bottleneck for the sustainable development of MFIs. This reflects in the quality of MFIs' staff, innovation in microfinance products, and implementation of management information system.

Staff quality is the basis for implement sound management. This is also noticed by the supervision authorities and reflects in qualification requirements on top management of MFIs (see table 3). However, in reality MFIs can hardly compete with commercial banks for qualified personnel in view of financial benefits and professional prospect. In our field survey to CZSWDA, we noticed more than half of its loan officers came from its earliest farmer clients, and the rest was recruited from graduates of high school or vocational school. Nearly none of them has financial education background, and their financial skills mainly came from work experience and internal trainings. Other surveys prove this phenomenon is rather common in MFIs.

For credit products, there is little innovation so far in China's MFIs. They tied either the Grameen Model of group lending or the traditional collateral loan as banks do. Despite of the success of the Grameen Bank (by group lending), it is generally considered difficult to replicate this success, especially in areas with lower population densities. There the cost-saving effect of group lending will be offset by the increase of operating cost of extending outreach. This is just the challenge faced by NGO MFIs working in the western poor areas in China. For MCCs and VTBs, the main methodology now is still the collateral or the third-party guarantee. As soon as commercial banks discover the same client group, they can hardly compete. For the long-term success of MFIs, it is believed necessary to develop new products and/or new operating models according to the local situation and the target groups. For credit loans, effective collection policy and techniques also need to be developed in case of delinquent borrowers and group coalition defaults. However such professionals are scarce in MFIs.

Management information system (MIS) is another weak point in management. In most MFIs, only a very basic manual MIS is in operation. There is no verification of the accuracy and timeliness of this process and whether the information has been used for management decisions. Thus there is a common need to upgrade current manual MIS to a comprehensive computerized system which will improve transparency of operation and support

management decision making. To achieve this goal, more computer skills need to be obtained by MFIs' staff. So are the management techniques.

Limited management capacity in MFIs was also realized by international development agencies such as World Bank, KfW, Grameen Foundation, etc. Recently they initiated several technical aid projects on capacity building and organized training workshops on microfinance. Without fundamental improvement in management, we think MFIs may run into trouble when their operations are extended and become too complex.

## Conclusion

Microfinance is promoted across the world because it is generally believed that microfinance will contribute positively to poverty reduction. But to target at poor areas and poor people, it means high transaction costs, high risk and lower expected returns. This makes financial sustainability an ever challenge for all MFIs.

In recent years, Chinese government took several initiatives to develop microfinance sector, especially encouraging private capital take part in MFIs. Apart from remaining NGO MFIs founded in previous development projects, new types of MFI came forth as MCC, VTB, and RMCC. Although the initial regulatory framework has been established for these new MFIs, there are many legal restrictions related to attracting funds (especially savings) and extending their business. And their legal status remains unclear. The outer supervision from authorities is either too much or not enough. All these factors bring challenge to the success of MFIs. Meantime they are counter more and more competition from traditional commercial banks which have obvious competition advantages. Ownership and governance structure also play a negative role. In general, NGO MFIs which lack of real ownership develop little interest in efficiency, while commercial MFIs (MCCs and VTBs) which involve in private capital care too much on short-term profit. RMCCs as member-owned organizations have high risk of being captured by a few influential leaders, and the members may lose their money. Another constraint to sustainability is management capacity and staff quality. And there is still a long-way to go.

In view of all these challenges, we think it is still too early to say whether MFIs will succeed or fail in China. And the government needs to take more measures to improve microfinance environment and promote the industry; meantime MFIs need to improve their governance structure and management capacities.

## Notes

### Abbreviations

ABC	<i>Agricultural Bank of China</i>
CBRC	<i>China Banking Regulatory Commission</i>
CDB	<i>China Development Bank</i>
CZSWDA	<i>Chifeng ZhaoWuDa Sustainable Women's Development Association</i>

MCCs	<i>Microcredit companies / Microloan companies</i>
MFI	<i>Microfinance institutions</i>
MIS	<i>Management information system</i>
NGOs	<i>Non government organizations</i>
PBOC	<i>People's Bank of China</i>
RCCs	<i>Rural Credit Cooperatives in China</i>
RMB	<i>Unit of Chinese currency</i>
RMCCs	<i>Rural mutual credit cooperatives</i>
VTBs	<i>Village/township banks</i>

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<sup>[1]</sup> Project sponsors include: (1) international organizations such as UNDP, UNICEF, etc; (2) foreign governmental agencies for development assistance such as CIDA (Canadian International Development Agency), etc; (3) international NGOs such as Grameen Foundation, Ford Foundation, etc.

<sup>[2]</sup> People's Bank of China (PBOC), (2011), "Statistics Report on Microloan Companies in 2010".

<sup>[3]</sup> The requirement on the least registered capital is 300,000 RMB in the township level and 100,000 RMB in the village level respectively.

<sup>[4]</sup> Such as Government Office, Agriculture Department, Poverty Alleviation Department, Women Association, etc.

<sup>[5]</sup> For example, according to the respective provincial regulations, the minimum registered capital for Limited Liability Company is RMB 20 million in Anhui, RMB 50 million in Shanghai, RMB 50 million / RMB 20 million for "less developed areas" in Zhejiang, RMB 30 million in Shannxi, etc.

<sup>[6]</sup> For example, in Shannxi the principle founder is allowed to have up to 35% of principal ownership, and the minimum capital for other minor founders is RMB 2 million.

<sup>[7]</sup> In our field survey to Chifeng ZhaoWuDa Sustainable Women's Development Association (CZSWDA), one of the best performers of NGO MFIs, we noticed that there were 305 loan centers, 609 loan groups, 3,866 effective clients as of end 2010 with the loan size of RMB 3,033 in average.

<sup>[8]</sup> In our field survey to CZSWDA, we noticed that the most remote clients live about 35 km away from MFI office in the county downtown.

<sup>[9]</sup> It means the ability of a microfinance institution to reach poorer and more remote people.



**VALUE-BASED MANAGEMENT FOR SMALL- AND MEDIUM-SIZED ENTERPRISES –  
FINDINGS OF AN EMPIRICAL STUDY ON THE DIFFUSION AND OBSTACLES OF THE  
IMPLEMENTATION**

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## **Abstract**

Based on the description of the theoretical background of value-based management and the characteristics of SMEs, the paper analyses the state of knowledge and the diffusion of value-based management among SMEs, shows the result of a recently undertaken empirical study and identifies possible implementation barriers of this concept.

**Keywords:** SME, Value Based Management, Performance Measurement

## **Introduction**

SMEs are seen as the “backbone” of the German economy (Schauf, 2009a, p. 15). According to the statistic of the SME-research institute „Institut für Mittelstandsforschung Bonn“ 99.7 % of the German companies subject to value-added tax in 2009 belong to the group of SMEs (IfM Bonn).

The management style of SME entrepreneurs is often characterised by short-term considerations (Wegmann, 2006, p. 148). In addition, a lot of decisions are taken intuitively (Wegmann, 2006, p. 185). Because of the increasing need of capital and the growing intensity of competition SMEs face high challenges (Schlüchtermann and Pointner, 2004, pp. 24-25). Thus, there the professionalization of the management in SMEs is getting more and more important (Schauf, 2009a, p. 15).

The importance of value-based management increased in recent years and it is now considered as one of the key management philosophies (e. g. Britzelmaier, 2009, p. 11). According to the shareholder value concept, the fundament of value-based management, the main objective of the management is to increase the value of the company for the shareholders (Rappaport, 1986, p. 1). However, value-based management is not only focused on the increase of the company value but also constitutes a managerial approach that enables a sustainable economic development (Piontkowski, 2009, p. 357). Fundamentally, value-based management can be applied by any company independent from its size and its capital market orientation (Krol, 2007, p. 3). Large listed companies are using value-based management instruments since years (Arbeitskreis “Wertorientierte Führung in mittelständischen Unternehmen“, 2003, p. 525). The objective of sustainable economic development is also pursued by SMEs (Piontkowski, 2009, p. 357). Additionally, there are several factors that promote the application of value-based management for SMEs (e.g. Krol, 2009a, pp. 89-128). Nevertheless, value-based management is only spread to a limited extend among SMEs (Piontkowski, 2009, p. 357).

Based on the description of the theoretical background of value-based management and the characteristics of SMEs, the paper analyses the state of knowledge and the diffusion of value-based management among SMEs and identifies possible implementation barriers of this concept.

### **Fundamentals of value-based management**

The first approach of value-based management was the shareholder value concept developed by Rappaport in 1986 (Rappaport, 1986). The company's activities should focus on the increase of the company value (Tappe, 2009, p. 64). Based on this concept, other approaches of value-based management like the Economic Value Added or the Cashflow Return on Investment have been developed (Britzelmaier, 2009, p. 12).

It has to be pointed out, that value orientation is not necessarily focused on monetary values. Business activities should always be based on ethically correct behavior. In western countries this is characterized by Christian and occidental values, in China e.g. by Confucianism and Taoism. Ethically correct behavior - the orientation of own actions along spiritual values - and shareholder value orientation do not exclude each other. A flourishing company preserves and generates jobs; content employees support a good company's performance. Economic, ecologic, ethic and social goals are not stringently working in opposite direction, but often have a complementary character.

Investments are only seen as beneficial if a positive net present value is reached under consideration of risk-adjusted capital costs (Arbeitskreis "Wertorientierte Führung in mittelständischen Unternehmen", 2003, p. 525). The consideration of this principle leads to an ameliorated capital allocation; management and decision-making are focused more in the long run and with a higher strategic focus (Krol, 2007, p. 3). This approach can be applied independently from the size and the capital-market orientation of a company (Krol, 2007, p. 3). The focus of value-based management on a sustainable and profitable growth goes perfectly with SMEs (Arbeitskreis "Wertorientierte Führung in mittelständischen Unternehmen", 2003, p. 526). To implement value-based management value-oriented figures and management instruments have to be integrated in the the control system of the company (Krol, 2009a, p. 85).

### **Characteristics of small- and medium-sized enterprises**

SMEs can be characterized by using qualitative as well as quantitative criteria. There are different quantitative definitions (Tappe, 2009, pp. 12-13). The definition of the SME-research institute „Institut für Mittelstandsforschung Bonn“ is commonly used in Germany (Stiegemann, 2007, p.19; Waltermann, 2009, p. 3). It defines SMEs as companies with less than 500 employees and sales below 50 million € (Institut für Mittelstandsforschung Bonn). Quantative definitions are also made by the German Commercial Code (HGB) and the EU Commission. The plurality of SMEs is not reflected by quantitative criteria (Tappe, 2009, pp. 14-15). They should be completed by qualitative factors to show the characteristics of SMEs (Tappe, 2009, p. 12).

Besides their legal and economic independence (Krol, 2007, p. 4), SMEs are characterised by the unity of ownership and management (Tappe, 2009, p. 15). The owner-manager exercises the functions

of the owner and the manager (Krol, 2007, p. 4). Thus, the principal-agent problem, occurring often in big companies, is less important for SMEs (Tappe, 2009, p. 16). Usually the owner-manager is the only decision maker; therefore he matters substantially for the company (Krol, 2007, p. 4) and has a major influence on the management of the company (Piontkowski, 2009, p. 357). Besides the positive features resulting from this person-oriented company structure, there are also negative ones (Piontkowski, 2009, p. 357). A lot of tasks are exercised in personal union. There is the danger of a too patriarchal management by an entrepreneur who's not qualified sufficiently (Piontkowski, 2009, p. 357). Often the management is also involved heavily in the operating activities (Krol, 2009b, p. 10). The management style of SME entrepreneurs is often characterised by short-term considerations and a lot of decisions are taken intuitively (Wegmann, 2006, p. 148). This management style is seen as a reason for the negligence of strategic and formal planning (Piontkowski, 2009, p. 358). The phenomenon of a lacking determination of specific goals and the lack of an institutionalised planning process is described as lack of planning (Tappe, 2009, p. 32).

Usually a clear distinction of the personal, meta-economical goals and entrepreneurial, mainly financial goals is not possible in SMEs (Tappe, 2009, p. 15). The high importance of meta-economical goals especially in independent companies and/or companies that are family-owned also reflects in an empirical study of Krol (Krol, 2009b, pp. 5-6).

A lot of SMEs are family businesses; this means that the majority of interest is held by up to two people resp. the members of the entrepreneur family, who are also part of the management board. In general family entrepreneurs face the same requirements as sole proprietors. But there is the risk of a conflict of interests between members of the family (Khadjavi, 2005, p. 60).

The embedding in tight and regional networks of relations is also typical for SMEs (Arbeitskreis „Wertorientierte Führung in mittelständischen Unternehmen“, 2003, p. 525). Tight relationships to customers, suppliers and employees usually exist for several years (Arbeitskreis „Wertorientierte Führung in mittelständischen Unternehmen“, 2003, p. 525). The importance of these relationships for the company success is much higher than in major enterprises (Arbeitskreis „Wertorientierte Führung in mittelständischen Unternehmen“, 2003, p. 525). The high relevance of stakeholders other than the owners for the definition of the company goals is also shown by an empirical study of Krol (Krol, 2009b9

SMEs often exhibit flat hierarchies because of the small company size in contradiction to major companies (Krämer, 2009, p. 210). This supports a high transparency and leads to short and direct information exchange and a low level of formalization (Krämer, 2006, pp. 214-215). Quick decision-making, realisation and processing indicate a high flexibility in SMEs (Hilzenbecher, 2006, pp. 88-89). In addition, SMEs are able to react quickly and efficiently on changes in the market environment (Hilzenbecher, 2006, p. 89). Low transaction costs, high efficiency and a high level innovation are additional strengths of SMEs.

Another characteristic of SMEs is the limited availability of resources. Usually, the management is not supported by staff departments (Krol, 2007, p. 12). Often, there are no independent controlling

departments (Krol, 2009b, p. 2). This can increase the risk of negligence of strategic planning. SMEs are also often dependent on only a few know-how bearers (Krol, 2007, p. 5). Moreover, the information and communication technologies and thus also the documentation in SMEs are more modest than in major enterprises (Arbeitskreis „Wertorientierte Führung in mittelständischen Unternehmen“, 2003, p. 525).

Oftentimes, the financial means of the proprietor are the main source of financing (Behringer, 2009, p. 46). The financial situation is very dependent on the personality and possibilities of the owner (Helbling, 2002, pp. 189-190). SMEs usually have low equity ratios (Hilzenbecher, 2006, p. 90). SMEs have to rely more on debt capital because their access to equity capital is limited in comparison to bigger companies. The capital market offers possibilities for alternative sources of financing. However, most SMEs have difficulties to get financial means on the capital market because they are not able to fulfill the requirements of the capital market and have a lower size of company (Bussiek, 1996, p. 139). Modern forms of equity financing are mostly rejected (Krol, 2009b, p. 13). This leads to a high dependency on the financing of the house bank, which can be seen as a main stakeholder of the company (Krol, 2007, p. 4). This is also a finding of an empirical study of Krol, in which nearly 78 % of the SMEs state that they use credits of the house bank frequently or very frequently (Krol, 2009b, p. 13). Though, it can be detected that more and more SMEs get access to the stock market (Behringer, 2009, pp. 34-35).

## **Concept and basic findings of the empirical study**

### **Concept of the empirical study**

#### **Determining an operational definition**

Because there is no generally accepted definition of SMEs, it seems to be reasonable to introduce an operational definition for the empirical study. Following the commonly used definition of the “Institut für Mittelstandsforschung Bonn” a SME is a legally and economically independent company,

- that is not publicly listed,
- that employs up to 500 employees and
- generates external sales of not more than 50 million € per year.

If the quantitative criteria are exceeded, more than 50 % of the shares should be held by the management.

#### **Data collection approaches**

The aim of the empirical study was to achieve adequate knowledge about the form of management in SMEs to be able to make statements to what extent SMEs act value-oriented.

To get relevant data, a questionnaire was developed on the basis of the empirical studies of Gonschorek, Krol and Tappe (Gonschorek, 2009; Krol, 2009a; Tappe, 2009, Britzelmaier et al 2009). The enquiry was carried out between the 12<sup>th</sup> april and the 15<sup>th</sup> may 2010. The participation in the survey was voluntary and anonymous. The collected data were treated strictly confidential and were not

transferred to third parties. To obtain a high response rate a specific online portal for enquiries was created. The advantages of this distribution channel towards other methods of survey (e.g. via mail or via fax) are the quick and cost-effective possibility to take part in the enquiry.

Two ways were used to collect data. On the one hand, a cover note asking for support and the reference to the URL address to fill out the questionnaire was posted to the International Controller Association ICV ([www.controllerverein.com](http://www.controllerverein.com)). On the other hand, the "Hoppenstedt Firmendatenbank", the federal company register and the database of the Chamber of Industry and Commerce in Baden-Württemberg, which provide criteria for the sampling process, were used. 201 German companies which fulfill the criteria presented in chapter 4.1.1 were addressed. The analysis of the data collected was made automatically with Q-set-Portal.

### **Corporate objectives of small- and medium-sized enterprises**

#### **Analysis of the importance of different corporate objectives**

The respondents have been asked to specify the importance of different corporate objectives for their company. It can be stated that all corporate objectives listed have a high importance to the responding SMEs. Each corporate objective was classified as "very important" or "important" by more than 50 % of the companies. Thus, it can be reasoned that the systems of objectives of the companies polled are multidimensional (Krol, 2009a, p. 176). The following figure shows the results.

Comparing the arithmetic means, it's apparent, that especially liquidity protection, continued existence of the company, and customer satisfaction are important for SMEs. Since the continued existence (100 %) and the entrepreneurial independence are of very high resp. high importance, the long-term focus of the business operations of SMEs can be assumed (Tappe, 2009, p. 205). Analysing the corporate objectives gives some indication about the value orientation of SMEs. It's apparent, that the increase of the corporate value under consideration of the stakeholder's interests is of high importance. The satisfaction of the customers (92 %) and the employees (77 %) as well as the increase of the company value (80 %) are "very important" resp. "important" for a major part of the responding companies. Analyzing the means of the several corporate objectives, it can be recognized that the financial objectives have a leading role. It's remarkable that the achievement of financial objectives like profit maximization and the increase of the return on equity have been named "not very important" resp. "unimportant" by 6 % resp. 5 %.

In total, it can be stated that the SMEs polled are characterised by the long-term focus of their corporate objectives and the desire to increase the corporate value. But it remains open, if they actually act value-oriented.

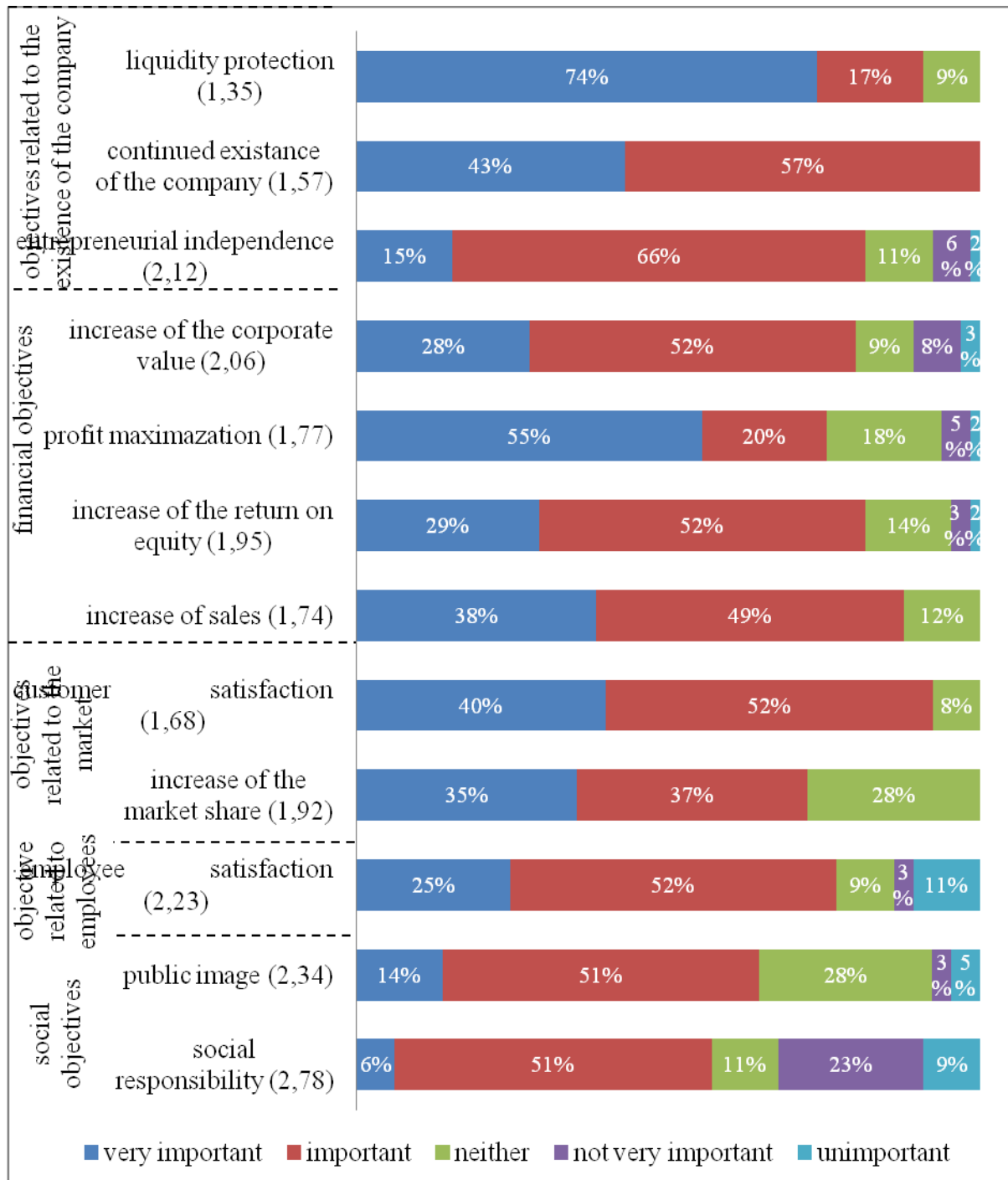


Figure 1: Importance of different goals for the respondents

### Importance of different stakeholders for the determination of the corporate objectives

The following figure shows, how much value is attached to the different stakeholders in the process of determining the corporate objectives.

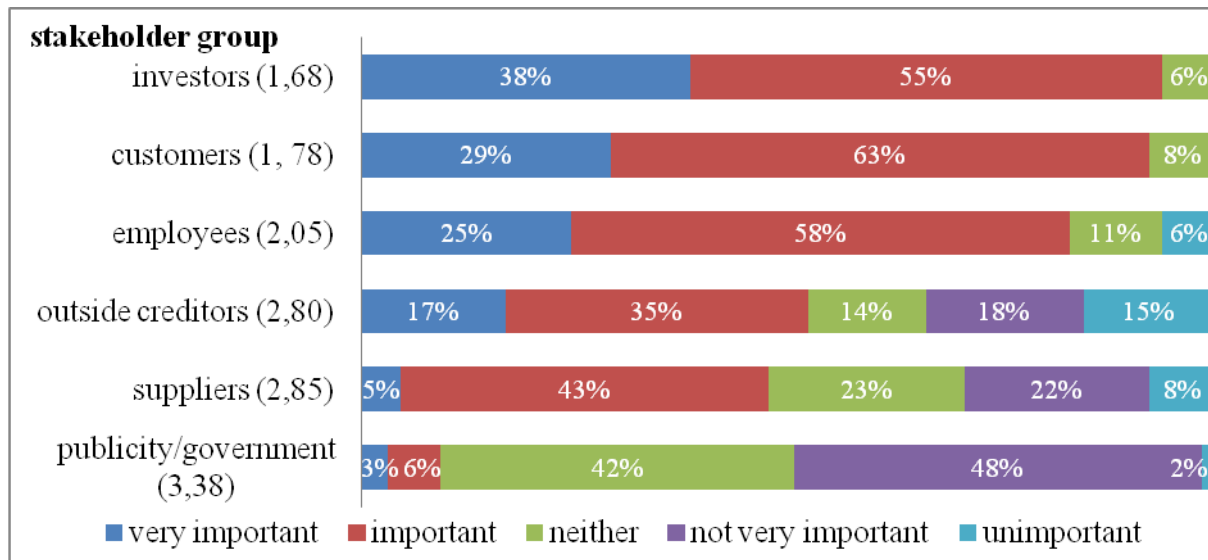


Figure 2: Relevance of different stakeholder groups for the determination of the corporate objectives

The majority of the SMEs (94 % “very important” resp. “important”) stated that mainly the interests of the investors are taken into account when determining the corporate objectives. This is of top priority because by providing capital the investors bear the entrepreneurial risk and enable the business activity (Behringer, 2009, p. 37). Furthermore, the interests of customers and employees have a great impact on the system of objectives (92 % resp. 83 % „very important“ or „important“). This can be ascribed to their major contribution to the value-added process (Krol, 2009a, p. 180). Because of the high importance of debt financing a high significance of outside creditors was assumed (Krol, 2009a, p. 180). Though, the empirical study showed that this stakeholder group which is important from a theoretical point of view, was “not very important” or “unimportant” for 34 % of the respondents. In comparison to the other stakeholders, the interest of the publicity is considered the least.

The analyses made so far give indications that SMEs are focused on shareholders as well as on stakeholders. The fulfillment of the expectations of all stakeholders has great attention in SMEs, what corresponds to the main principles of value-based management.

### Characteristics of the strategy orientation

The enquiry shows that more than half of the respondents (55 %) have a strategy that is written down. Besides that, 48 % stated that the objectives set out are phrased clearly and definitely (“applies completely” resp. “applies predominantly”). This is an essential prerequisite for the successful implementation of the company’s strategy (see Krol, 2009a, p. 186 for the rationale). Furthermore, 37 % objected the statement that the management has not enough time for the strategic planning. Nearly every second respondent prepares plans and budgets for all relevant business areas systematically. Despite the percentage of the companies where the management is “completely” or “predominantly” occupied with operative tasks is 42 %, only 18 respondents (29 %) stated that is a reason for the lack of application of new business administration methods.

Although the majority of the respondents take the interests of the employees into account (see chapter 4.2.2) only 46 % declared that they communicate the long-term corporate objectives and

strategies “completely” or “predominantly” to their employees. Furthermore, it’s negative that external stakeholders like customers or suppliers are “predominantly not” or “not at all” informed about the current business development (42 %).

In compliance with the lack of long-term strategy, often criticised in the literature (e.g. Wegmann, 2006, p. 148), the empirical study indicated that SMEs are characterized by deficits in strategic planning and a lack of communication of the objectives set out. But they are aware of the necessity of a strategic orientation. However, worse results were expected. But it has to be taken into account that the information given in an enquiry is not necessarily consistent with reality. Aspects considered positively can be overemphasized or imagined intentionally or unknowingly (Bortz and Döring, 2002, p. 231).

### **Analysis of the financing of SMEs**

The questioned SMEs were asked to evaluate different instruments of financing according to their importance for their company. It could be proven that bank loans are the most favored source of financing (68 % “(very) important”). This can be confirmed by the fact that the majority (89 %) of the companies is interested in a long-term cooperation with their bank. 77 % report the current business development systematically to their house bank. Every second agreed to the statement that the granting of a bank loan became a highly complex process in the last three years. This may be a reason for the fact that leasing as alternative form of financing is gaining importance in SMEs (Wegmann, 2006, p. 231). Only 18 % are of the opinion that leasing is „not very important“ or „unimportant“. Nearly every SME (91 %) renounces the possibility to raise capital by admittance of new partners. The fear of small- and medium-sized entrepreneurs to lose the sole responsibility for the business activities can be stated as one reason for this (Bussiek, 1996, pp. 42-44). The importance of forms of financing like bonds, increase of capital via the capital market, private equity, mezzanine and factoring is seen mainly as „not very important“ or „unimportant“.

Thus, the results of this empirical study are in compliance with other studies which came to the conclusion that the bank loan is the most often used form of financing in SMEs (Krol, 2009a, pp. 195-196; Gonschorek, 2009, pp. 200-201).

## **Diffusion of value-based management in small- and medium sized enterprises**

### **Findings of previous empirical studies**

Up to now, value-based management for SMEs doesn’t attract a lot of attention in economic literature as well as in the practical application (Tappe, 2009, p. 2). Krol investigated the application of value-based instruments in SMEs in an empirical study (Krol, 2009b). For independent SMEs the increase of the corporate value was the most important financial goal (Krol, 2009b, p. 5). Nevertheless, 81 % of the companies polled stated that they make investment decisions “very often” respectively “often” based on experience rather than on calculations (Krol, 2009b, p. 12). The net present value and the internal rate of return which are value-oriented assessment criteria are used only seldom (Krol, 2009b, p. 12). The enquiry of Piontkowski comes to the conclusion that SMEs show an underdeveloped application of value-based management also related to such instruments and



controlling processes which would be suitable for SMEs (Piontkowski, 2009, p. 363). Larger SMEs tend to use value-based instruments for management more often than smaller SMEs (Piontkowski, 2009, p. 362). The analysis of the use of different target figures also shows the rather low use of value-oriented figures (Krol, 2009b, p. 8). Traditional, not value-oriented figures like profit or sales are used much more often (Krol, 2009b, p. 8). Also regarding the management instruments used, mostly operative management instruments are widespread (Krol, 2009b, p. 16, Beck and Britzelmaier 2010). This and the examination of the methods of investment calculation show the low consideration of value-oriented principles in the management of SMEs (Krol, 2009b, p. 17).

## Findings of the empirical study

### Application of different target figures for management

The respondents were asked to state how often they use different target figures. Two new answering possibilities were added to the five answering possibilities. The respondents could state that this figure is unknown or that they plan to use this figure in the future.

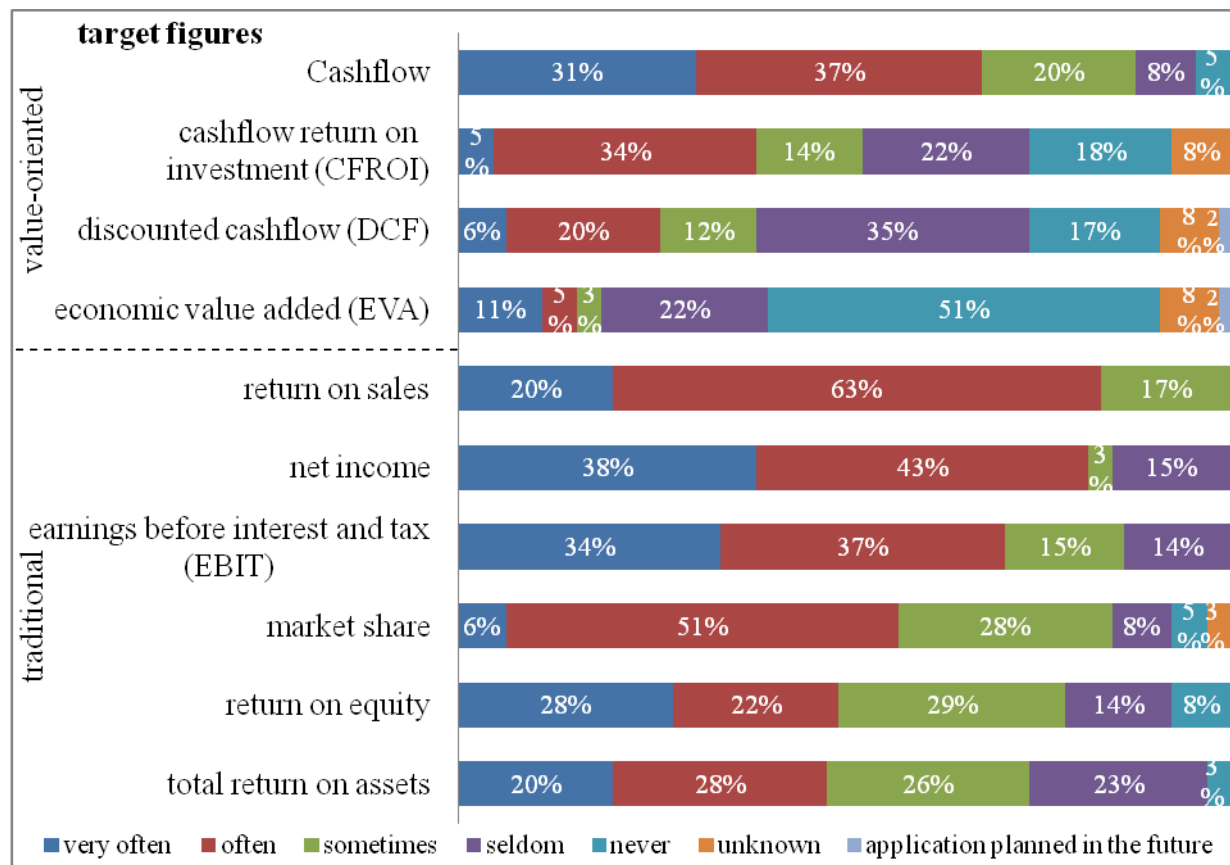


Figure 3: Application of different target figures for management

By examining the number of companies who apply several figures „very often“ or „often“, it can be determined that the traditional figures are seen as more relevant for practical application than value-oriented target figures. Figures like return on sales (83 %), net income (82 %) and earnings before interests and tax (71 %) are used „(very) often“. Typical value-oriented figures like CFROI (40 %), DCF (52 %) und EVA (72 %) are applied „seldom“ or „never“. Besides this, 8 % of the companies stated that

they even don't know these metrics. The low intensity of use is seen critical in light of the high importance of the corporate objective to increase the corporate value. Overall, it can be assumed that SMEs are not familiar with the basics and specifics of value-based management and that value creation is a vague goal (see Krol, 2009a, pp. 182-183 and 219 for the rationale).

### Application of management instruments

To make a final assessment of the degree of establishment of value orientation in SMEs, it's not sufficient to focus on the analysis of the use of value-oriented figures. It's necessary to analyse the answers related to the application of management instruments (see chapter 5.2.1.3; Krol, 2009a, p. 68 and 78). According to their frequency of use (used "very often" or "often"), the results were grouped into four categories:

- High level of application (51-100 %),
- Medium level of application (26-50 %),
- Low level of application (11-25 %) and
- scarcely used

The results are shown in the following graph.

<i>Diffusion</i>	<i>Management instrument</i>	<i>Application „very often“ resp. „often“</i>
<i>High level of application (51 - 100 %)</i>	<i>Liquidity planning</i>	91 %
	<i>Cost type and cost centre accounting</i>	82 %
	<i>Business analysis</i>	72 %
	<i>Budgeting</i>	65 %
	<i>Standard costing</i>	63 %
	<i>Marginal costing</i>	60 %
	<i>Ex post calculation</i>	57 %
	<i>Variance analysis</i>	54 %
<i>Medium level of application (26 – 50 %)</i>	<i>Budgeted balance sheet and budgeted income statement</i>	51 %
	<i>Multi-period investment calculation</i>	48 %
	<i>Business plan</i>	43 %
	<i>Variable compensation systems</i>	42 %
	<i>Risk management</i>	38 %
	<i>Cash-flow statement</i>	35 %
<i>Low level of application (11 – 25 %)</i>	<i>One-period investment calculation</i>	22 %
	<i>Balanced scorecard</i>	18 %
	<i>Value driver analysis</i>	18 %
	<i>Analysis of strengths and weaknesses</i>	15 %
<i>Scarcely used (0 – 10 %)</i>	<i>Portfolio analysis</i>	9 %
	<i>Process analysis / activity based costing</i>	9 %

Figure 4: Application of management instruments

It can be observed that value-oriented management instruments are not used as frequently as standard management instruments. Multi-period investment calculation, variable compensation systems, risk management and cash-flow statements are only applied on a medium level by SMEs. Only 42 % use e.g. a variable compensation system. However, it's necessary that executive managers as well as employees do not only understand the basic principles of value-based management but are also encouraged to act value-oriented (Weber et. al., 2004, p. 189).

While the balanced scorecard and the value driver analysis show a low level of application (18 % each), process analysis / activity based costing are scarcely used. This is seen critically regarding the contribution of these instruments to a successful realization of a value-increasing strategy (Krol, 2009a, pp. 205-211).

In total, a low relevance of value-based management instruments in SMEs can be observed. Nevertheless, it's positive that some companies plan to apply the balanced scorecard (17 %), the variable compensation system (9 %), the value driver analysis (6 %) and the process analysis / activity based costing (6 %) in the future.

## **Obstacles of the application of value-based management in small- and medium-sized enterprises**

### **Findings of the literature and previous empirical studies**

The principal-agent problem is considered as one of the main reasons for the application of value-based management in major enterprises (Vogelsang, 2009, p. 19). Usually, there is an information asymmetry between the owners, who are in the role of the principal and the management, which has the role of the agent (e. g. Britzelmaier, 2009, pp. 19-20). Value-based management helps to enforce a management behavior in the interest of the owner (Piontkowski, 2009, p. 359). Because of the unity of ownership and management in SMEs, there's no principal-agent problem and such a control function is not necessary (Vogelsang, 2009, p. 19). Thus, this incentive for value-based management is not important for many SMEs.

A significant obstacle for value-based management is the lack of resources in SMEs (Schomaker and Günther, 2006, p. 218). Often a documentation and information management structure, needed for the implementation of complex value-based management systems can't be found (Krol, 2007, p. 13). This may cause the problem that the information necessary for a precise and detailed calculation of the value-based figures are not available (Tappe, 2009, p. 3). To determine the essential parameters out of the accounting requires economical and financial understanding and causes considerable effort (Schomaker and Günther, 2006, p. 218). The companies questioned by Krol state that the lack of resources is the main obstacle for value-based management in SMEs: 38 % think, that additional information management systems are necessary, 35 % are of the opinion that there's a need for an increase of employees and 30 % expect high expenditures (Krol, 2009b, pp. 18-19). The enquiry of Krol shows that mainly effort and cost aspects are seen as obstacles for an implementation of value-based management instruments (Krol, 2009b, p. 19).

Due to mainly technical-oriented careers of SME entrepreneurs, there is a lack of information about value-based management (Krol, 2009a, p. 3). 31 % of the respondents state this as an implementation obstacle (Krol, 2009b, pp. 18-19). This lack of information cannot be overcome because there are no staff departments and an uneasiness to hire outside consultants (Krol, 2007, p. 12).

The low diffusion of value-based management in SMEs can also be explained by the fact that value-based management was developed especially with regard to large, listed companies and does not take the characteristics of SMEs into account (Schomaker and Günther, 2006, p. 217). So far, there is no generally accepted concept which considers the characteristics of SMEs. This is caused among other things by the heterogeneity of SMEs. The fact that the specific situation of the company has to be considered to develop and apply a value-based management system makes the development of a universal concept more difficult (Krol, 2009a, p. 3).

### **Findings of the empirical study**

#### **Attitude towards value orientation**

The study is focused on the analysis of the respondents' attitude towards a value-oriented management. At first, the information about occasions for the determination of the corporate value is analysed. 28 % of the companies calculate the corporate value in case of the sale of the company or parts of it or in case of reorganizations. Every second names the credit check and value-based management as important occasions. This indicates the value-oriented perception of the half of the respondents. The following graph shows the results of the survey on the attitude towards value orientation.

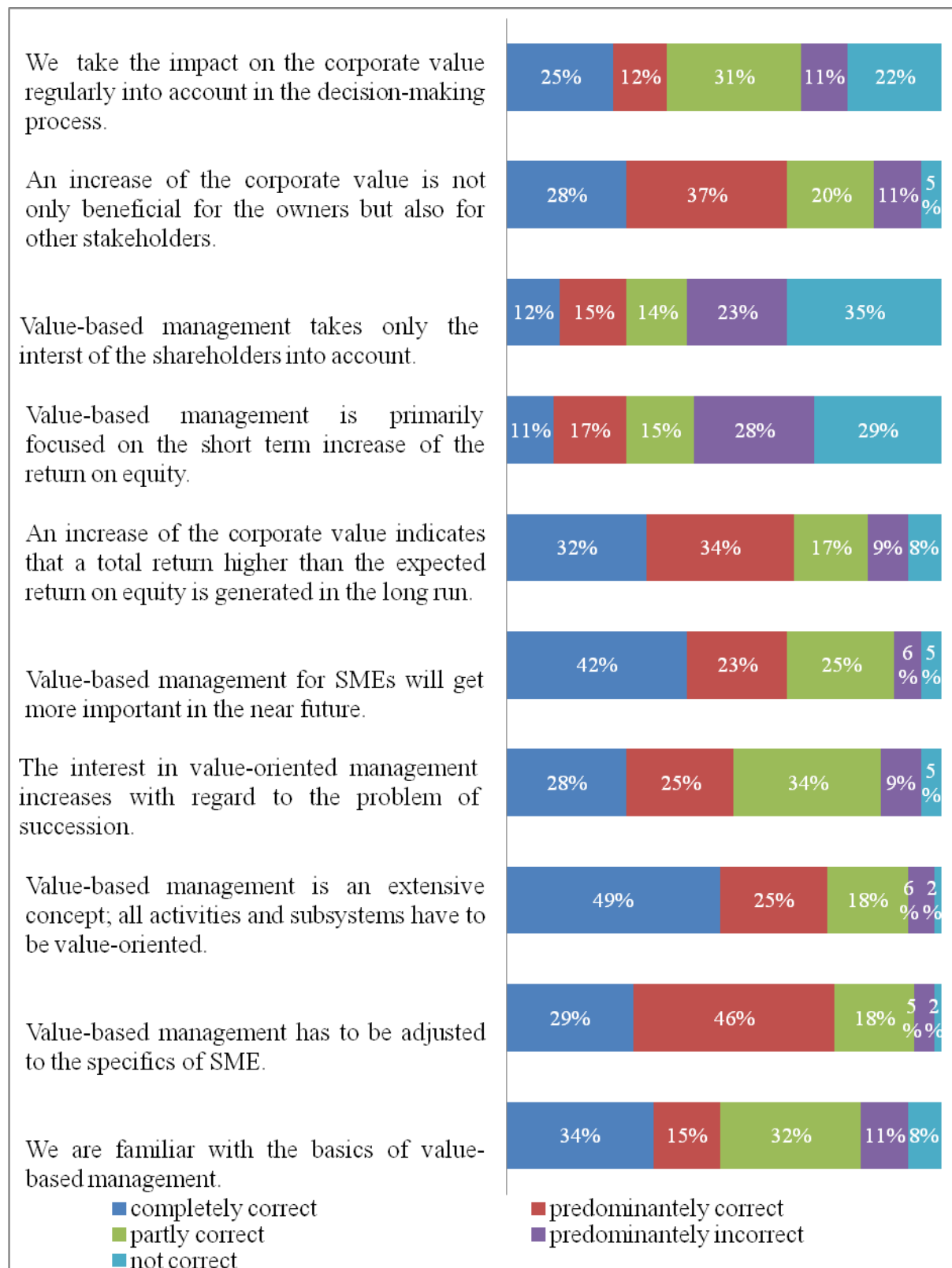


Figure 5: Perception to value-based management

The statements, that value-based management takes only the interests of the shareholders into account and that it's mainly focused on the short-term increase of the return on equity are seen as „predominantly incorrect“ resp. “not correct” by more than a half of the respondents each (58 %resp.

57 %). Since 28 % agree „completely“ respectively „predominantly“ to this statements, it can be concluded that there are some misunderstandings about the focus of value orientation among some SMEs.

The next question was related to the evaluation of the contribution of value-based management to the success of the SMEs. The majority of the respondents agrees „completely“ or „predominantly“ to the statement that not only the owners but also other stakeholders benefit from the increase of the corporate value. The number of respondents who agrees „completely“ or „predominantly“ to opposite statements<sup>32</sup> was 18.

Furthermore, the majority of the respondents (74 %) knows, that value-based management is an extensive concept, in that all activities and subsystems have to contribute to the increase of the corporate value (Tappe, 2009, pp. 69-70). 66 % also answered that the statement that an increase of the corporate value indicates that the return generated in the long run is higher than the expected return on equity is “completely” resp. “predominantly” correct.

The statement that value-based management will get more and more important in the near future was also highly accepted by 65 %. More than the half of the respondents (52 %) stated that the successor problem is a reason for this development. The growing interest in value orientation can be confirmed by the fact that one third of the questionnaires was filled out by a member of the management.

Another interesting fact is, that 46 % are of the opinion that the not-value oriented management instruments currently used are absolutely sufficient for a successful management.

Regarding the results it can be concluded that the majority of the SMEs knows the basic principles of value-based management. Nevertheless there are some misunderstandings regarding the focus of value orientation among some SME entrepreneurs.

### **Implementation problems**

Previous studies found a low level of diffusion of value-based management in SMEs (Gonschorek, 2009, pp. 98-203; Krol, 2009a, pp. 157-219; Tappe, 2009, pp. 191-294). Therefore one objective of this empirical study was to examine implementation problems. The following illustration shows the related results.

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<sup>32</sup> „Value-based management takes only the interest of the shareholders into account.“ and „An increase of the corporate value is not only beneficial for the owners but also for other stakeholders.“

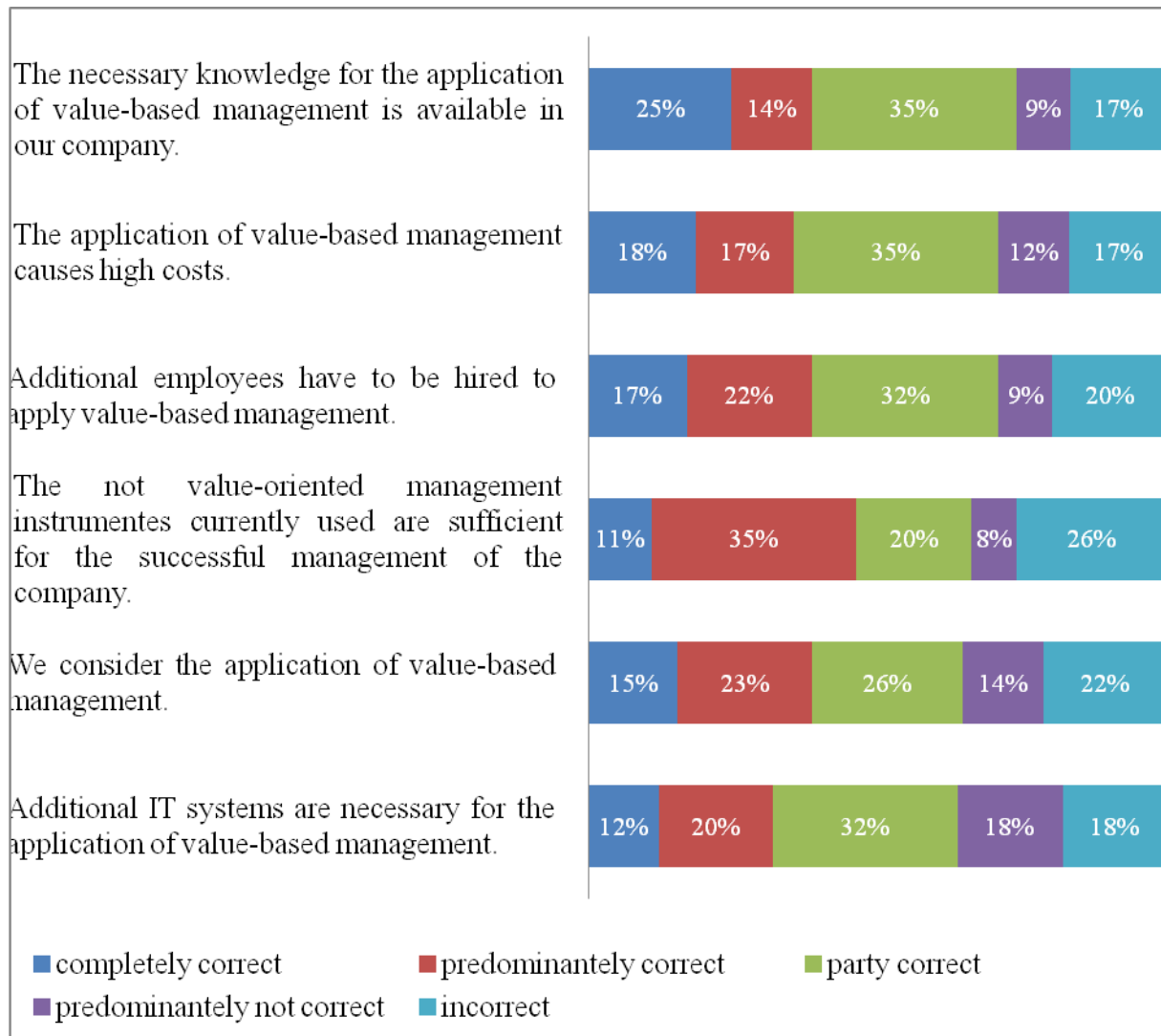


Figure 6: Implementation problems of value orientation

26 % believe that the company doesn't have the necessary knowledge to apply value-based management (statement "completely correct" resp. "predominantly correct"). Despite this, 38 % of the respondents state that the application of value-based management requires the hiring of additional employees. Nearly every third respondent names the costs related to the application of value-based management as implementation barrier. According to the economic literature there is a lack of well structured IT-systems in SMEs. It is not possible to make a clear-cut statement to this opinion because one third (32 %) agrees to this position and one third (37 %) doesn't agree.

The study showed some evidence that the lack of resources is an implementation barrier of value-based management in SMEs, but this cannot be assessed finally.

#### Perception of the potential benefits of value-based management

As there is the assumption that there are other implementation barriers than these dealt with in this empirical study, the respondents were asked to evaluate potential benefits of value-based management. By analyzing the answers it should be examined if the low level of diffusion of value-

based management is related to the ignorance of the benefits of value-based management (Krol, 2009a, pp. 215-219). The results are shown in the following graph.

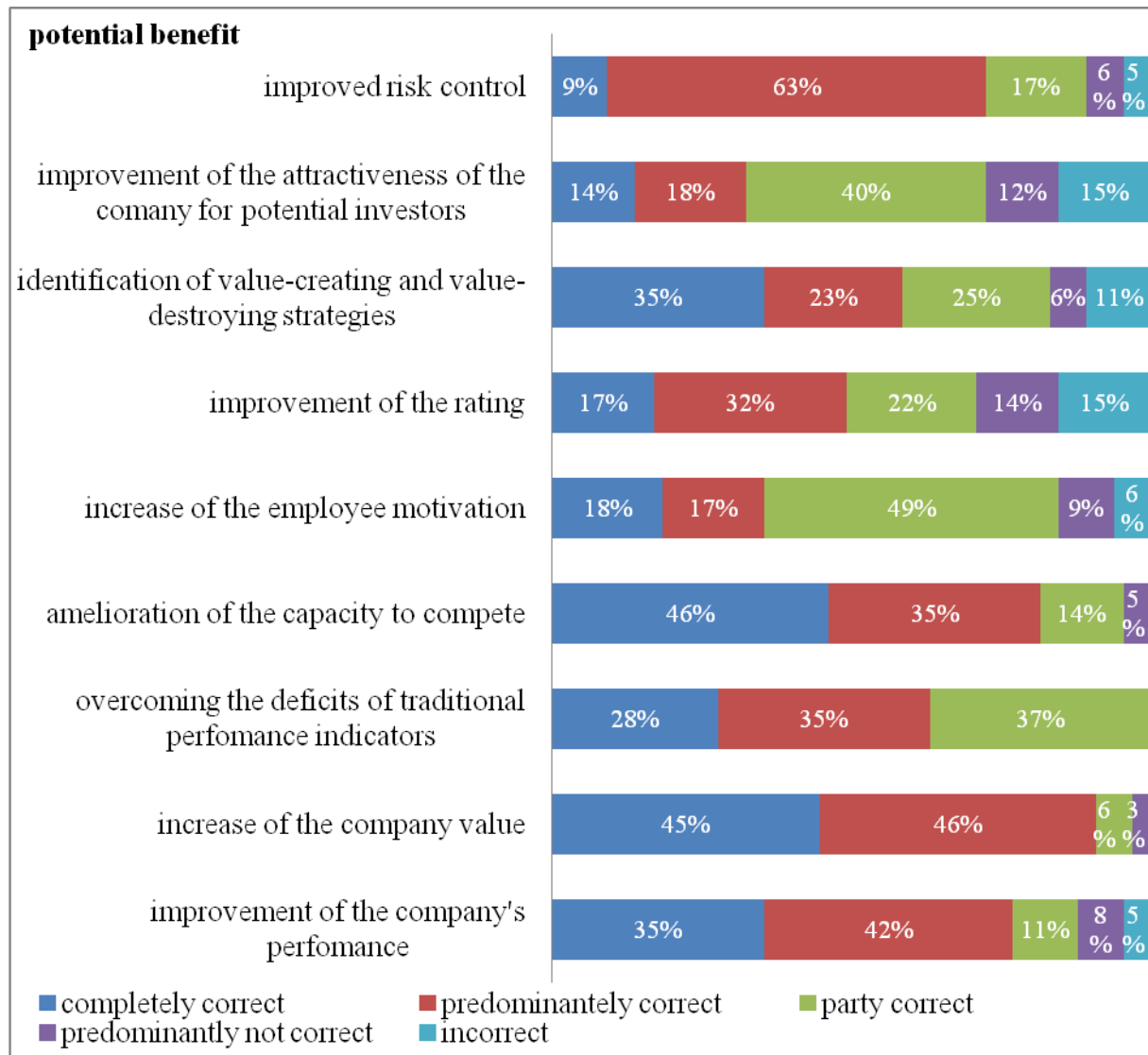


Figure 7: Potential benefits of value-based management

Nearly every respondent (91 %) agreed „completely“ or „predominantly“ to the statement that value-based management results in an increase of the company value. The majority of the companies (82 %) also are of the opinion that value-based management increases the capacity to compete. Regarding the low level of diffusion (see chapter 5.2.2) and the high importance of non-financial objectives (see chapter 4.2.1.) the approval to the statement that value-based management makes a contribution to the improvement of the company's performance was very high (77 %). The percentage of SMEs which are of the opinion that value-based management improves the risk control and the identification of value-creating and value-destroying strategies is 72 % resp. 58 %. The adherence of such aspects is important for a successful implementation of value-creating strategies (Krol, 2009a, p. 217). The improvement of the rating is only seen as potential benefit by 49 % („completely correct“ resp. „predominantly correct“). The lowest approval was given to the statements that value orientation increases the employee motivation and that a higher value orientation leads to a higher



attractiveness of the company for potential investors (35 % resp. 32 %). This can be explained by the fact that the sale of the company is not very popular among the majority of SME entrepreneurs and that there are nearly no variable compensation systems for employees (Krol, 2009, pp. 218-219).

On the basis of the high approval to the different potential benefits it can be concluded, that the responding companies are aware of the benefits that can be achieved by value-based management.

### **Requirements for value-based management concept appropriate for small- and medium-sized enterprises**

Despite the positive results described above, it's negative that only 37 % take the impact on the company value "completely" resp. "predominantly" into account in the decision-making process. The fact that the concept of value-based management was developed for the needs of big listed companies and that the specifics of SMEs are not considered can be seen as reason for this (Krol, 2009a, p. 1). The majority of the respondents (75 %) agrees „completely“ resp. “predominantly” to the statement that value-based management has to be adjusted to the specifics of SMEs. This confirms the assumption stated above.

The respondents were asked to evaluate the requirements for a value-based management concept appropriate for SMEs. Simplicity and practicability can be seen as the most important requirements because all participants agreed "completely" or "predominantly". The understandability of the concept, the ease of use of value-oriented instruments and the consideration of the typical lack of resources in terms of personnel and financial means are also important for the SMEs questioned. 92 % also state that the acceptance of the value-based management is an important requirement. Thus, value-based management can only be applied successfully if the corporate objectives are communicated transparently to the management as well as to all stakeholders. 52 % deem the flexibility of the concept necessary. This is an indispensable requirement for the implementation and application of value-based management because especially operational objectives change very quickly which makes the immediate adjustment of the objective targets necessary.

In total, it can be concluded that value-based management cannot be transferred to SMEs without necessary simplifications and adjustments. In addition the cost effectiveness has to be made sure. The cost-effectiveness can be evaluated by a cost-benefit-equation. No respondent is of the opinion that the cost effectiveness of value-based management is not important.

### **Conclusion**

It was focused on the form and diffusion of value-based management in small- and medium-sized enterprises by a synthesis of the description of theoretical and empirical findings.

By analysing the answers of respondents to several aspects of the object of research a high relevance of the objective to increase the corporate value was determined. Although there are several figures and management instruments that contribute to the achievement of this corporate objective, a low level of diffusion of value-oriented methods was perceived. Possible reasons for this are the lack of institutionalization of the controlling department, scarce management support by strategic planning

and a lack of resources. Despite these disadvantages it can be observed that the respondents consider value based-management positively. Based on the findings it can be concluded that the basic principles of value-based management and its potential benefits are known to a large extent by SMEs. However, the hiring of additional personnel and the application of additional IT systems are considered necessary. In addition the costs related to the implementation of value-based management are stated as implementation barrier. The perception of nearly the half of the respondents that the existing management instruments are absolutely adequate for the management of the company can be seen as another main obstacle for the diffusion of value-based management among SMEs. The majority of the respondents is of the opinion that the concepts of value-based management have to be adjusted to the specifics of SMEs. The findings of this empirical study can be determined by the random sample and cannot be generalized for the main unit of German SMEs (Gonschorek, 2009, p. 206; Krol, 2009a, p. 196 and pp. 219-221).

It has to be pointed out that there is only a small theoretical basis and little empirical research on value-based management for SMEs (Krol, 2009a, pp. 3-4; Tappe, 2009, pp. 289 and 291-292; Britzelmaier et al 2009). Due to this it is desirable, to do more scientific research on this subject to close this research gap and to promote the establishment of value-based management in SMEs.

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## AMERICAN, EUROPEAN AND AFRICAN SYSTEMS OF GOVERNANCE: HOW DO THEY DIFFER?

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### Abstract

Most researches in corporate governance field are focused on developed nations. Institutional differences between developed and developing nations call for a better comprehension of corporate governance systems in developing nations.

In this article we examined Egyptian system of governance through a longitudinal and cross national analysis. The state of corporate governance in Egypt is assessed using official World Bank–IMF reports on corporate governance in Egypt, proceeding of regional roundtable discussions and personal interviews with managers of Egyptian firms.

We first evidenced the evolution of corporate governance in Egypt. Then we compared Egyptian system of corporate governance with two model developed in advanced economies: Anglo-American and Italian model.

Our study helps to explain the differences of Egyptian corporate governance from developed countries and why certain practices are more widely spread in developed countries than in Egypt. Our research also has implications for studies of internationalization of firms from developed countries in Egypt.

**Keywords:** America, Europe, Africa, Corporate governance, cross national analysis.

### Introduction

Corporate Governance is the system by which companies are directed and controlled. Involving laws, regulations, institutions and enforcement mechanisms, it is part of the institutional infrastructure underlying sound economic performance. It is the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled. It also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. The main stakeholders are the shareholders, management and the board of directors. Other stakeholders include employees, suppliers, customers, banks and other lenders, regulators, the environment and the community at large. Good corporate governance stimulates performance, generating higher returns and profitability of companies, leads to higher total factor productivity growth, a major source of economic growth. Thus, corporate governance is an area of great interest for groups across the Middle East and North Africa (MENA). However, most researches in corporate governance field are focused on developed nations. Institutional differences

between developed and developing nations call for a better comprehension of corporate governance systems in developing nations. In this article we examined Egyptian system of governance through a longitudinal and cross national analysis.

Since 1980s laws that govern the incorporation of companies in Egypt and laws that govern companies listed in the Cairo and Alexandria Stock Exchange (CASE) represent the legal framework that impacts the concepts of corporate governance. However, corporate governance in Egypt is a novel term that has started to appear in the late 1990s as part of a modernization program for the whole economy. In the late 1990s, in fact, Egypt noted the need of gaining trust of the international community and foreign direct investment. At the aim to raise new foreign capital and to encourage more Egyptians to invest in the domestic the Egyptian government revitalized its capital market, by improving its reputation and building confidence among investors. This development program aimed at sound financial principles, availability of reliable corporate information, and adoption of international accounting and auditing standards. As a result the Egyptian government recognized the need for a high level of corporate governance practices to reach its aspired goals. The first assessment of World Bank and IMF to test the alignment of Egypt's corporate governance system with internationally accepted norms evidenced that in 2001 Egyptian companies applied 62% of the OECD principles. As a result of the ROSC, Egypt started issuing new rules to guarantee companies' implementation of corporate governance practices. The most important among these rules were the new CASE listing rules issued in 2002. Currently, CASE is working on producing new listing rules that incorporate a number of changes to further strengthen the corporate governance practices of the companies that are listed on the CASE. In 2004 the World Bank conducted a re-assessment of corporate governance implementation in Egypt, concluding that Egypt applied 82% of the OECD principles (OECD, 2004). This indicated that Egypt is continuously improving in the area of corporate governance. The report observed that the major areas of improvement included creation of a center for directors that could develop a Code of CG, new listing rules and implementation of legislative reform to bring the policy framework into greater compliance with the OECD Principles. As result the Egyptian Institute of Directors (EIOD) was created for working on designing CG code. In October 2005, Egypt adopted a draft Corporate Governance Code based on the OECD principles, to improve the legal, institutional and regulatory framework and to provide guidance and suggestions for stock exchanges, investors, corporations and other parties that have a role in the process of developing good corporate governance (OECD, 2005). There is a growing tendency among Egyptian companies to apply principles of corporate governance. This trend is more common and visible among large companies listed on the Cairo & Alexandria Stock Exchanges and monitored by the Capital Market Authority (CMA). Despite of two decades of changes Egyptian corporate governance system, like the other MENA regions, differs from Anglo-American model, stylized in terms of financing through equity, dispersed ownership, active markets for corporate control, and flexible labor

markets, and from Continental European model, stylized in terms of long term debt finance, ownership by large block-holders, weak markets for corporate control, and rigid labor markets (Becht and Roel, 1999; Berglof, 1991; Hall and Soskice, 2001; La Porta et al., 1998).

In this article we first evidenced the evolution of corporate governance in Egypt. Then we compared Egyptian system of corporate governance with two model developed in advanced economies: Anglo-American and Italian model.

The state of corporate governance in Egypt is assessed using official World Bank–IMF reports on corporate governance in Egypt, proceeding of regional roundtable discussions and personal interviews with managers of Egyptian firms.

First, our study helps to explain the differences of Egyptian corporate governance from developed countries and why certain practices are more widely spread in developed countries than in Egypt. Second, our research also has implications for studies of internationalization of firms from developed countries in Egypt.

### **Longitudinal Analysis of Egyptian Corporate Governance System**

The foundation of Egyptian corporate governance system is provided by its legal framework. Company, civil, and securities laws, regulations of the stock exchange, and the accounting standards in fact, affect the way in which corporations are directed, management behavior and values of the business culture.

The concept of corporate governance was introduced in 1990 as part of a modernization program for the whole Egyptian economy. Since then Egypt reform program has included a legal reforms, new institutions and codes of conduct which specifically seek to create good corporate governance practices. Periodical World Bank's ROSC studies of Egypt, have evidenced country's progresses in promoting corporate governance. In 2001, an assessment of Egyptian corporate governance of World Bank and IMF evaluated that Egypt applied 62% of Organization for Economic Cooperation and Development (OECD) Principles of Corporate Governance. After the assessment Egypt started issuing new CASE listing rules. The new listing rules included corporate governance disclosure requirements and detailed requirements for financial statements preparation and presentation. In addition, the new rules required the presentation of complete information about a company's board members, signed contracts with other companies, auditors, and the audit committee. Improvement in the area of corporate governance led the World Bank to evidence that Egypt applied 82% of the OECD corporate governance principles in 2004 (OECD, 2004). Some areas of improvement included shareholders rights and disclosure standards. The Egyptian Institute of Directors (EIOD) was created jointly with a range of international organizations, including the World Bank, International Finance Corporation, UNCTAD and the Centre for International Private Enterprise for working on designing corporate governance code and new listing rules (OECD, 2005).

The Egyptian Institute of Directors (EIoD), working under the umbrella of the Ministry of Investment, aims to spread awareness, knowledge, and best practices of corporate governance in Egypt, the Middle East, and North Africa (MENA) region in a way that meets the legitimate expectations and best interests of various stakeholders, and in different types of organizations such as listed, non-listed, family-owned and state-owned enterprises (SOEs). The activities of the Institute are targeted at directors, key executives, shareholders, and other stakeholders of such organizations.

Contemporary Egyptian government implemented legislative reforms to bring the policy framework into greater compliance with the OECD Principles. In October 2005 the Capital Market Authority (CMA) restructured its organization and the Ministry of Investment and GAFI introduced the first Egyptian Code of Corporate Governance (ECCG) written in Arabic. The code indicates that its rules should be considered in addition to the corporate related provisions stated under various laws and the executive regulations and decrees regarding their implementation. In 2006, the Ministry of Investment issued the Code of Corporate Governance for State Owned Companies based on the ECCG and the report of the OECD working group on privatization and corporate governance of State-owned assets. The code focuses on the actions of the State as a regulator versus its role as an owner and introduces the principles of governing State-owned companies by presenting an organizational and legal framework within which such companies should operate. In addition, The Egyptian Junior Businessmen association issued the Corporate Governance Manual for Family Businesses in October 2006.

In 2006, CMA created an auditors registry. The auditors that join this registry are the only ones that are allowed to audit companies that are listed on the stock exchange. In 2007, CMA issued a new code of ethics for auditors in Egypt and The Egyptian Institute of Directors Institute issued a manual for audit committees to ensure that corporate governance principles will be applied properly. In 2009, 11 corporate governance codes were introduced by national regulations, in addition to specialised guidance for state-owned enterprises, banks and family-owned companies (OECD, 2009). The Egyptian Institute of Directors was the first in the region to introduce a governance code targeted specifically at state-owned entities, based on the OECD Guidelines on Corporate Governance of State-Owned Enterprises (World Bank, 2010). Despite of much has been done, in Egypt there is still a need for corporate governance reform. Thus, a comparison of the Egyptian corporate governance system with advanced economies' models would indicate the required reforms.

### **Cross-national Analysis of Egyptian System of Corporate Governance**

Following La Porta et al. (1998) we used several variables to compare Egyptian system of corporate governance with Anglo-American and Italian models.

The first variable of comparisons between the different systems of governance is the degree of ownership concentration (La Porta et al., 1998). Anglo-American model is stylized in terms



of financing through equity, dispersed ownership and active markets for corporate control. Some Continental-European countries, such as Italy, instead, have concentrated ownership with stronger external influence on management. In Egypt the free float of listed companies on the stock exchanges is small because strategic investors, the State, or other stakeholders control most shares. It is possible to distinguish three main categories of joint stock companies: privatized state-owned companies, small and medium sized companies and family firms. Many large companies are closely held and often controlled by family groups or by individuals. Few companies are widely held and many listed companies have at least one shareholder with more than 20% of the shares. The dominance of family-owned firms and the absence of a system that prevents family members from dominating the decision making process has resulted in the poor protection of minority shareholders' rights and restriction of managers autonomy.

Countries are also distinguished as having strong or weak shareholder rights (La Porta et al., 1998). United States exemplifies a liberal market approach facilitating market-oriented mechanisms of control. Liberal property rights provide strong minority shareholder protection owing to relatively high disclosure requirements and norms of one-share-one-vote. Property rights thus create incentives to pursue greater capital liquidity and gravitate against strategic interests by discouraging disproportionate control through blocks. While a strong shareholder right characterizes American system of governance, weak shareholder right characterizes some continental european countries, such as Italy. Earlier versions of Egyptian commercial laws lack sufficient and detailed provisions of shareholder protection, which explains the tendency towards concentrated ownership structures. Minority shareholders are usually protected by the laws that allow those representing more than a certain percentage of the capital to force a specific topic onto the agenda at the General Assembly and call it to a vote, even if it is not already on the agenda. The laws are relatively clear on the notion that, within a given share class, all shareholders have the same rights. Any interference with voting rights within the class is illegal. However, company laws appear to comply with the basic standard of one-share one vote.

Another variable we used to compare Egyptian system of corporate governance with the developed ones is the role of managers. Managers are the stakeholders occupying positions of strategic leadership in the firm and exercising control over business activities (Chandler and Daems, 1980). Autonomous managers with a large degree of independence from specific relationships within the firm characterize American system. These managers may find it easier to make tough decisions or to impose hierarchical control in the firm. In contrast, European systems of governance characterized by concentrated ownership have committed managers. In Egypt, managers' lack of autonomy, flexibility, and objectivity to monitor company activities and to achieve its objectives is the main barrier to the implementation of corporate governance principles.

While in the American system of public companies the board role is to mitigate conflicts between shareholders and managers, in Italy and the other systems with concentrated ownership board of directors is much more dependent from block-holders and less active in the process of firm strategic orientation. In Egypt, companies tend to follow a parliamentary model of board representation, where directors represent the constituency that elected them. Boards' members oversee the management of the company and are elected by shareholders who meet in General Assemblies (GA). Board managing director is responsible for the Board's detailed oversight of the company. The Board can also hire a general manager who is an employee of the company to run the operations. In addition to defining strategy, selecting, monitoring and overseeing management is the most fundamental function of the board. A board that cannot dismiss management is not an effective board. This function requires an independence from management and controlling shareholders that is generally lacking in Egypt. In Egypt where ownership is highly concentrated, chief executive officer (CEO) is also the chairperson of the board and represents the majority shareholders. This set-up makes it virtually impossible for outsiders to replace management because it would mean firing themselves. Therefore, the board fails in this fundamental respect. In addition to this fundamental problem, another recurring theme on the subject of board duties in Egypt is the lack of training and the limited understanding that directors have of corporate governance issues.

Another important variable in describing corporate governance systems is financial issues. Financial systems influence the relation of capital to the firm by shaping the supply-side capacity to provide diverse sources of finance and thereby generate different patterns of control. The two major alternatives for financial mediation between households and enterprises are bank based or market based. In the American market-based financial systems, households invest in companies' publicly issued equity, such as stocks and bonds, thereby expanding the size and liquidity of capital markets and leaving the primary monitoring role to institutional investors and other shareholders (Steinherr and Huveneers, 1994). Market-based systems encourage equity finance through active capital markets in which shareholders invest chiefly to pursue financial interests. Some continental European countries, such as Italy, instead are dominated by model of governance in which the bank has a central role. Egypt also is a bank-based financial system in which takeover market is in early stages of development. In Egypt banks are the key financial institutions, mediating deposits from households and channeling them into loans made directly to firms.

Another variable we used to describe the different systems of governance is the labor market and skill formation. Differently from advanced America and European economies, in Egypt the labor market hasn't a strict regulation and cost of labor is country specific factor that attract some investment. Skill formation directly affects corporate governance, because the portability or firm-specific nature of skill investments influences the relation of employees to the firm. Skill formation institutions are subject to considerable national variation

(Finegold and Soskice, 1988; Locke et al., 1995; Sorge, 1990). In the United States and some European countries with concerted ownership, a mix of on-the-job training and markets is used to generate employee skills (Brown et al., 1997). The undersupply in skills, particularly among production workers, is closely related to high employee turnover and strategies of control in representing employee interests (Freeman, 1994). The lack of local capabilities imposes to firms that operate in Egypt to spend money and time in creating skills. As emerging economy, Egypt has weak legal and judiciary system, some political and economic problems. Moreover differently from advanced America and European economies, in Egypt disclosure is not a common practice (Table 1).

Table 1 Cross National Analysis

	USA	Italy	Egypt
<i>Degree of ownership concentration</i>	<i>Dispersed ownership</i>	<i>Concentrated ownership</i>	<i>Concentrated ownership</i>
<i>Shareholder rights</i>	<i>High</i>	<i>Low</i>	<i>Low</i>
<i>Managerial autonomy</i>	<i>High</i>	<i>Low</i>	<i>Low</i>
<i>Board activity</i>	<i>High</i>	<i>Low</i>	<i>Low</i>
<i>Financial issues</i>	<i>Equity</i>	<i>Long term debt</i>	<i>Long term debt</i>
<i>Capital market liquidity</i>	<i>Active takeover market</i>	<i>Limited takeover market</i>	<i>Limited takeover market</i>
<i>Labor market</i>	<i>Rigid labor markets</i>	<i>Rigid labor markets</i>	<i>Flexible labor markets</i>
<i>Legal and juridical system</i>	<i>Strong legal and judiciary system</i>	<i>Strong legal and judiciary system</i>	<i>Weak legal and judiciary system</i>
<i>Disclosure</i>	<i>Not limited disclosure</i>	<i>Limited disclosure</i>	<i>Limited disclosure</i>

## Conclusion

In Egypt key support for the corporate governance agenda has come directly from the public sector. Thus, the corporate governance centers operate under the umbrella of governmental institutions. There are many integral factors that hinder the development of corporate governance in Egypt. Egyptian system of corporate governance, in fact, is characterized by weak legal and judiciary system, weak institutions and limited human resources capabilities. Moreover, it faces financial problems of weak and illiquid stock markets, government interventions, economic uncertainties, weak legal controls and investor protection and frequent government intervention (Fawzy, 2004; Bremer and Elias, 2007). These characteristics would definitely have a strong impact on Egypt corporate governance system.

It differs from the Anglo-American model is stylized in terms of financing through equity, dispersed ownership, active markets for corporate control, and flexible labor markets. However, Egyptian corporate governance system has some similarity with some continental European systems of governance, such as Italian, stylized in terms of long term debt finance, ownership by large block-holders, weak markets for corporate control, and rigid labor markets (Becht and Roel, 1999; Berglof, 1991; Hall and Soskice, 2001; La Porta et al., 1998).

Italian System, thus, could be used as benchmark for the future development of Egyptian system of corporate governance.

The rescue of financial and industrial entities in Europe and North America might be seen as remote. Egyptian regulators will need to learn from these cases, taking into account international developments, which will only gain importance as the region becomes increasingly integrated in the global financial architecture. Whereas efforts to establish common regional or sub-regional corporate governance policies may not be the immediate objective, ongoing dialogue between regulators will be crucial. The ability of regulators to address bread and butter corporate governance issues in the coming years will be paramount to upholding investor confidence in the Egyptian markets. Particularly at a time regulators' ability to combat related-party transactions, improve transparency and disclosure, and foster effective board outcomes will determine the future of corporate governance in Egypt. Moreover, after President Hosni Mubarak leaves office, America and Europe could support Egyptian democratization. This process of democratization of institutions could affect the whole Egyptian system of corporate governance facilitating all the requested changes able to reduce the existing differences between Egypt, Europe and America.

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## THE EXPLORATION ACTIVITY'S ADDED VALUE INTO THE INNOVATION PROCESS

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### **Abstract**

This article responds to the lack of research on the way a new idea is transformed into a market-accepted new product. Through non-participant observation and multiple interviews, an empirical investigation within a large French telecommunications operator (OPERACOM), shows the strategic role of exploration as a new activity integrated into the innovation process. In order to facilitate its implementation by managers, the research proposes a synthesis of features, comprising the exploration axes/criteria (technology, client use and business value), the participants (clients/creative users, designers, partners...), the organizational system (exploration center, core team), the governance as well as the added value of the activity. The paper further combines theoretical findings with empirical data to identify the managerial implications of the findings, as well as additional theoretical considerations.

**Keywords:** New Product Development, Innovation, Idea, Creativity, Exploration, Telecommunications

### **Introduction**

Reviewing existing research on creativity and innovation, depicts that these two fields are often studied separately and that their understanding and definition among researchers, are frequently ambiguous (Chebbi, 2008). Indeed, the innovation process has, for a long time, been described as sequential and linear since it creates value through the implementation and use of one or several ideas (Van de Ven & al., 1989). Criticized by evolutionists (Nelson & Winter, 1982; Dosi, 1982) and neo-Schumpeterians (Kline & Rosenberg, 1986), innovation became a part of an interactive process based on learning (Roozenburg & Eekels, 1995; Hatchuel & Weil, 2003). Thus, we can consider innovation as a process of value creation, through the implementation and setting of one or several ideas. Certainly, this evolution bestows a central role to the conception and birth of ideas, but it does not integrate creativity into the innovation process. Several researchers who studied the characteristics of individual and collective creativity (Pelz & Andrew, 1966; Amabile, 1997; Woodman & al., 1993; Majaro, 1992; Styhre and Sundgren, 2005) consider creativity to be a process in itself, independent of

the innovation process. In this research's opinion though, this does not necessarily relate to the existing, practically implemented, innovation process in organizations. This research further found, that very little research has focused on or at least partially studied the path from creativity to innovation (Staw, 1990, Flynn & al, 2003, Hatchuel & al. 2003), and this paper's partial aim is to fill this gap. Specifically, the research develops a reflection that operationalizes this strategic stage of the innovation process and provides a more precise understanding of the transformation from stage of ideas into innovations.

*The aim of this study is to undertake theoretical and empirical research that will descriptively improve our understanding of the process through which new market-accepted products are developed; and prescriptively indicate its theoretical underpinnings and managerial implications.*

Towards this aim, five objectives have been set:

- To perform an extensive literature review, that will set the research's theoretical foundations and will define and interrelate the various product development process concepts and sub-processes.
- To identify any potential gaps and/or inconsistencies of the existing literature.
- To undertake empirical research, towards filling the identified theoretical gaps.
- To indicate the managerial implications of the existing theoretical gaps and propose managerial actions.
- To record the various theoretical considerations, consequent of the existing gaps, and propose further research action.

## **Literature Review (Objectives 1 and 2)**

### **Creativity**

The researchers in the fields of individual and organizational creativity endeavor to answer the question, "How are ideas born?" This question is linked with the genesis of novelty, as introduced by Lecoivre and Verstraete (1998). The generation of ideas is a matter of creativity, and several authors have accented the confusing border between it and innovation (Woodman & al., 1993; West & Farr, 1989; Ford, 1996; Hauch, 2002). Creativity has been studied at the individual level (Pelz & Andrew, 1966; Amabile, 1997) or the collective and organizational level (Woodman & al., 1993) in connection with the management of innovation. It is this last dimension that interests this research most. These authors define organizational creativity as the creation of new products, services, ideas or useful processes on behalf of individuals working together in a complex social system (Woodman & Sawyer, 1993).

Creativity can be different according to the situation (Majaro, 1992). As Flynn et al. (2003) underlined, creativity can be reactive and answer to a specific need. Also, it can be exploratory and proactive, generating a large spectrum of ideas, not necessarily bound to

demands or previous situations. In this case, creativity reveals opportunities, without any link to planned objectives. In addition, creativity is related to "Serendipity", so it is more linked to discovery and science. In general, researchers converge to underline that creativity leads to the collection of information (preparation) and analysis (Incubation/Illumination) before being tested in the real world (Verification). Researchers have also studied the factors that encourage creativity (McFadzean, 1988) such as wishful thinking, unrelated stimuli and mind mapping.

this research has noted that some researchers tried to link creativity with innovation. Amabile (1997), for example, suggested that creativity permits the production of new products, ideas, and services that could be implemented through an innovation. She suggests that, creativity is connected to socio-cultural validation or even to acceptance by the social environment (Cropley, 1999). However, it is important to think about the modes that can be used to structure ideas and identify the axes of values, before moving on to the development. To make this possible, an intermediate phase seems necessary to study the path from creativity to innovation.

### From creativity to the innovation

To think about the uphill phases of the innovation process, we have to study the generation, selection and assessment of ideas. Thus, creativity and the transition to innovation can take on a truly strategic character for all innovating firms. Some authors have attempted to integrate creativity into the process of innovation. Staw (1990), for example, proposed a model that considers innovation as the result of developing ideas in a specific context (figure 1).

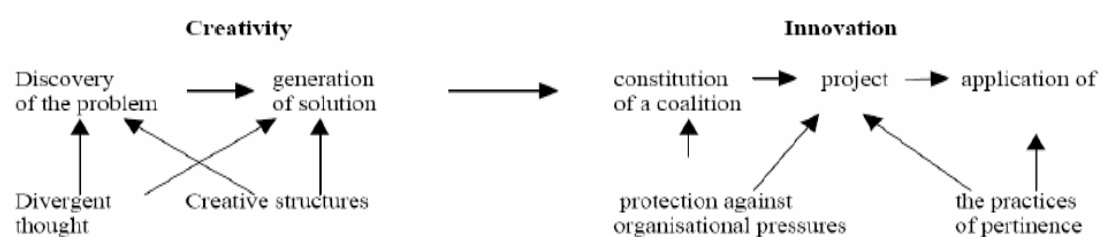


figure 1 : the two parts of the innovation process, staw (1990)

Getz (2002) suggests that research and development (R&D) activity is removed from the reality of the market. That is why it should be included in what he called "the execution of the idea". Creativity can even be considered as the first step toward "intrapreneurship" (Carrier, 1997) by making innovation more dynamic. Another important work has been presented by Flynn et al. (2003), who propose an integrator model called "the Innovation Funnel". This model integrates a sub-creativity and a sub-innovation process. The authors distinguish two main funnels: the first one concerns the creative process (environment

analysis, identification of opportunities and ideas generation); the second transforms creative ideas into real innovations (objectives, teams and resources). In their model, the authors focused mainly on creativity, while proposing a tool, based on creativity techniques (like brainstorming for example).

Although all these quoted authors have the privilege of introducing the first integrative reflections on creativity in the innovation process, this research underlines the lack of operationalisation of the ideas' transformation steps. According to Stoycheva and Lubart (2001), this transient phase is strategic because it can be included within a "pre-conception" logic: selecting projects, reducing risks and time to market (TTM). This research's extensive review has encountered only one work (Hatchuel and Weil, 2003) that really covers this phenomenon. They, while studying the innovation strategies within "Sekurit Saint Gobain", showed that each enterprise must think about new creative tracks, without cutting down on planned objectives. Thus, they developed the R-I-D (Research-Innovation-Development) model. Embedded in collective action theory, this model marks the passage of the reflections dealing with innovation to those studying the innovating organizations. Their so-named "I" function consists of managing the "*fields of innovation, which are conducive to new programs of product developments and new questions for research*". It creates value and manages the process of the emergence and structuring of new knowledge.

According to Hatchuel and Weil (2003), this strategic dimension appears on three levels:

- *Piloting by concepts* - Innovation activity is characterized by a "prudential" logic. It aims to explore the strategic space in order to generate new ideas with potential value;
- *Joint learning* - The learning takes place at the internal level and with customers;
- *The conception of strategy* - The strategy is based on the previous two kinds of piloting.

Based on this reflection, this research notes that Hatchuel and Weil (2003) highlight the importance of studying the transition from idea to development. However, two remarks deserve to be looked at in more detail. Firstly, the authors evoke the "I" function (innovation) between the research and development stages. Secondly, they present this phase as a supplementary organizational system to establish innovation in less structured situations. Certainly the "I" function is important, but it focuses only on one dimension of this strategic activity. Thus, it is necessary to develop a deeper study of the modes of the transition from idea to product. It is in this setting that we studied this phenomenon within the OPERACOM group.



### **Conclusions – Theoretical Gaps**

The theoretical part of this research has shown that the concepts of 'idea', 'creativity', 'innovation' and others, are relatively extensively researched. At the same time there appear to be a number of matters that demand further research into these subjects.

Firstly, the various concepts are not defined, nor utilized in the same manner by the researchers. Secondly, a gap appears to exist in terms of the way that these concepts are transformed from the one into the other, especially the leap from 'new idea' to 'market-accepted product', or essentially, 'creativity' to 'innovation'. Thirdly, these concepts are not adequately intra-related i.e. their linkage within a defined process is still not distinct. Finally, these concepts are not adequately inter-related i.e. their relationship with other critical organizational functions, such as market/consumer research and R&D, within the wider strategic/marketing contexts, is also still not distinct.

### **Empirical Research Findings (Objective 3)**

#### **Methodology**

The path from idea to innovation has a strategic character for an organization. Indeed, the ideas chosen are usually integrated into a strategic "roadmap". Thus, before all conception activity, innovating ideas are pedantically studied and selected.

In order to identify the features of this innovation phase, which is generally inexistent or rarely structured within firms, this exploratory research has effectively pursued an empirical investigation within OPERACOM (Yin, 1994). This large operator of telecommunications is currently a leader in France and has recently followed an intensive innovation strategy at a group level. In order to structure it and accelerate the marketing of new telecommunication services, OPERACOM reconsidered its innovation process. In this setting, new exploration activity has been undertaken. This section of the paper presents the methodology and subsequently the main findings of the research.

This research's verified position, that exploration characterizes the transition from creativity to innovation, led to the study of its features. Towards this end, a qualitative research is better advised (Hlady-Rispal, 2002). Therefore, the research methodology consisted of a non-participant observation over a period of six months, at the R&D site of the OPERACOM group. The non-participant presence of the researchers within this company enabled the observation and recording of the creation of the new exploration activity and the study of research-significant internal documents. Additionally, twenty-seven semi-directive interviews were conducted, with the managers of the group. The profiles of the managers interviewed are detailed in table 1.

<i>Job/ role</i>	<i>R&amp;D</i>	<i>IS integrator</i>	<i>Developers, ergonomists, designers, quality</i>	<i>Marketing manager</i>	<i>Strategic marketing &amp; middle managers</i>
<i>Division</i>	<i>Creative studio</i>	<i>Information system</i>	<i>R&amp;D</i>	<i>Explocenter</i>	<i>Technocenter</i>
<i>Number of interviews</i>	6	1	7	7	6

Table 1: Profile of interviewed managers

In order to analyze the information collected from the interviews, observation and internal documents, the research employed the “Nvivo” software. This tool enabled the organization of information and better defined the new activity created by the innovation department of OPERACOM.

From the answers, exploration appears as an intermediary stage, between creativity and conception, within the innovation channel, in order to study the ideas found. Towards defining and comprehending the attributes of this new activity, five categories were created and studied using the “Nvivo” software: *the exploration axes/ Criteria, the participants, the organizational system/pattern, the governance* and the added value of the activity. The research subsequently presents the findings of the study.

### Findings – Exploring the activity features

Aiming to become a leader of European telecommunication, the OPERACOM group attaches significant importance to searching for innovative and original ideas. To achieve this goal, several methods are used, such as creativity sessions, innovation open door days and meetings on an international scale. A “creative studio” was even created to this end. Once the ideas are identified, a team project starts the conception refinement and development, before merchandising the innovation.

In this setting, customers were solicited to test the services before their introduction to the market. In spite of the importance of this step, “*some service offers experienced real failure*”, declared an interviewed manager. In order to understand the reasons underlying this phenomenon, a survey was initiated by the innovation committee of OPERACOM. Several factors were identified, including the weak funding of the concepts, the lack of reflection on the ideas identified and the path followed to develop ideas. These results drove the managers to create a new structure: “the Explocenter”.

This exploration activity has a very short-term orientation (three months). It aims to ensure a better transition between research on ideas and their development into a marketable product. In this context, new concepts of service are brought to maturity to add value for the group. “Given the strategic character of this phase, it remains confidential, with an added value to and compatibility with the global strategy of the group” (R&D and quality manager).

As mentioned above, the research findings identified many features of the exploration activity:

**The Three Exploration Criteria: 'Technology', 'Client Use' and 'Business Value'.**

For every non-mature concept, the exploration studies also technological aspects and risk. An analysis of the "business case" is also conducted (target, business model, positioning). Considering this element, exploration activity calls for various kinds of knowledge: design of services, marketing, information systems and networks, technology, etc.

"The exploration concerns ideas or concepts that present a strong potential, but are risky because they are not of a mature technology"

(Manager, Explocenter).

"Within the Explocenter, we find good ideas, but also ideas not to be pursued. There is also a paradox between the long-term vision and business goals, which may not be in the same time frame"

(Excerpt meeting, ExploDay).

**The Actors**

The exploration activity is characterized by the "trial and error" process with training/experimentation by customers. Consequently, this "user-creative" step is linked to service co-creation. During the explorations, the client "ambassadors" give sense to the ideas. Some external partners also participate, depending on the nature of the service being studied.

"The customer is indeed in the heart of the Explocenter's activity. Indicatively, during six months of exploration, more than two hundred working hours were spent with customers"

(Manager, Explocentre).

"A co-localized team composed of five or six people is often used to study the concepts and to choose those that have potential value, while being among the strategic priorities of the group"

(Marketing manager).

**The Organizational Pattern**

The creation of the Explocenter is the first organizational step toward consolidating the exploration of new "business territories". This center is based on the innovation-related concept of incubation. Its creation is made in a very confidential setting, and announced to the staff of the group at an information day: the ExploDay. During this day, the responsible individuals present the new structure as an innovating project "nursery". Functional for one year, it is characterized by a "core team" that collaborates closely with customers (co-creation).

According to the interviewed managers, the ideas of new concepts of business to explore, are formulated by their owners in the setting of an exploration file (DEX). This is a common procedure for the whole group, that guarantees better homogeneity and internal coordination. Every file contains “reviews”, “jalons” and standardized categories. For every concept to study, in fact, the actors are brought in, to exchange their thoughts about the aspects summarized in table 2.

<i>Kind of Knowledge exchanged</i>	<i>Features</i>
<i>Knowledge linked to services and customer uses</i>	<i>Evolution of customer uses, uncertainty, divergences / convergences</i>
<i>The group's strategy</i>	<i>The adequacy of the potential offering within the group's services portfolio, the ecosystem</i>
<i>Technological knowledge</i>	<i>Risks, problems, infrastructure and technical network</i>
<i>The cost structure</i>	<i>Profits, uses, costs</i>
<i>The customers' knowledge</i>	<i>Tests and technical experiments, customer perceptions</i>
<i>Knowledge linked to materials</i>	<i>Technical specifications to consider, design, universality, potential industrial partners, integration of the service</i>
<i>Business needs</i>	<i>Pricing, media and sales plan</i>

Table 2 : The content of explorations

As shown in the table above, the exploration of innovative concepts requires a continuous exchange among the actors, which facilitates the transition of a creative idea to a real, market-accepted innovation.

The Explocenter is also characterized by the division of work between the "core team" and "the second circle". The former regroups people from the design, marketing, business, ergonomic and technical fields. The latter ("second circle") consists of people who participate in the Explocenter's activities from home or abroad. It is in this setting that subsidiaries or international R&D laboratories participate.

"The Core team is a multidisciplinary team that regroups managers from the design, marketing, ergonomic, and technical domains with customers. This team is made up of about five or six people. The second circle is made up of the people who are involved in the Explocenter while abroad"

(Excerpt from the Exploday meeting).

### **Governance**

The governance style within the Explocenter is inspired by a financial approach. It diverges from the internal fundamental venture with a "deal flow" process. Every project is considered as a small firm or "start-up". Some small budgets are provided by investors and sponsors, who support the exploration projects. According to the interviewed managers, this method of

governance is compatible with the length of the exploration and the risk denoted through this new activity.

"Indeed, in the second or the third exploration phase, depending on the degree of maturity of the projects, there is a business sponsor who comes from the Technocenter"

(Explocenter manager, Exploday).

### The Added-Value of the Exploration Activity

After some experience within the Explocenter, the innovation committee analyzes the projects associated with the services developed. The interviewed managers underlined that the creation of the exploration activity brought real added value on several levels, and offered benefits such as accelerating the ideas' transformation, an improved perspective on the fitness of the projects with OPERACOM's strategy and better concept maturity. As shown in the figure below (figure 2), some managers interviewed stressed that the analysis of the concepts on three levels (technology, market/use and business) consolidated the files of new ideas. They also mentioned "pre-conception" while describing the exploration process and stated that this activity is a strategic link in OPERACOM's innovation chain.

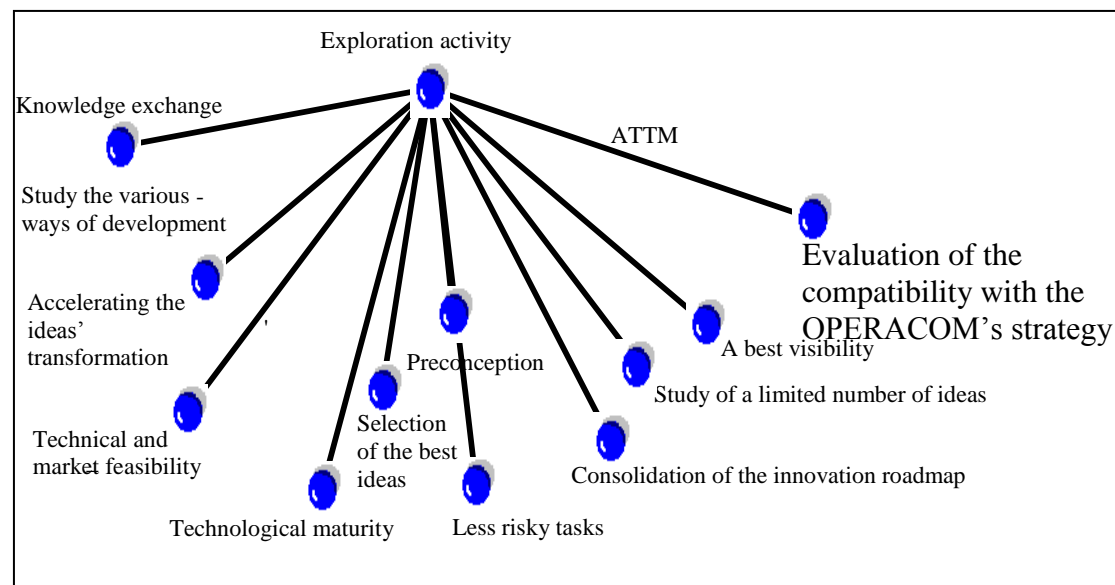


Figure 2 : The added-value of the exploration activity

In terms of the progress of the exploration activity, some managers said that there were various achievements, and distinguished three categories of concepts: swarmed, capitalized and transformed.

- The "swarmed" concepts, which can be used as "inputs" for other new projects;
- The "capitalized" concepts, which can be mobilized for other projects (customer uses, technical features); and

- The “transformed” concepts”, which emerge when the ideas initially coming from creativity sessions mature through the contributions of customers and partners. The output is concept transformed in the preliminary offer (innovation), which is refined and elaborated in more detail throughout the innovation process.
- These issues show that at the end of the exploration activity, the concept is sent back to the researchers if it proves to be technologically “non-mature”. When the concept appears too risky, the project is abandoned after the capitalization or swarming process. If the concept is not mature enough, an anticipatory action and a feasibility survey are undertaken. If the idea proves to have high potential, a project team is put in charge of the conception and development within the Technocenter. For all consolidation needs, the concept is sent back to the Explocenter. The choice of the trajectory of every innovative idea is made according to three main criteria: the degree of maturity, the market concerned and feasibility.

"According to the degree of maturity of the concept, the project is oriented to anticipation or capitalization. Then, according to the market, we choose the Technocenter to develop the services. In some cases, we find that the project is too complex, so we don't proceed. It is too risky. Otherwise, if the project is not complex, we launch what we call a fast cycle of TTM (time to market)"

(Project manager, R&D)

Based on the investigation led within the OPERACOM group, the research found that the development of a creative idea into a real innovation is not a hazardous step. It is about a reflexive and structured process that should be integrated into the innovation chain. The strategic nature of the exploration activity also shows that the flexibility and degree of interaction can be facilitated by the mode of governance.

## Discussion

### The Features of Exploration

As described in the previous section, exploration is an activity recently created within the OPERACOM group. Its features (governance style, new structure, confidentiality, criteria of analysis) allow managers to strengthen the innovation roadmap of the group. Based on these features, the research has shown that the development of an idea into a real innovation (accepted by the market) must take place in the setting of a structured and organized process (also, Le Masson et al., 2006). Depending always on the characteristics of the individual organization, it is proposed that all organizations should explore new fields of innovation through the development of an exploratory activity and its integration with their corresponding innovation processes.

The potential paths of innovation though, do not emerge in a spontaneous way. The ideas are studied in a pre-conceived way within the business test (market opportunity) phase.

Customers play a very important role in testing the commercial feasibility of new ideas. This role recalls the notion of "lead user" introduced by Von Hippel (1978, 1986). In this setting, a distinction is made between the customers who think and conceive new products, from the "early adopters" or precocious purchasers.

The exploration of new tracks of innovation requires the mobilization of customers, as well as partners from different fields: research, development, marketing and design. Based on this finding, it is indicated that for the best results from this intermediate step, works must better be project-based (also, Midler, 1993; Azan and Mayrhofer, 2003; Garel et al., 2004). Consequently, the co-localization of managers facilitates inter-functional integration and the exploitation of hybrid knowledge (Chebbi & Yahiaoui, 2008). It also reduces risk, analyses new ideas and reduces the time to market (TTM). Finally, the ideas become "pre-concepts" that are better refined and enriched with potential business value. This approach can be called piloting by learning (also, Hatchuel & Weil, 2003).

Adjacent to the project mode, a second organizational feature characterizes exploration. It entails the creation of a structure exclusively dedicated to this activity, corresponding to the 'Explocenter' for OPERACOM. The importance of the organizational structure deserves to be emphasized, noting also the thin and obscure line that divides technological and organizational innovation (Damanpour, 1991). Recapitulating on the above, the main features of the exploration process are summarized in the table 3.

<i>From Creativity to Innovation : the features of the exploration</i>	
<i>The exploration criteria</i>	<i>New concepts with business potential: risks of use, business case (target, business model, positioning), design, technology</i>
<i>The actors (participants)</i>	<i>Customers (creative users and ambassadors), designers, ergonomists, marketing managers, partners, R&amp;D engineers...</i>
<i>Structure and organization of the activity</i>	<i>New structure : The Explocenter Projects and co-localized teams (Core team &amp; Circle 2) Trial-and-error process Coordination through the exploration file (DEX)</i>
<i>Governance</i>	<i>Method of governance «venture capital» Sponsor from the Technocenter (development)</i>
<i>Added value to the innovation process</i>	<i>Accelerating the transformation of ideas (more mature concepts) Improved view of the relationship between projects and the strategy of the company Better selection of concepts with great business potential</i>
<i>Results and concepts</i>	<i>Swarmed concepts Capitalized concepts Transformed concepts</i>

*Table 3 : Synthesis of the characteristics of the exploration activity*

As shown by the table above, the nature of the concepts resulting from the exploration activity is variable. Indeed, a capitalization process must be conducted when the ideas are not completely mature and cannot be transformed into innovation. However, new concepts can constitute real "input" for new projects. This allows the enrichment of the innovation pipelines (Amabile, 1997). All of these features improve our descriptive, but also prescriptive understanding of the method of operationalising the transition from idea to innovation; a method that also recalls the concept of exploratory creativity of Flynn et al. (2003).

### **Empirical Research Conclusions**

Noting that very few researchers have studied the passage from creativity to innovation, this work brings true added value to the field. This research underlines the importance of interconnecting creativity and conception within the innovation process. It further proposes an operationalization of this strategic step for firms. On the theoretical level, it links two fields of research that have been disconnected until now.

For managers, this research highlights the necessity of creating exploration activity in order to bring to maturity the ideas and concepts for organizations. This "pre-conception" step can be organized at several levels: the axes of exploration (technology, business), the participants (customers, managers), the organizational pattern (new structure, standardization of the procedures, project) and the mode of governance.

While articulating the exploration into the different activities of the innovation process, this research also portrays the diversity of the outputs generated by the exploration. Concepts can be swarmed, capitalized or transformed, which increases the degree of interaction in the process. New projects can also be initiated to enrich the pipeline of firm-level innovation in order to create further added value. Researchers are invited to study this phenomenon within other organizations; a step that strengthen our understanding of and propose a mode of operationalizing the transition from creativity to innovation.

### **Projected Managerial Implications (Objective 4)**

The above theoretical and empirical research findings have expanded our knowledge on the subject, and made the various aspects of the process more distinct. As it often occurs in such cases though, the findings also gave rise to the need for substantial considerations in the overall manner that organizations practically deal with the wider process of new product development.

More specifically, the research showed that organizations need to:

- Focus even more greatly on the process and its constituent components, such as innovation, creativity, exploration, R&D etc.



- Understand these components, place them within a single, unified and comprehensive context, and define the role and function for each, specifically for each organization at hand.
- Organize the practical implementation of the whole transition process, in a manner that makes both practical and economic sense.
- Breakdown the concept of 'value' in relation to each of the value stakeholders, both within and outside the organization e.g. value to existing customers, potential customers, employees, associates, departments, the public, society, the industry etc.
- Breakdown the concept of 'value' in terms of value type e.g. financial, time, effort, psychological, image, social/ethical, functional, technological, infrastructural, knowledge etc.
- 'Evaluate value' i.e. be able to decide on the absolute and relative importance of each value type and for each value stakeholder.
- 'Transcribe value' into a single currency i.e. be able to objectively and if possible quantitatively measure each value type in a manner that allows direct comparison between benefits/options.
- Interrelate the whole 'idea to innovation' process with (and if needed incorporate into) the wider strategic marketing, marketing research, R&D and consumer analysis processes.

Irrespective of the theoretical taxonomy, classification and categorization of the components and steps comprising the 'idea to innovation' and wider new product development processes; individual organizations need to redefine and reorganize their processes based on their individual characteristics, resources and strategic aims. The refinement of the processes at a scholarly level is a useful knowledge foundation; on which nonetheless, organizations need to build their own practical implementation.

### **Catalexis - Theoretical Considerations (Objective 5)**

The research findings, along with the managerial implications listed above, also give rise to considerations of a scholarly/scientific nature. Considerations, which need to be born in mind by researchers continuing the work on the subject.

More specifically, researchers, further to the points above, need to:

- Theoretically position and test the 'idea to innovation' process, within the wider strategic marketing context.
- Theoretically position and test the 'idea to innovation' process, within the more specific new product development process.

- Interrelate and 'synergise' the 'idea to innovation' process with the marketing and consumer research functions
- Interrelate and 'synergise' the 'idea to innovation' process with the management and human resource contexts, as the value stakeholders of innovations / new products are often internal ones
- Investigate the features of the 'exploration activity' presented earlier (Criteria, Actors, Governance etc), separately and adjacent to economic factors
- Research the ultimate strategic-level question, adjacent to organizational culture: whether innovation / new product development are more consequent of abstract human qualities (creativity, vision, imagination, inspiration, ingenuity, inventiveness, resourcefulness), or methodical and mechanistic processes (market research, consumer profiling and analysis, idea filtering systems, etc).

Perhaps, more importantly than any other theoretical consideration, researchers need to understand that the epicenter of innovation ('value') also has a context. A context shaped by consumer behavior and all the macro- and micro-environmental factors affecting it (Thrassou, 2007; Vrontis and Thrassou, 2007; Thrassou and Vrontis, 2009). While, therefore, further research should continue to focus on the various new product development processes and sub-processes, a 'zoom-out' path must also be followed. This will allow the understanding and definition of the factors that create the value offered to value stakeholders (Vrontis and Thrassou, 2010) and thus, ultimately, add value to value itself.

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## THE JOINT ORDER AND PROMOTIONAL EFFORT DECISIONS FOR A FASION APPAREL COMMODITY UNDER PRE-ACQUIRED MARKDOWN INFORMATION

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### Abstract

This work considers a two stage newsvendor problem that a retailer places an order of a fashion product with the short life cycle from her supplier and sells goods directly to customers. Due to the vulnerability of a product over time which results in customers losing interest, she then markdowns items. The buyback contract is adopted that the supplier pays a fixed cost per unit to redeem unsold items when the life is over. Based on this, a retailer makes the ordering and promotional effort decisions which depends on a pre-acquired markdown information before the sale starts. The development of model begins from the decentralized supply chain and later extends to the vertically-integrated supply chain. This work highlights to analyze the effect of markdown to the joint promotional effort and quantity decisions. In addition, numerical experiments illustrate the sensitivity analysis to various parameters. To achieve the channel coordination, the share of promotional effort and the penalty charged to a retailer's shortage are proposed. The performance of profit under these two methods are examined in the computational section as well.

**Keywords:** joint promotion effort and ordering decisions; markdown timing and magnitude; buyback; channel coordination

### Introduction

Unlike products with stable demand over time, the sales of fashion clothes are affected by factors, such as the attractiveness to customers and substitute of similar products from competitors. Hence, thees commodities have a shorter sales period and the sales condition is getting worse when it approach the end of sales. For example, Zara, a world famous clothing retailer, sells a type of cloth no longer than 30 days from its debut to the off from the shelf. This fact results in Zara's retail stores not to adopt the replenishment during the sales period. Most likely, a type of item plans one order only which arrives before the sale starts. The seasonality-influenced apparel, such as ski clothes, is another example to illustrate how demand shrinks when the winter comes to the end. Sport Obermeyer Limited, a company which offers a broad line of fashion ski apparel, received 80% of retailers orders in the annual Las Vegas Show hold in March which is six months before the release of goods in the stores. If specific items are sold well during the selling period, then the replenishment is planned.

Generally speaking, retailers would choose to make one or few times order for fashion clothes.

The promotional marketing is a popular and effective method to generate revenue directly from customers who shop in these store. For them, being recognized with a good taste in wearing apparel is one of the essential reasons how they choose clothing commodities. Through the appropriate advertising on the various media and celebrity endorsement, demand can be expected to increase drastically. Although the promotion allures customers' buying, the cost paid for the promotional efforts becomes a trade-off when a retailer regards the profit as a significantly operational performance. In addition to quantity, the promotional effort is also a critical decision a fashion retailer should pay attention.

Another mechanism a retailer would love to manipulate is through the pricing strategy. Due to the fashion characteristic, the skimming pricing becomes favorable in the fashion clothing industry. In the early stage of the sale, the high price tag aims at the high end customers who are willing to pay premium to get goods sooner. As time goes, the closer the sale approaches the end, the less unattractive items become. Therefore markdown at some point of time is exerted to stimulate demand. The consequence of the discount follows the saturation effect. This effect is caused from various factors, including the loss of customers' interest and items' acquisition from other sources. When the initial price is set too high, customers tend to be conservative of owning goods at first and wait for the price drop. When items are discounted, the potential surge on demand becomes larger due to the less saturation effect (Raman and Chatterjee, 1995).

As for the unsold items, the retailer would generally not let them obsolete and absorb all the overstock loss. The book industry, for instance, adopts the buyback mode from which publishers bundle old books with new released books for sale. The buyback contract between the retailer and supplier plays an important role to accomplish a win-win situation, from which a retailer orders more and has the opportunities to generate more revenue. When the time is over, the supplier buybacks unsold items, from which a retailer receives the salvage value, and could resell them to other channels, such as discounted stores and countries with developing economies.

To summarize all the observations and motivations mentioned above, this work considers a two stage newsvendor problem that a retailer places an order of a fashion apparel with the short life cycle from her supplier and sells goods directly to customers. Due to the vulnerability of product over time which results in customers losing interest, a markdown is adopted in the late stage of sales. When the life is over, a supplier pays a fixed cost per unit to redeem unsold items. Based on this, the retailer makes the ordering and promotional effort decisions before the sale starts in attempt to gain a better profit. As argued above, a fashion product's value drops over time quickly. A common method a brand vendor would take is to request its retailers to markdown the same style of items concurrently. Most likely, when to

let markdown take effects in each store can be evaluated from the past sales analysis and the synchronized markdown is usually derived by a brand vendor's hope to have consistent sales price. Here this work intends to make the joint decisions which depend on the pre-acquired markdown information. In addition, the share of promotional effort and the penalty of a retailer's shortage are proposed to achieve the channel coordination.

To the best of our understanding, this is the first work to probe how the joint quantity and promotional decisions is affected by markdown. The following gives a broad literature review and then develops the mathematical model in Section 3. In Section 4, numerical experiments are computed for the sensitivity analysis and profit performance. Conclusions are made in Section 5.

## Literature Review

The literature is classified into three categories. The first category belongs to the pricing strategy. This mechanism plays an essential mechanism to support the retailer's operation of fashion goods whose sales conditions would be heavily affected by customers' degree of freshness. There are abundant pricing literatures addressed in the economic and marketing area. (Noble and Gruca, 1999) compared three pricing strategies: skimming, penetration, and experience curve pricing exerted in the new product. (Nagle, 1984) focused on the pricing strategy in identifiable segments and (Stole, 2007) concentrated on price discrimination. (Spann et al., 2009) empirically studied the profit rewards to various dynamic pricing strategies in the digital camera market.

From the operations management perspective, (Khouja and Robbins, 2005) analyzed the pricing decisions of a firm offering a products with two versions. Several recent studies examine the coordination of price (or demand) and production/ordering decisions for non-perishable products. Using a periodic review model with random demand, (Chen and Simchi-Levi, 2004) and (Federgruen and Heching, 1999) developed optimal policies with and without fixed cost of order placement and backlogging. (Chen et al., 2006) considered the problem with fixed cost but assume that excess demand is lost. (Huh and Janakiraman, 2008) generalized these results using alternative proof techniques. For short-life cycle products with a single replenishment opportunity, (Petruzzi and Dada, 1999) analyzed a newsvendor model with price-dependent demand. Excellent reviews of literature on the coordination of price and inventory decisions appear in (Parlar and Weng, 2006) and (Elmaghraby and Keskinocak, 2003). (Chande et al., 2005) and (Chande et al., 2004) also considered replenishment and demand management decisions for perishable products, but these papers model only a single promotion (the only demand-related decision) during the horizon.

Another type of pricing is to markdown items when they become more unattractable over time. (Feng and Xiao, 2000) and (Feng and Gallego, 2000) analyzed the optimal timing of price change. (Smith and Achabal, 1998) developed the optimal clearance prices and inventory management policies where sales rate is dependent on inventory and time. (Nair and Closs,

2006) examined the effects of price markdowns, replenishment, and transportation decisions on the retailer's performance of a short life cycle product. (Pashigian, 1998) adopted the clearance markdown for a single product with heterogeneous demand. (Bitran et al., 1998) developed a methodology with coordinated clearance markdown sale of a seasonal product.

Literatures on the decisions of joint quantity and sales effort compose the second category. (Tsao and Sheen, 2008) analyzed the dynamic pricing and promotional effort of a deteriorating product inventory system with multi-cycle, where the demand is deterministic. Demand which is affected by sales efforts, is broadly studied by (Taylor, 2002). For various sales effort on inventory decisions, list a few as follows. (Balcer, 1980, Balcer, 1983) investigated the joint inventory and advertising policies. (Cheng and Sethi, 1999) modeled demand as a Markov decision process and explore the joint promotion and inventory decisions. (Chen, 2000) studied the inventory problem by offering incentive to salespersons for more sales effort. (Ernst and Kouvelis, 1999) adopted the newsvendor problem where items are sold in a bundling form. (Wei and Chen) considered the joint sales effort and replenishment decisions with uncertain market responses, attempting to maximize the long-run average profit over an infinite horizon. (Zhang et al., 2008) examined the joint promotion and price decisions based on the finite, periodic-review setting.

The last category aims at the channel coordination. (Weng, 1995) justified that the mechanism of quantity discounts with a franchise fee paid from a retailer to its supplier can coordinate the channel. (Pasternack, 2008) showed that a partial credit for all unsold perishable items can achieve channel coordination in a multi-retailer environment. (Padmanabhan and Png, 1997) explored the return policies in the retail competition environment. (Cachon and Lariviere, 2005) coordinated the channel through the revenue-sharing contract. (Krishnan et al., 2004) proposed contracts to coordinate supply chain with retailer promotional effort. To the best of our understanding, this is the first work analyzing the effects of markdown magnitude and timing on joint promotional effort and ordering decisions.

## Mathematical Models

The following work starts to establish the inventory model of a fashion commodity, particularly in the apparel industry. A supplier charges a wholesales price  $w$  to his retailer and the sales price  $p$  has been decided before the sale starts. The randomness of demand here is considered based upon the entire sales period. To an easy exposition, the randomness in each period(interval) is not taken into account in this work. To illustrate that the items' sale decreases in time, an exponential trend,  $\xi(p) \cdot e^{-\lambda t}$ , is adopted to represent the amount of demand in time  $t$  accumulated from the beginning of sale, where  $\lambda$  is the declining rate of demand as time eclipses and  $\xi(p)$  represents the price-dependent demand with distribution  $F(\cdot)$  and density function  $f(\cdot)$ . To simplify the notation, we represent a realized  $\xi$  only

unless necessary since price is known in advance. In addition, a retailer takes the markdown action at time  $s$  which counts from the start of the sale. When the discount timing arrives, a retailer provides  $(1 - \mu)\%$  off of the original sales price. This action provides an incentive for a stronger purchasing willingness and results in a multiplier  $\nu(p, \mu)$ , which is relevant to the discount percentage and initial pricing, of demand surge. This work assumes the transparency of markdown information to the public and, hence, demand from period  $t$  to the end of sales equals  $\xi \int_s^T \nu(p, \mu) e^{-\lambda t} dt$ . Note that  $\nu \geq 1$  and  $\nu(\cdot, \mu)$  drops in  $\mu$ , otherwise the markdown brings a negative effect of attracting demand. This multiplier is set to be price-dependent since the characteristic of fashion commodity. A higher pricing strategy at the beginning intimidates customer. Following the markdown, more people, who originally intended to purchase goods but eventually gave up due to price consideration, are now back. Hence, this saturation effect demonstrates that  $\nu(p, \cdot)$  decreases in  $p$ .

With the information mentioned above, a retailer then makes the joint decisions on promotional effort  $\rho$  and quantity  $q$ , which depends on the pre-acquired markdown information, before the sales. The effort stimulates demand from  $\xi e^{-\lambda t}$  to  $\rho \xi e^{-\lambda t}$  and a cost  $\Psi(\rho)$ , assumed as nondecreasing convex in  $\rho$ , is incurred. When items are released to the shelf, a retailer sells  $\min\{q, \rho \xi \int_0^s e^{-\lambda t} dt\}$  units with the original sales price. When the markdown timing arrives, she then markets  $\min\{(q - \rho \xi \int_0^s e^{-\lambda t} dt)^+, \rho \xi \int_s^T \nu(p, \mu) e^{-\lambda t} dt\}$  units with discounted price  $\mu p$  to customers. If ordered quantity can not satisfy demand, a shortage cost  $\pi$  per unit is incurred. When the sale ends, unsold items are pulled out of the shelf and the supplier buybacks them with price  $b$  per unit. Given a set of  $(\rho, q)$ , a retailer's revenue is established mathematically as

$$R_r(s, \mu, \rho, q) = pE[\min\{q, \rho \xi h(s)\}] + \mu pE[\min\{(q - \rho \xi h(s))^+, \rho \xi \int_s^T \nu(p, \mu) e^{-\lambda t} dt\}] \\ + bE[q - \rho \xi c(s, \mu)]^+ - \pi E[\rho \xi c(s, \mu) - q]^+ - \Psi(\rho),$$

$$\text{where } h(s) = \int_0^s e^{-\lambda t} dt, \quad c(s, \mu) = \int_0^s e^{-\lambda t} dt + \int_s^T \nu(p, \mu) e^{-\lambda t} dt, \quad \text{and } x^+ = \max[0, x].$$

Including the purchasing cost, a retailer's profit is written as

$$G(s, \mu, \rho, q) = -wq + R_r(s, \mu, \rho, q).$$

Thus, the optimal profit function of a retailer is written as

$$v_r(s, \mu) = \max_{\rho \geq 1, q \geq 0} G(s, \mu, \rho, q). \quad (1)$$

**Proposition 1** (a) Given  $(s, \mu)$ ,  $G(s, \mu, \rho, q)$  is a joint concave function in  $(\rho, q)$ .



(b) There exists a unique set of  $(\rho, q)$  to maximize  $v_r(s, \mu)$ .

Proof. See appendix.

Eq. (1) can also be represented as

$$v_r(s, \mu) = \max_{q \geq 0} \{-wq + \{\max_{\rho \geq 1} R_r(s, \mu, \rho, q)\}\},$$

where  $R_r(s, \mu, \rho, q) = pq + (b - p)E[q - \rho \xi c(s, \mu)]^+ - \pi E[\rho \xi c(s, \mu) - q]^+ - \Psi(\rho)$ .

Given a  $q$ ,  $\rho^*(q)$  optimizes  $R_r(s, \mu, \rho, q)$  and the following lemma is justified.

**Proposition 2**  $G(s, \mu, \rho^*(q), q)$  is concave in  $q$ .

Proof. Proposition 1 demonstrates that

$$G(s, \mu, \frac{1}{2}\rho^*(q^1) + \frac{1}{2}\rho^*(q^2), \frac{1}{2}q^1 + \frac{1}{2}q^2) \geq \frac{1}{2}G(s, \mu, \rho^*(q^1), q^1) + \frac{1}{2}G(s, \mu, \rho^*(q^2), q^2)$$

Since  $\rho^*(q) = \operatorname{argmax}_{\rho} G(s, \mu, \rho, q)$ ,

$$G(s, \mu, \rho^*(\frac{1}{2}q^1 + \frac{1}{2}q^2), \frac{1}{2}q^1 + \frac{1}{2}q^2) \geq G(s, \mu, \frac{1}{2}\rho^*(q^1) + \frac{1}{2}\rho^*(q^2), \frac{1}{2}q^1 + \frac{1}{2}q^2),$$

from which  $G(s, \mu, \rho^*(q), q)$  is justified as concave in  $q$ .

Consider the replenishment decision of the non-cooperated retailer, an order, denoted as  $q_r^*$ , must be placed. Furthermore, observe that the increase on wholesales cost will decrease retailer's order quantity. The following proposition formally represents it.

**Proposition 3** (a)  $q_r^* > 0$ .

(b)  $q_r^*(w)$  is nonincreasing in  $w$ .

Proof. (a) When  $q_r = 0$ ,  $\frac{\partial}{\partial q}[R_r(s, \mu, \rho^*(q_r), q_r)]|_{q=0} = p + \pi$ . The maximization of  $v_r$

results in

$$\frac{\partial}{\partial q}[R_r(s, \mu, \rho^*(q_r), q_r)]|_{q_r=q_r^*} = w < p + \pi.$$

From the concavity of  $R_r(\cdot, \cdot, \cdot, q_r)$ ,  $q_r^* > 0$ .

(b)  $\frac{\partial}{\partial q}[R_r(s, \mu, \rho^*(q_r), q_r)]|_{q_r=q_r^*}$  increases in  $w$ . Hence, the concavity also

demonstrates that  $q_r^*$  decreases in  $w$ .

For fashion clothes in particular, a retailer's loss from the inventory understock is restricted. The reason is since customers can find the substitute in the same store or are willing to wait for the retailer's replenishment. Based on the setting of  $\pi = 0$ , the following identifies a nice structure for the promotional effort and quantity decisions with respect to the markdown action.

**Proposition 4** When  $\pi = 0$ , then

(a)  $\rho^*(s, \mu)$  and  $q^*(s, \mu)$  are nondecreasing in  $s$  if  $\mu p \geq b$ .

(b)  $\rho^*(s, \mu)$  and  $q^*(s, \mu)$  are nondecreasing in  $\mu$  if  $\mu p < b$ .

*Proof.* See appendix.

### Vertically-integrated Supply Chain

From the above discussion, a retailer regards the buyback as a incentive and further makes the joint promotional effort and ordering decisions. Apparently, a retailer's gain from the action of buyback becomes her supplier's cost but these two shifts are offset when channel's profit is taken into account. It is well known that the the collaborated channel profit performs better than non-collaborated one (details omitted). In the following, this work continues to explore the joint decisions based on the case of channel cooperation. First, the profit is represented as

$$v_{\Pi}(s, \mu) = \max_{q \geq 0, \rho \geq 1} \{-cq + R_{\Pi}(s, \mu, \rho, q)\}, \quad (2)$$

where  $R_{\Pi}(s, \mu, \rho, q) = pE[\min\{q, \rho \xi h(s)\}] + \mu p E[\min\{(q - \rho \xi h(s))^+\}]$ ,  
 $\rho \xi \int_s^T v(p, \mu) e^{-\lambda t} dt] - \pi E[\rho \xi c(s, \mu) - q]^+ - \Psi(\rho)$ . Note that

$R_{\Pi}(s, \mu, \rho, q)$  also equals  $R_r(s, \mu, \rho, q) - bE[q - \rho \xi c(s, \mu)]^+$ . To know if a retailer can make the decisions from which the performance of the channel cooperation is maximized, this work thus defines  $H(s, \mu, \rho, q)$ , the terms of  $-cq + R_{\Pi}(s, \mu, \rho, q)$ , as the channel profit based on a given  $(s, \mu, \rho, q)$ . The mathematical justification illustrates that it is jointly concave in  $(\rho, q)$  which implies the optimal decisions exists. Denote  $(q_{\Pi}^*, \rho_{\Pi}^*)$  be the optimal decisions to form  $v_{\Pi}(\cdot)$  and then more findings are concluded in the following proposition.

Proposition 5 (a)  $H(s, \mu, \rho, q)$  is joint concave in  $(\rho, q)$ .

(b)  $R_{\Pi}(s, \mu, \rho^*(q), q)$  is concave in  $q$ .

(c) When  $b = 0$ ,  $q_{\Pi}^* > q_r^* > 0$ .

Proof. (a) and (b) These two can be justified through the same steps shown in the proof of Proposition 1. (c) When  $b = 0$ ,  $R_{\Pi}(s, \mu, \rho, q) = R_r(s, \mu, \rho, q)$ . Hence,

$$\frac{\partial R_{\Pi}(s, \mu, \rho^*(q), q)}{\partial q} \Big|_{q=q_{\Pi}^*} = c < w = \frac{\partial R_r(s, \mu, \rho^*(q), q)}{\partial q} \Big|_{q=q_r^*}$$

demonstrates that  $q_r^* \geq q_{\Pi}^*$  which is justified from part (b). To know an order must be placed under the integrated supply chain, examine

$$\frac{\partial}{\partial q} [R_{\Pi}(s, \mu, \rho^*(q), q) \Big|_{q=0}] = p + \pi,$$

which is larger than  $w$ . Thus,  $q_{\Pi}^* > 0$ .

With the inclusion of buyback, more properties related to decisions where this work focuses are illustrated in the following.

**Proposition 6** Given  $(s, \mu)$ ,

(a)  $\rho_{\Pi}^* > \rho_r^*$ .

(b)  $q_{\Pi}^* > 0$ .

(c)  $q_{\Pi}^* > q_r^*$  if  $c < w - b$ .

Proof. (a) Through the algebraic identity,

$$\frac{\partial H(s, \mu, \rho, q)}{\partial \rho} = \frac{\partial G(s, \mu, \rho, q)}{\partial \rho} + b \int_{\xi=0}^q \xi c(s, \mu) f(\xi) d\xi.$$

Hence,  $\frac{\partial H(s, \mu, \rho, q)}{\partial \rho} \Big|_{\rho=\rho_r^*, q=q_r^*} > \frac{\partial G(s, \mu, \rho, q)}{\partial \rho} \Big|_{\rho=\rho_r^*, q=q_r^*} = 0$ . We have known that, for any  $q$ ,  $\frac{\partial H(s, \mu, \rho, q)}{\partial \rho} \Big|_{\rho=\rho_r^*} > 0$  implies that  $\rho_{\Pi}^* > \rho_r^*$  due to the characteristic of joint concavity of  $H(\cdot)$  in  $(\rho, q)$ .

(b) To know an order must be placed under the integrated supply chain, examine

$\frac{\partial}{\partial q} [H(s, \mu, \rho^*(q), q) \Big|_{q=0}] = -c + p + \pi$ , which is a positive value. Hence,  $q_{\Pi}^* > 0$  is justified.

(c)  $\frac{\partial H(s, \mu, \rho, q)}{\partial q}$  can be represented as  $\frac{\partial G(s, \mu, \rho, q)}{\partial q} - c + w - bF[\frac{q}{\rho c(s, \mu)}]$ . When  $\rho = \rho_r^*, q = q_r^*$ ,  $\frac{\partial H(s, \mu, \rho, q)}{\partial q} \Big|_{\rho=\rho_r^*, q=q_r^*} = -c + w - bF[\frac{q_r^*}{\rho_r^* c(s, \mu)}] > 0$  since  $c < w - b$ . Hence,  $\rho_{\Pi}^* > \rho_r^*$  holds.

Observe that the results acquired from Proposition 5 are once again illustrated in this proposition when buyback is set as zero. The changes on joint decisions with respect to markdown needs to do some revision in terms of what is mentioned in Proposition 4. When  $\pi$  is set as zero, the different parameter settings would result in the difficulty to identify if decisions display a positive or negative trend as the markdown magnitude increases. However, the joint decisions have a nondecreasing trend when a retailer delays the discount timing. The following formally represents this.

**Proposition 7** When  $\pi = 0$ ,

(a)  $\rho_{\Pi}^*(s)$  is nondecreasing in  $s$ .

(b)  $q_{\Pi}^*(s)$  is nondecreasing in  $s$ .

*Proof.* Similar to the steps in the proof of Proposition 4,

$$\begin{aligned} \Psi''(\rho_{\Pi}^*) \frac{\partial \rho_{\Pi}^*}{\partial s} = & (-\mu p) \int_0^{\frac{q^*}{\rho^* c(s, \mu)}} -\xi \frac{\partial c(s, \mu)}{\partial s} f(\xi) d\xi \\ & + p \int_0^{\frac{q^*}{\rho^* h(s)}} \xi \frac{\partial h(s)}{\partial s} f(\xi) d\xi + \underbrace{\mu p \int_{\frac{q^*}{\rho^* h(s)}}^{\frac{q^*}{\rho^* c(s, \mu)}} \xi \frac{\partial h(s)}{\partial s} f(\xi) d\xi - \mu p E[\Xi] \frac{\partial h(s)}{\partial s}}_{>0}, \end{aligned}$$

which implies  $\frac{\partial \rho_{\Pi}^*}{\partial s} \geq 0$ . Besides,  $\frac{\partial q_{\Pi}^*}{\partial s} \geq 0$  can be further justified as well.

Next, this work continues to discuss the channel coordination. Based upon the model we develop, the coordination can not been achieved when buyback plays the only mechanism (detail omitted). Thus, the following proposes two types of contract designed to accomplish the channel coordination. Observe that a retailer would still intimidate to order more even the buyback is designed to offset her potential loss. One scenario is when the buyback is set to low and becomes unattractable. In addition, recall that the shortage cost is limited or neglected in the fashion cloth industry. Thus, a retailer can play conservative to make order decision due to the mitigated damage from shortage. From the supplier's perspective, the first contract considers that he, on one hand, buybacks unsold items. On the other hand, he charges a fraction  $\phi$  of total lost-sales cost to penalize a retailer's insufficient order. This

could prevent a supplier's potential loss of a retailer's unwillingness to order more. Hence, represent the retailer's profit as

$$v_r^{(\phi)} = \max_{q \geq 0, \rho \geq 1} -wq + R_r(s, \mu, \rho, q) + \phi \pi E[\rho \xi c(s, \mu) - q]^+.$$

**Proposition 8** Set  $\phi = \frac{-b}{\pi}$  and  $b = w - c$  coordinate the lost-sales cost sharing contract.

Proof.

To obtain

$$\frac{\partial v_r^{(\phi)}(s, \mu, \rho, q)}{\partial q} = (p + (1 - \phi)\pi - w) + (b - \mu p - (1 - \phi)\pi)F\left[\frac{q}{\rho c(s, \mu)}\right] + (\mu p - p)F\left[\frac{q}{\rho h(s)}\right]_{\rho=\rho_{\Pi}^*, q=q_{\Pi}^*} = 0$$

, substitute  $\frac{\partial v_{\Pi}}{\partial q} = (p + \pi - c) + (-\mu p - \pi)F\left[\frac{q}{\rho c(s, \mu)}\right] + (\mu p - p)F\left[\frac{q}{\rho h(s)}\right]_{\rho=\rho_{\Pi}^*, q=q_{\Pi}^*} = 0$

into the function. Thus,  $\phi = \frac{-b}{\pi}$  and  $b = w - c$  coordinate the supply chain.

Another type of contract is the sharing of the promotional effort. When the buyback is used as the only mechanism to encourage a retailer ordering more and then matching items by generating more demand, the cost of effort paid to stimulate demand becomes a concern. The high price of effort would force a retailer's stoppage to pursue more demand, which makes the buyback be ineffective. To wipe out this concern, this work proposes a contract to pass on partial effort cost to the supplier. Hence, the retailer's profit becomes

$$v_r^{(\Omega)} = \max_{q \geq 0, \rho \geq 1} -wq + R_r(s, \mu, \rho, q) + \Omega \Psi(\rho),$$

where  $\Omega$  denote the fraction of the promotional cost shared by the supplier.

**Proposition 9** When  $\Omega = \frac{bc(s, \mu) \int_0^q \xi f(\xi) d\xi}{\frac{\partial}{\partial q} \Psi(\rho_{\Pi}^*)|_{q=q_{\Pi}^*}}$  and  $b = \frac{-c + w}{F\left[\frac{q_{\Pi}^*}{\rho_{\Pi}^* c(s, \mu)}\right]}$ , the contract

with promotional effort sharing is coordinated.

Proof. Since  $\frac{\partial v_{\Pi}}{\partial \rho}|_{q=q_{\Pi}^*, \rho=\rho_{\Pi}^*} = 0$ , set  $\frac{\partial v_r^{\Omega}}{\partial \rho}|_{q=q_{\Pi}^*, \rho=\rho_{\Pi}^*} = 0$  derives

$bc(s, \mu) \int_0^q \xi f(\xi) d\xi = \Omega \Psi'(\rho)|_{\rho=\rho_{\Pi}^*}$ . As for the derivative of  $v_{\Pi}$  with respect to  $q$ ,

$$\frac{\partial v_{\Pi}}{\partial q}|_{q=q_{\Pi}^*, \rho=\rho_{\Pi}^*} = (p + \pi - c) - [\mu p + \pi]F\left[\frac{q}{\rho c(s, \mu)}\right] + (\mu p - p)F\left[\frac{q}{\rho h(s)}\right]|_{q=q_{\Pi}^*, \rho=\rho_{\Pi}^*} = 0.$$

By setting  $\frac{\partial v_r^\Omega}{\partial q} \Big|_{q=q_\Pi^*, \rho=\rho_\Pi^*} = 0$  and substituting terms from the above equation, we have

$$-w + bF\left[\frac{q}{\rho c(s, \mu)}\right] \Big|_{q=q_\Pi^*, \rho=\rho_\Pi^*} = -c.$$

Note that  $(\rho_\Pi^*, q_\Pi^*)$  is irrelevant to  $\Omega$  but depends on parameters  $c$ ,  $s$ , and  $\mu$ .

## Numerical Experiments and Sensitivity Analysis

This section presents an elaborate computational experiment and probes the numerical findings from the analytical perspective. First explore the channel and retailer's profits with respect to various combination of markdown magnitude and timing. Then examine if a retailer takes advantage of markdown and if so, to what extent. As for the performance of retailer's profit based on the contracts we proposed to coordinate channel, the last part of the experiments is to see which contract could benefit a retailer more according to the change on wholesales cost. The parameter setting is illustrated as follows. Define  $v(p, \mu) = \beta \frac{p}{p_0} [\gamma_1 e^{-\gamma_2 \mu} + (1 - \gamma_1) e^{-\gamma_2}]$ . The cost of promotional effort, representing a convex form by assumption, is measured by  $\Psi(\rho) = \kappa(\rho - 1)^2$ . The randomness of demand is captured in the interval  $[E[\Xi] - \varepsilon, E[\Xi] + \varepsilon]$  with truncated normally distributed parameter  $(E[\Xi], \sigma)$ . The detail of parametric values is summarized below.

$T$	$c$	$w$	$p$	$\pi$	$b$	$\gamma_1$	$\gamma_2$	$\beta$	$\lambda$	$E[\Xi]$	$\sigma$	$\kappa$	$\varepsilon$
50	10	15	20	0	8	20	1	1	0.05	40	10	3000	30

Table 1: Parameter Setting

## Profit Performance for Various Markdown Settings

Considering the optimization on a retailer's profit (see Fig. 1), experiments reveal that a better profit performance can be achieved when a larger(smaller) discount choice accompanies the synchronized decision of delaying(expediting) the markdown timing.

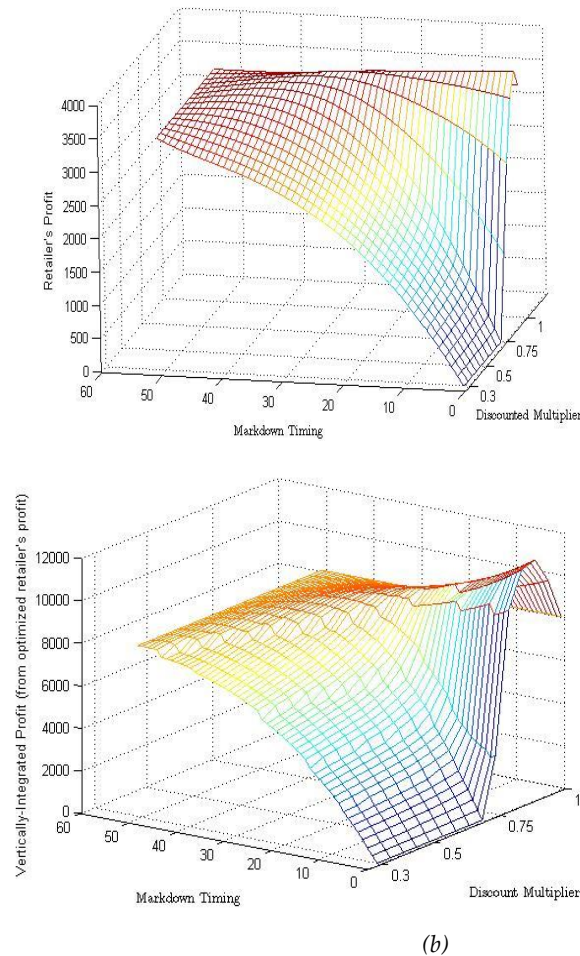


Figure 1: Profits based on the optimization of retailer's profit. a) Retailer's profit. b) Vertically-integrated profit.

For the optimized vertically-integrated (channel) profit (see Fig. 2), a smaller discount results in a even quicker arrival of markdown comparing to the decisions made from only the retailer-dependent profit. As displayed in both graphs, providing a 10% off of the original price tag at the beginning of sales period maximizes the channel profit. However, this does not address what the best pricing straty is. Note that this result depends on the design of  $\nu(s, \mu)$  used in the experiment. Instead of identifying the optimal pricing strategy, this work concentrates on the exploration of how decisions are affected by markdown.

Based upon the promotional effort and ordering decisions from the optimized channel profit, observe that a retailer displays a serious profit loss when the range between 50 to 60% off discount is scheduled on the early stage of sales cycle. Breaking down each term of a retailer's profit reveals that sales revenue is insufficient to compensate the expense on items procurement. Besides, the buyback brings a limited gaining on profit. Hence, the decisions depending on the channel profit could potentially become the retailer's barrier to cooperate with her supplier. To prevent this, the following sensitivity analysis adopts scenarios that 20, 30, 40 % off of the original price are offered to customers in the 30 th, 35 th and 40 th period in order. Before this exposition, first sums up observations based on the above figures.

1. Even though the cooperation brings the maximum vertically-integrated profit, the retailer's profit is hurt in comparison with the non-cooperated case.
2. The retailer would endeavor to make more promotion effort when she collaborates with the supplier.
3. The extra demand stimulated from the increase on promotion effort consequently results in the retailer ordering more.

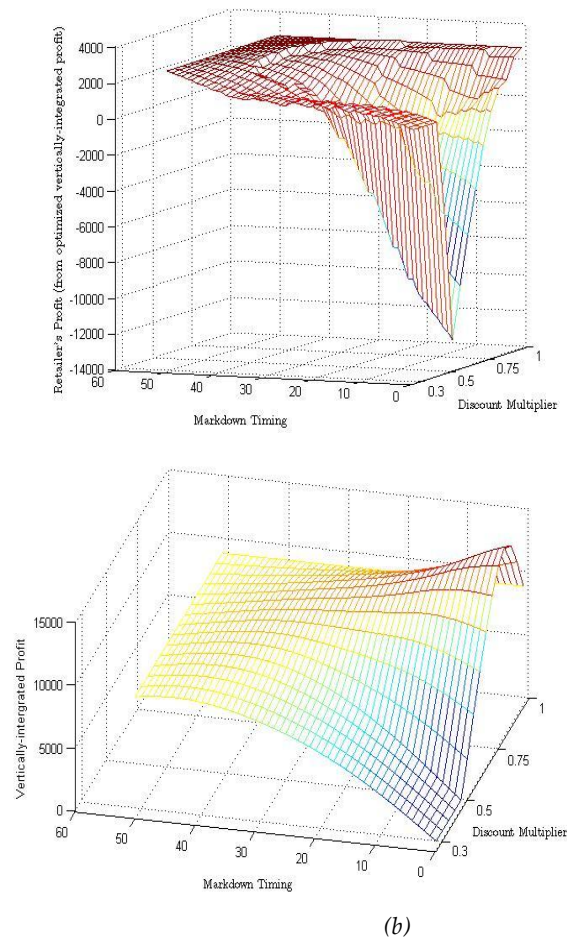


Figure 2: Profits based on the optimization of vertically-integrated profit. a) Retailer's profit. b) Vertically-integrated profit.

### Sensitivity Analysis

To evaluate if markdown benefits profits, define the metric, Fraction of the Single Price Strategy, as

$$\text{Fraction of the Single Price Strategy} = \frac{\text{Profit}_{\text{with markdown}}}{\text{Profit}_{\text{without markdown}}}.$$

The following denotes R to represent this fraction on retailer's profit and VI to be the fraction of the vertically-integrated profit. When the retailer cooperates with her supplier to



pursue the maximum profit, how much the supplier is willing to buyback unsold items does not affect her profit too much (see Figure 2). In the non-cooperated case showed in Figure 2, each scenario reveals that a retailer indeed adds her order amount when the buyback cost per unit increases. However, the metric used to measure the markdown performance constantly goes down when the offered buyback cost enlarges, from which keeping the single price strategy probably becomes a much wiser choice for a high  $b$  value.

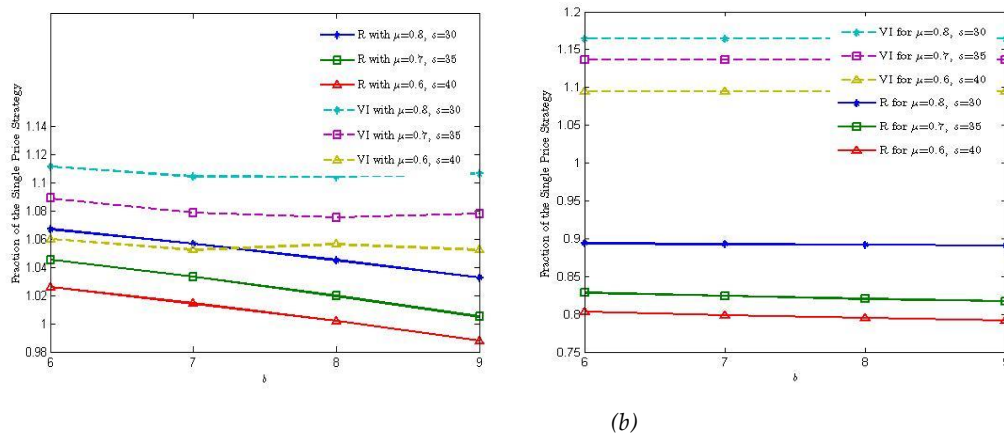


Figure 3: Fraction of the single price strategy based on different buyback cost. a) Optimization of the retailer's profit. b) Optimization of the vertically-integrated profit.

This work assumes that demand has an exponential decrease over time. Figure 4 demonstrates that the larger descending rate of demand diminishes the benefit of the vertically-integrated profit in either cooperated or non-cooperated case since markdown results in less demand raise and further compressed the growth on profit. However, the retailer takes advantage of the larger descending rate of demand and gains more from the supplier's buyback action.

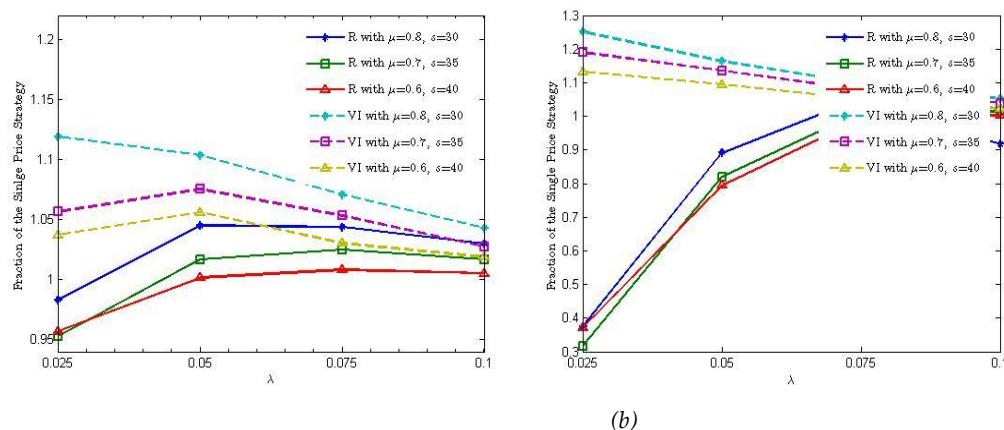


Figure 4: Fraction of the single price strategy based on different  $\lambda$ . a) Optimization of the retailer's profit. b) Optimization of the vertically-integrated profit.

This work next probes the sensitivity of profits on unit promotional cost (Figure 5). Under the vertically-integrated profit scenario, the effort a retailer is willing to devote drops once the corresponding unit cost raises. Consequently, the profit gap between the non-discounted and discounted strategies of the retailer diminishes. As observed, the profits do not reveal too much change in the retailer-optimized case.

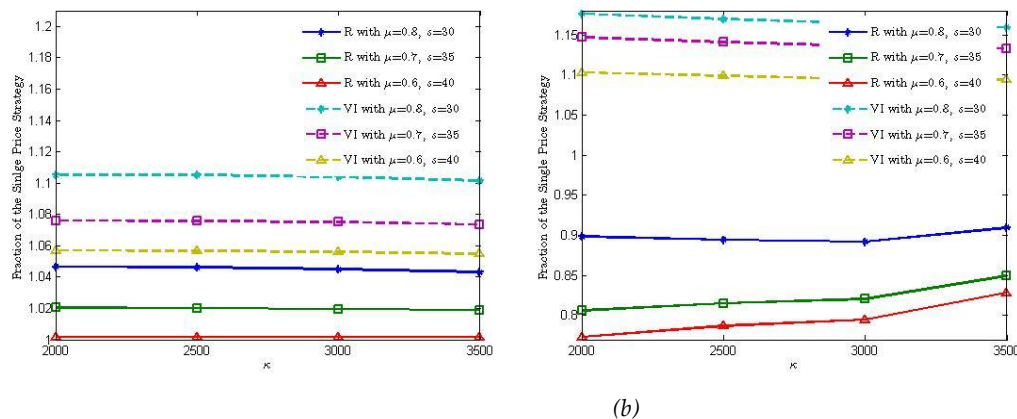


Figure 5: Fraction of the single price strategy based on different  $\kappa$ . a) Optimization of the retailer's profit. b) Optimization of the vertically-integrated profit.

In Figure 6, the existence of shortage cost brings a trade-off about whether the retailer should discount a product. When this cost is small, the non-cooperated retailer's profit get a slight benefit from discount. With the higher cost, it exacerbates her loss of profit and results in that the decision maker prefers the single pricing strategy. Furthermore, the retailer would love the saturation effect brought from the high pricing strategy when a new type of product is launched (Figure 7).

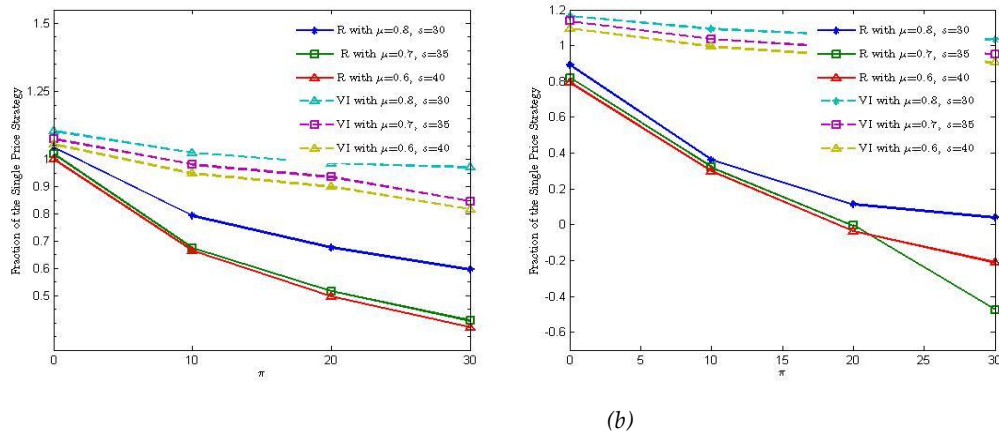


Figure 6: Fraction of the single price strategy based on different  $\pi$ . a) Optimization of the retailer's profit. b) Optimization of the vertically-integrated profit.

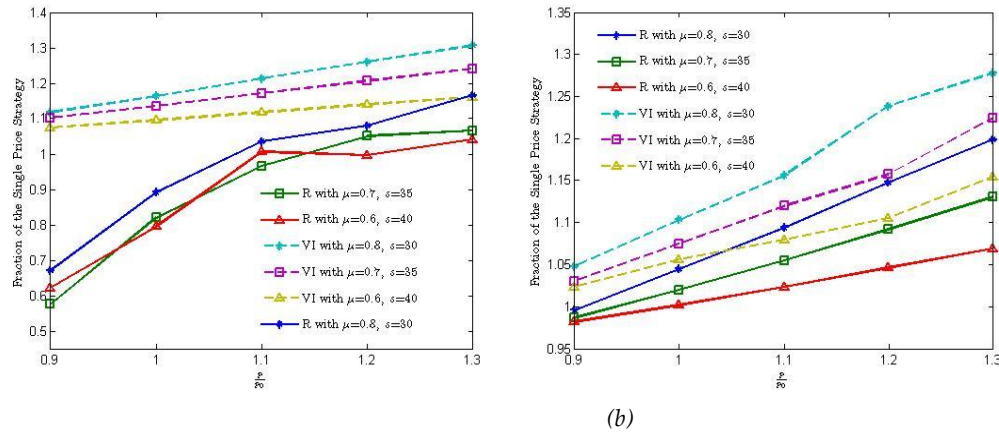


Figure 7: Fraction of the single price strategy based on different  $\pi$ . a) Optimization of the retailer's profit. b) Optimization of the vertically-integrated profit.

## Performance of Supply Chain Coordination

In this subsection, we slightly adjust the parameter setting for a better interpretation of results. Here the lostsales cost is taken into account with  $\pi = 20$  and wholesales price is set equal to  $w = 14$ . To measure the retailer' performance from the channel coordination, define a metric as

$$\text{Percent of Profit Advantage} = \frac{v_r^{(\phi)} - v_r^{(\Omega)}}{v_r^{(\Omega)}} \times 100\%.$$

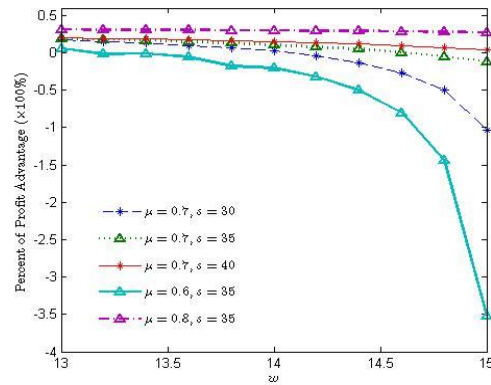


Figure 8: Percent of Profit Advantage

From Figure 8, the lost-sales compensation contract takes advantage of the promotional effort sharing contract when the wholesales price is low. With the increase of a supplier's charge per unit to a retailer, this advantage diminishes. By observing the negative value of this metric, this shows that the effort sharing becomes an ideal contract for channel coordination. Furthermore, the effort-sharing contract comes more preferable when the retailer makes an early promotion. As for the markdown magnitude, the high discount strategy (small  $\mu$ ) favors the effort-sharing contract.

## Conclusions

When a retailer finds that she orders too much and has the potential overstock crisis, she afterward provides discount to draw customers and solves the inventory excess. Most likely, markdown is regarded as a decision while managing inventory. The current trend in the fashion clothing industry discloses that a product has a shorter life cycle due to the intense competition which implies that the value of a product fades away quickly. This work provides a proactive vision to make the early stage decisions. A retailer makes the quantity and promotional effort based on considering the following markdown action. One way to evaluate the information of markdown timing and discount magnitude is through the past sales data for similar products. Assume the markdown information is given in advance, the purpose of this work is to identify the ordering and promotion effort. These decisions made are more accurate to match demand with supply when the fashion clothing industry manage inventory.

Based on the developed model, we verify the existence of optimally joint decisions. Besides, the properties and comparisons of decisions in both non-cooperated and cooperated channel profit cases are analyzed mathematically. To achieve the channel coordination, two contracts, effort-sharing and penalty of shortage, are proposed. The experiment reveals that an early promotion or larger discount rate favors the promotional effort sharing contract and vice versa.

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## Appendix

**Lemma 1** (a)  $\frac{\partial c(s, \mu)}{\partial s} \geq 0$ .

(b)  $\frac{\partial c(s, \mu)}{\partial \mu} \leq 0$ .

**Proof.**  $\frac{\partial c(s, \mu)}{\partial s} = (1 - v(p, \mu))e^{-\lambda s}$  which is nondecreasing in  $s$ .

As for  $\frac{\partial c(s, \mu)}{\partial \mu} = \frac{-1}{\lambda} \frac{\partial v(s, \mu)}{\partial \mu} [e^{-\lambda T} - e^{-\lambda s}]$ , this is a non-positive value. Through the

same logic,  $\frac{\partial h(s)}{\partial s} \geq 0$ .

**Proof of Proposition 1.** From Eq. (1),

$$G(s, \mu, \rho, q) = -wq + pq - pE[q - \rho \xi h(s)]^+ + \mu p E[q - \rho \xi h(s)] + (b - \mu p) E[q - \rho \xi c(s, \mu)]^+ \\ + \mu p E[\rho \xi h(s) - q]^+ - \pi E[\rho \xi c(s, \mu) - q]^+ - \Psi(\rho),$$

which is another form to represent a retailer's profit. From the fact that the distribution of  $\xi$  is assumed to be continuous and differentiable, rewrite

$$\begin{aligned}
G(s, \mu, \rho, q) = & -wq + pq + (b - \mu p) \int_{\xi=0}^{\frac{q}{\rho c(s, \mu)}} [q - \rho \xi c(s, \mu)] f(\xi) d\xi - p \int_{\xi=0}^{\frac{q}{\rho h(s)}} [q - \rho \xi h(s)] f(\xi) d\xi \\
& + \mu p E[q - \rho \xi h(s)] + \mu p \int_{\xi=\frac{q}{\rho h(s)}}^{\infty} [\rho \xi h(s) - q] f(\xi) d\xi - \pi \int_{\xi=\frac{q}{\rho c(s, \mu)}}^{\infty} [\rho \xi c(s, \mu) - q] f(\xi) d\xi - \Psi(\rho).
\end{aligned}$$

To justify that  $G(s, \mu, \rho, q)$  is jointly concave in  $(\rho, q)$  for a given  $(s, \mu)$ , first differentiate it respect to  $\rho$  and  $q$  where

$$\begin{aligned}
\frac{\partial G(s, \mu, \rho, q)}{\partial \rho} = & (b - \mu p) \int_{\xi=0}^{\frac{q}{\rho c(s, \mu)}} [-\xi c(s, \mu)] f(\xi) d\xi + p \int_{\xi=0}^{\frac{q}{\rho h(s)}} \xi h(s) f(\xi) d\xi - \mu p h(s) E[\Xi] \\
& + \mu p \int_{\xi=\frac{q}{\rho h(s)}}^{\infty} \xi h(s) f(\xi) d\xi - \pi \int_{\xi=\frac{q}{\rho c(s, \mu)}}^{\infty} \xi c(s, \mu) f(\xi) d\xi - \Psi'(\rho) \quad (3)
\end{aligned}$$

$$\frac{\partial G(s, \mu, \rho, q)}{\partial q} = (p + \pi - w) + (b - \mu p - \pi) F\left[\frac{q}{\rho c(s, \mu)}\right] + (\mu p - p) F\left[\frac{q}{\rho h(s)}\right] \quad (4)$$

$G(\cdot)$  is then twice differentiated with respect to  $\partial \rho^2$ ,  $\partial q^2$ , and  $\partial \rho \partial q$  to get

$$\frac{\partial G^2(s, \mu, \rho, q)}{\partial \rho^2} = (b - \mu p - \pi) \left[ \frac{q^2}{\rho^3 c(s, \mu)} \right] f\left(\frac{q}{\rho c(s, \mu)}\right) + (\mu p - p) \left[ \frac{q^2}{\rho^3 h(s)} \right] f\left(\frac{q}{\rho h(s)}\right) - \Psi''(\rho) \leq 0 \quad (5)$$

$$\frac{\partial G^2(s, \mu, \rho, q)}{\partial q^2} = (b - \mu p - \pi) f\left(\frac{q}{\rho c(s, \mu)}\right) \left[ \frac{1}{\rho c(s, \mu)} \right] + (\mu p - p) \left[ \frac{1}{\rho h(s)} \right] f\left(\frac{q}{\rho h(s)}\right) \leq 0 \quad (6)$$

$$\frac{\partial G^2(s, \mu, \rho, q)}{\partial q \partial \rho} = (-b + \mu p + \pi) f\left(\frac{q}{\rho c(s, \mu)}\right) \left[ \frac{q}{\rho^2 c(s, \mu)} \right] + (p - \mu p) \left[ \frac{q}{\rho^2 h(s)} \right] f\left(\frac{q}{\rho h(s)}\right). \quad (7)$$

From above, the Hessian Matrix

$$\begin{aligned}
& \frac{\partial G^2(s, \mu, \rho, q)}{\partial \rho^2} \cdot \frac{\partial G^2(s, \mu, \rho, q)}{\partial q^2} - \left[ \frac{\partial G^2(s, \mu, \rho, q)}{\partial q \partial \rho} \right]^2 \\
& = -\Psi''(\rho) \left\{ (b - \mu p - \pi) f\left(\frac{q}{\rho c(s, \mu)}\right) \left[ \frac{1}{\rho c(s, \mu)} \right] + (\mu p - p) \left[ \frac{1}{\rho h(s)} \right] f\left(\frac{q}{\rho h(s)}\right) \right\},
\end{aligned}$$

which displays a non-negative value. Thus, the joint concavity holds.

$$\frac{\partial G(s, \mu, \rho, q)}{\partial q} \Big|_{\rho=\rho^*, q=q^*} = \frac{\partial G(s, \mu, \rho, q)}{\partial \rho} \Big|_{\rho=\rho^*, q=q^*} = 0$$

**Proof of Proposition 4.** (a) Since the Implicit Function Theorem (Krantz and Parks, 2003) results in

$$\begin{aligned} \frac{\partial}{\partial s} \left[ \frac{\partial G(s, \mu, \rho, q)}{\partial q} \Big|_{\rho=\rho^*, q=q^*} \right] &= (b - \mu p) f\left(\frac{q^*}{\rho^* c(s, \mu)}\right) \left[ \frac{\frac{\partial q^*}{\partial s} \rho^* c(s, \mu) - q^* \left( \frac{\partial \rho^*}{\partial s} c(s, \mu) + \frac{\partial c(s, \mu)}{\partial s} \rho^* \right)}{(\rho^* c(s, \mu))^2} \right] \\ &+ (\mu p - p) f\left(\frac{q^*}{\rho^* h(s)}\right) \left[ \frac{\frac{\partial q^*}{\partial s} \rho^* h(s) - q^* \left( \frac{\partial \rho^*}{\partial s} h(s) + \frac{\partial h(s)}{\partial s} \rho^* \right)}{(\rho^* h(s))^2} \right] = 0 \quad (8) \\ \frac{\partial}{\partial s} \left[ \frac{\partial G(s, \mu, \rho, q)}{\partial \rho} \Big|_{\rho=\rho^*, q=q^*} \right] &= (\mu p - b) f\left(\frac{q^*}{\rho^* c(s, \mu)}\right) \left[ \frac{\frac{\partial q^*}{\partial s} \rho^* c(s, \mu) - q^* \left( \frac{\partial \rho^*}{\partial s} c(s, \mu) + \frac{\partial c(s, \mu)}{\partial s} \rho^* \right)}{(\rho^* c(s, \mu))^2} \right] \left(\frac{q^*}{\rho^*}\right) \\ &+ (p - \mu p) f\left(\frac{q^*}{\rho^* h(s)}\right) \left[ \frac{\frac{\partial q^*}{\partial s} \rho^* h(s) - q^* \left( \frac{\partial \rho^*}{\partial s} h(s) + \frac{\partial h(s)}{\partial s} \rho^* \right)}{(\rho^* h(s))^2} \right] \left(\frac{q^*}{\rho^*}\right) \\ &- \Psi''(\rho) \frac{\partial \rho^*}{\partial s} + (b - \mu p) \int_0^{\frac{q^*}{\rho^* c(s, \mu)}} -\xi \frac{\partial c(s, \mu)}{\partial s} f(\xi) d\xi \\ &+ p \int_0^{\frac{q^*}{\rho^* h(s)}} \xi \frac{\partial h(s)}{\partial s} f(\xi) d\xi + \mu p \int_{\frac{q^*}{\rho^* h(s)}}^{\infty} \xi \frac{\partial h(s)}{\partial s} f(\xi) d\xi - \mu p E[\Xi] \frac{\partial h(s)}{\partial s} = 0, \quad (9) \end{aligned}$$

which are derived from Eqs. (3) and (4). The first two terms in Eq. (9) can be substituted by Eq. (8) and thus

$$\begin{aligned} \Psi''(\rho) \frac{\partial \rho^*}{\partial s} &= (b - \mu p) \int_0^{\frac{q^*}{\rho^* c(s, \mu)}} -\xi \frac{\partial c(s, \mu)}{\partial s} f(\xi) d\xi \\ &+ p \int_0^{\frac{q^*}{\rho^* h(s)}} \xi \frac{\partial h(s)}{\partial s} f(\xi) d\xi + \mu p \int_{\frac{q^*}{\rho^* h(s)}}^{\infty} \xi \frac{\partial h(s)}{\partial s} f(\xi) d\xi - \mu p E[\Xi] \frac{\partial h(s)}{\partial s}. \end{aligned}$$

>0

To make the equality hold, it must be  $\frac{\partial \rho^*}{\partial s} \geq 0$  since  $b \leq \mu p$  and  $\frac{\partial c(s, \mu)}{\partial s} \geq 0$ . To verify how the quantity decision changes according to the discount timing, we prove this by

contradiction. Suppose  $\frac{\partial q^*}{\partial s} < 0$ , the inequality in Eq. (8) would not hold. Hence,  $\frac{\partial q^*}{\partial s} \geq 0$  is verified.



(b) Following the same logic as we prove in part (a), the Implicit Function Theorem once again shows the following equations that

$$\begin{aligned}
 \frac{\partial}{\partial \mu} \left[ \frac{\partial G(s, \mu, \rho, q)}{\partial q} \right]_{\rho=\rho^*, q=q^*} &= (b - \mu p) f\left(\frac{q^*}{\rho^* c(s, \mu)}\right) \left[ \frac{\frac{\partial q^*}{\partial \mu} \rho^* c(s, \mu) - q^* \left( \frac{\partial \rho^*}{\partial \mu} c(s, \mu) + \frac{\partial c(s, \mu)}{\partial \mu} \rho^* \right)}{(\rho^* c(s, \mu))^2} \right] \\
 &+ (\mu p - p) f\left(\frac{q^*}{\rho^* h(s)}\right) \left[ \frac{\frac{\partial q^*}{\partial \mu} \rho^* h(s) - q^* \left( \frac{\partial \rho^*}{\partial \mu} h(s) + \frac{\partial h(s)}{\partial \mu} \rho^* \right)}{(\rho^* h(s))^2} \right] \\
 &+ p - pF\left(\frac{q^*}{\rho^* c(s, \mu)}\right) + pF\left(\frac{q^*}{\rho^* h(s)}\right) = 0 \quad (10)
 \end{aligned}$$

$$\begin{aligned}
 \frac{\partial}{\partial \mu} \left[ \frac{\partial G(s, \mu, \rho, q)}{\partial \rho} \right]_{\rho=\rho^*, q=q^*} &= (\mu p - b) f\left(\frac{q^*}{\rho^* c(s, \mu)}\right) \left[ \frac{\frac{\partial q^*}{\partial \mu} \rho^* c(s, \mu) - q^* \left( \frac{\partial \rho^*}{\partial \mu} c(s, \mu) + \frac{\partial c(s, \mu)}{\partial \mu} \rho^* \right)}{(\rho^* c(s, \mu))^2} \right] \left(\frac{q^*}{\rho^*}\right) \\
 &+ (p - \mu p) f\left(\frac{q^*}{\rho^* h(s)}\right) \left[ \frac{\frac{\partial q^*}{\partial \mu} \rho^* h(s) - q^* \left( \frac{\partial \rho^*}{\partial \mu} h(s) + \frac{\partial h(s)}{\partial \mu} \rho^* \right)}{(\rho^* h(s))^2} \right] \left(\frac{q^*}{\rho^*}\right) \\
 &- \Psi''(\rho) \frac{\partial \rho^*}{\partial \mu} + (b - \mu p) \int_0^{\frac{q^*}{\rho^* c(s, \mu)}} -\xi \frac{\partial c(s, \mu)}{\partial \mu} f(\xi) d\xi \\
 &- p \int_0^{\frac{q^*}{\rho^* c(s, \mu)}} -\xi c(s, \mu) f(\xi) d\xi + p \int_{\frac{q^*}{\rho^* h(s)}}^{\infty} \xi h(s) f(\xi) d\xi - ph(s) E[\Xi] = 0.
 \end{aligned}$$

(11)

Deriving from Eq. (10) and (11),

$$\begin{aligned}
 \Psi''(\rho) \frac{\partial \rho^*}{\partial \mu} &= p \frac{q^*}{\rho^*} \underbrace{\left[ 1 - F\left(\frac{q^*}{\rho^* c(s, \mu)}\right) + F\left(\frac{q^*}{\rho^* h(s)}\right) \right]}_{>0} + (b - \mu p) \int_0^{\frac{q^*}{\rho^* c(s, \mu)}} -\xi \frac{\partial c(s, \mu)}{\partial \mu} f(\xi) d\xi \\
 &- p \int_0^{\frac{q^*}{\rho^* c(s, \mu)}} -\xi c(s, \mu) f(\xi) d\xi + p \underbrace{\int_{\frac{q^*}{\rho^* h(s)}}^{\infty} \xi h(s) f(\xi) d\xi - ph(s) E[\Xi]}_{>0}.
 \end{aligned}$$

Observe that  $c(s, \mu)$  decreases in  $\mu$ , and thus  $\frac{\partial \rho^*}{\partial \mu} \geq 0$ . By taking this result back to Eq. (10),  $\frac{\partial q^*}{\partial \mu} \geq 0$ .



## TOWARDS THE DEVELOPMENT OF A CRM SUCCESS INDEX

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### Abstract

The field of Cause-Related Marketing has expanded rapidly in recent years and organizations invest a large amount of money in CRM campaigns in order to improve sales performance, and positively enhance their corporate and brand image. However, the results expected from CRM practices are often not achieved. Based on an extensive and systematic review of the literature, this article identifies all 21 CRM success factors for profit organizations, examined implicitly in 18 articles published in top tier scientific journals. As such, the paper consequently synthesizes the results into a CRM success index and divides the CRM success factors into four main categories: CRM design and structure, Experience, Authenticity, and Socio-demographic variables. In parallel, it is contended that the conceptualization of the results and the generation of a CRM success index, provides theoretical and practical implications that advance the current level of success in CRM campaigns. This CRM success index can help marketing practitioners manage CRM campaigns more efficiently and fulfil their company's goals more effectively. Lastly, the research conducted in this paper, represents the only systematic identification, examination and incorporation of all CRM success factors identified through the existing literature and discusses promising aspects of Cause-Related Marketing for future research.

**Keywords:** Cause-Related Marketing, Social Marketing, influence\*, affect\*, success factors.

### Introduction

Over the past two decades, corporate social responsibility (CSR), within the context of business activities, has been increasingly recognized, researched by scholars and utilized by organizations as an effectible business tool that promotes sustainable competitive advantage (Larson et al., 2008; Vlachos et al., 2009; Demetriou et al., 2010). In a recent examination of corporate associations and their degree of influence on consumer behaviour, Brown and Dacin (1997), as cited in Webb and Mohr, (1998) found that consumers' perceptions of corporate social responsibility predisposes their beliefs about and attitudes toward new products. (ibid.).

In principle, CSR can infuse brand loyalty and trust, strengthen corporate reputation and increase profitability (Larson et al., 2008; Demetriou et al., 2010). However, towards the quest of a holistic understanding of the concept of CSR, is not easy for the public to comprehend. When a company is involved with CSR practises, it might need to give explanations on what they stand for, the way corporate responsibility is carried out, and how the community benefits from such actions. Therefore, in order to justify support of nonprofits from a corporate perspective or a specific cause for promotional purposes, many organizations have refocused their social responsibility programs to

include cause related marketing. (Varadarajan and Menon, 1988; Webb and Mohr, 1998; Mohr et al., 2001; Polonsky and Speed, 2001; Brink et al., 2006; Nan and Heo, 2007; Singh et al., 2009; Sheikh and Beise-Zee, 2011). As a CSR technique, cause-related marketing (CRM) has received particular interest from corporations. This is due to the fact that especially CRM campaigns have positive effects on consumer behavior and they provide an ideal context for delving into consumers' interpretation of promotions with a social dimension and exploring their behaviours to such corporate "do-gooding" (Webb and Mohr, 1998; Tangari et al., 2010).

Furthermore, continued growth in this area is expected as a result of the fruitful outcomes experienced by vast corporations in their cause-related marketing (CRM) efforts (Varadarajan and Menon 1988; Barone et al., 2000). However, in parallel with the rise of CRM, scepticism by the consumers is starting to surface in the marketplace regarding the for profit companies' CRM practices. It has been argued that CRM breeds public cynicism, suspicion of green washing and cause exploitation (Bronn and Vrioni, 2001; Vlachos et al., 2009; Folse et al., 2010). Scandals within the business society, ethical mistakes, and anxiety for contemporary life, all steer consumers to be sceptical and doubtful regarding firms' reasons for practising CRM (Vlachos et al., 2009). Consequently, this scepticism can lead consumers to reject claims raised in CRM campaigns, it can influence their purchasing behaviour and can even lead to stronger actions (Bronn and Vrioni, 2001). Hereupon, it is necessary for organizations pursuing CRM to understand the underline success factors and have a key success index of CRM practises because even if the benefits associated with well-implemented and well-promoted cause-related marketing (CRM) campaigns are well documented, ineffective cause-related marketing campaigns can cause negative results to the reputation of the partner organization and damage the work of the charity (Demetriou et al., 2010; Tangari et al., 2010).

In sum, the structure of this systematic literature review paper is as follows: Section 2 presents the research aim and objectives of this study and reveal the literature gap that exists both in theory and practice. Furthermore, in the same section the key concepts are defined and an analysis of the Systematic Literature Review concept is fulfilled. In the following section the methodology adopted is described along with the Quality assessment and the Data extraction process. Section 4 refers to the synthesis that is adopted, analyzes the key findings and illustrates the initial conceptualization of a CRM success index to be tested in a later stage. Section 5 is comprised by the limitations occurred for the present systematic literature review paper and section 6 concludes the paper by summarizing the key findings and a discussion of implications and opportunities of future research.

## **Background**

### **Research Aim and Objectives**

The aim of this research is to develop an interactive conceptual framework for successful Cause-Related Marketing practices through a CRM success index. Therefore, as with any other research project, Systematic review of the relevant existing literature comprises the basis for the framework's development. A certain number of the discovered success factors constitute the CRM success index,

by which it will be tested and then adjusted accordingly in order to create new knowledge and thus, to contribute both to theory and practise.

Towards this aim, four specific research objectives have been set:

1. To undertake an extensive systematic literature review that will set the theoretical foundation of the research and span the field of Cause Related Marketing.
2. To investigate and identify the key success factors of Cause Related Marketing practice.
3. To bring together the refined research outcomes towards the development of a conceptual framework.
4. To test the CRM success index as a result of the developed conceptual framework in the Cyprus market and thus, to create new knowledge contributing in that way not only to theory, but also in practise, and to overlaying the way for further research.

The value and originality of this work relates to its focus on a new theoretical framework comprised by a CRM success index which is tested to Cyprus market, by which the research study is conducted.

In addition, this paper develops for the first time a success index for CRM strategies by incorporating all the key success factors from the existing literature. Moreover, by implementing objective 4 the paper also contributes a new CRM framework to existing literature, which constitutes a trail-blazer platform for future research, as well as a tool for practical implication.

#### **Towards the necessity of a CRM success index**

Due to the growth of corporate social responsibility and corporate alliances with non-profit organizations, the potential for future research on cause-related marketing is clear. However, factors leading to the success or failure of cause related marketing programs implemented by for profit organizations, haven't been documented or explored in a methodologically broader way (Grau and Folse, 2007; File & Prince, 1998; . Larson, et al., 2008; Moosmayer, and Fuljahn, 2010). Consequently, in order to fill this gap there is a need for research in order to identify those factors that have a direct impact on successful implementation of cause-related marketing practice and how they could be applied in order to create a success index for CRM practice.

#### **Defining Cause Related Marketing**

The origins of CRM can be traced back in 1983, when American Express supported the Statue of Liberty's restoration through donations based on card usage and uptake (File and Prince, 1998; Polonsky and MacDonald 2001; Porter & Kramer, 2002; Broderick et al., 2003; Grau and Folse, 2007; Hoek and Gendall, 2008; Demetriou et al, 2010;). From the marketing perspective, CRM is a marketing strategy that combines company charity, fundraising for a non-profit organization and social responsibility. CRM, first proposed by Varadarajan in 1986, as cited in Wu and Hung (2008), as a joint-transaction model, resulting from the coalition of product and donation through the partnership between a firm and a non-profit organization. In addition, the author adds that this coalition promotes gain and interests for both parties. Furthermore, in their research work on CRM,

Varadarajan and Menon (1988, p. 60), provided a comprehensive conceptual examination of CRM and defined it *'as the process of formulating and implementing marketing activities that are characterized by an offer from the firm to contribute a specified amount to a designated cause when customers engage in revenue-providing exchanges that satisfy organizational and individual objectives'*. This definition of CRM has been widely accepted from the scientific community and used in a major degree for a long time (Mullen, 1997; Bronn and Vrioni, 2001; Pracejus et al., 2003).

Gradually, Andreasen (1996), extended the concept of CRM, using the condition that increasing product sales for the organization concomitances with fundraising for the non-profit organization. Any marketing activity promoted by the firm and the non-profit organization can be reckoned as a CRM activity as long as it has a direct or indirect impact on sales boost. In parallel, Kolter & Andreasen (2002), as cited in Wu and Hung (2008), believed that when a company promotes a certain issue or idea by itself, it should also be considered as CRM activity. Hereupon, according to them, the scope of CRM covers all kinds of social issues.

In conclusion, Varadarajan and Menon (1988), argued that CRM helps to achieve many substantial benefits, such as improving performance, strengthening corporate reputation and brand image, and expanding the target market of a company. Hereupon, continued growth in this area is expected as a result of these benefits experienced by major corporations in their cause-related marketing (CRM) efforts (Varadarajan and Menon 1988; Tate 1995; Brown and Dacin 1997; Barone et al., 2000). Dupree (2000), as cited in Broderick et al., (2003), suggests that this rapid growth and interest within Cause Related Marketing is happening due to the consumers' increased social consciousness.

### **Defining the term success within the concept of Cause Related Marketing**

According to Eid (2007), there is no clear definition of a successful CRM project. A successful CRM implementation is one that meets the business objectives. Mustonen (1996), as cited in Rainisto (2003), defines success as the accomplishment of some explicit or implicit goals, evaluated with criteria set at a specific time. Assessment criteria of the same situation can also vary with the anchoring point changes. In corporate marketing the term "success" is interrelated with the fulfillment of the set goals, which can be concrete (turnover) or abstract (corporate image) (ibid.). In parallel, Varadarajan and Menon (1988), argued that a successful CRM program is translated by achieving many substantial benefits towards the organization, such as strengthening corporate and brand image, improving performance, and extending the target market. Furthermore, Andreasen (1996), as cited in Wu and Hung (2008), connected the concept of CRM, with sales growth, thus CRM success also depends on whether or not it has a direct or indirect impact on sales growth .

With the arguments of Varadarajan and Menon (1988), and Andreasen, (1996), regarding the meaning of a successful CRM campaign and what benefits arise from it, seems to agree the majority of scholars. For instance, Ross, Patterson, and Stutts (1992), Brown and Dacin 1997, Berger, Cunningham and Kozinets (1996), and Creyer and Ross (1996), as cited in Strahilevitz (2003), argue that some of the benefits to using charitable donations as purchase incentives include improving the corporate image of and attitude towards the sponsoring organization, differentiating a brand from its competitors

(Berger, Cunningham and Kozinets, 1996; Murphy, 1997; Brown and Dacin, 1997;) and increasing sales in the short run (Sen and Morwitz, 1996; Strahilevitz and Myers 1998; Murphy, 1997; Strahilevitz, 1999; Strahilevitz, 2003). In the context of this research, the term "success" complies with the analysis given by both Varadarajan and Menon (1988), and Andreasen, (1996).

### **Defining the term Index**

According to Diamantopoulos & Winklhofer, (2001), as cited in Arnett et al., (2003), an index is a value assigned to people that reflects the degree to which they possess some latent trait and the calculation of it requires the use of more formative than reflective indicators. In addition, when a latent construct is measured using formative indicators it is hypothesized that the observed indicators cause or 'develop' the latent construct. On the contrary, when reflective indicators are used, it is hypothesized that the latent construct causes the observed indicators, and as a result the observed variables "reflect" the changes in the latent construct (Bollen, 1989, as cited in Arnett et al., 2003).

Another definition given by Babbie (2011), refers that the term index within the social sciences perspective is defined as a method of classifying subjects for analysis, in terms of some variables or attributes by the combination of their responses to items included in the index. In addition, indexes measure variables and their measurements are based on more than one data item (Babbie, 2011; Kim et al., 2011). In addition, Babbie (2007), as cited in Kim et al., (2011), argues that the development of an index involves several methodological steps, comprising by: the selection of the index items; scoring of the items that are going to be included in the index; and validating the index.

Furthermore, indexes can be used for a variety of reasons such as to provide both researchers and practitioners with broad measures of marketing phenomena. In the present study the development of the CRM success index will be derived in two steps:

- Identification and documentation of key success factors for Cause-related marketing programs;
- Integration of these factors by means of an index formula;

### **Systematic Literature review versus narrative literature review**

The kind of the review that is adopted for the present study is the systematic review due to the multiple advantages against the narrative review. The aim of the present literature review is the systematic review of the existing literature on the cause-related marketing concept. Towards this aim, the following three objectives have been set:

1. A thorough examination of the existing literature review towards the holistic understanding of Cause Related Marketing concept.
2. The identification and documentation of the key success factors of CRM practices.
3. Conceptualization of a CRM success index.



## Methods

### Search Strategy

The search strategy of the present systematic review was implemented by using an automated search.

### Specification of the search terms

In the context of the present systematic literature review the following English search terms were used in the corresponding electronic databases:

EBSCO Host: Cause related marketing OR social marketing AND success factors

Emerald Insight: factor\* AND influence\* AND Cause-related marketing

Science Direct: cause-related marketing AND success factor\*

Springer Link: 1.) Factor\* AND affect\* AND cause related marketing  
2.) cause related marketing

Google Scholar: Cause related marketing

Wildcard character: The asterisk symbol (\*) within the search terms was used in order to include both singular and plural forms of the search terms such as factor, but also factors.

Different search term sequences and strategies were used for each electronic database due to the lack of standardization between them. In addition, the variety of search terms used, enhanced the possibility to include as much as possible relevant literature. Moreover, the choice of the above mentioned search terms emanates from the fact that they are sensitive for the present research topic. Hereupon, this reduced the possibility of missing research papers that could be relevant with the present study.

Moreover, the selection process for the identification and inclusion of the relevant research papers included the following three steps:

- A broad screen of the titles of the citations retrieved from the literature search and extraction of the studies irrelevant with the present study.
- A broad screen of the abstracts of the citations passed from stage one and selection of the most relevant with the present research topic.
- A strict screen of the remaining studies that past the previous two stages and selection of the most appropriate and relevant ones with the present research topic.

### Specification and justification of the time frame to be examined by the systematic literature review

Due to the fact that one of the objectives of this study is to identify and document all the researched CRM success factors, the time period investigated starts from the inception of Cause-related marketing in 1983 until present (2011).

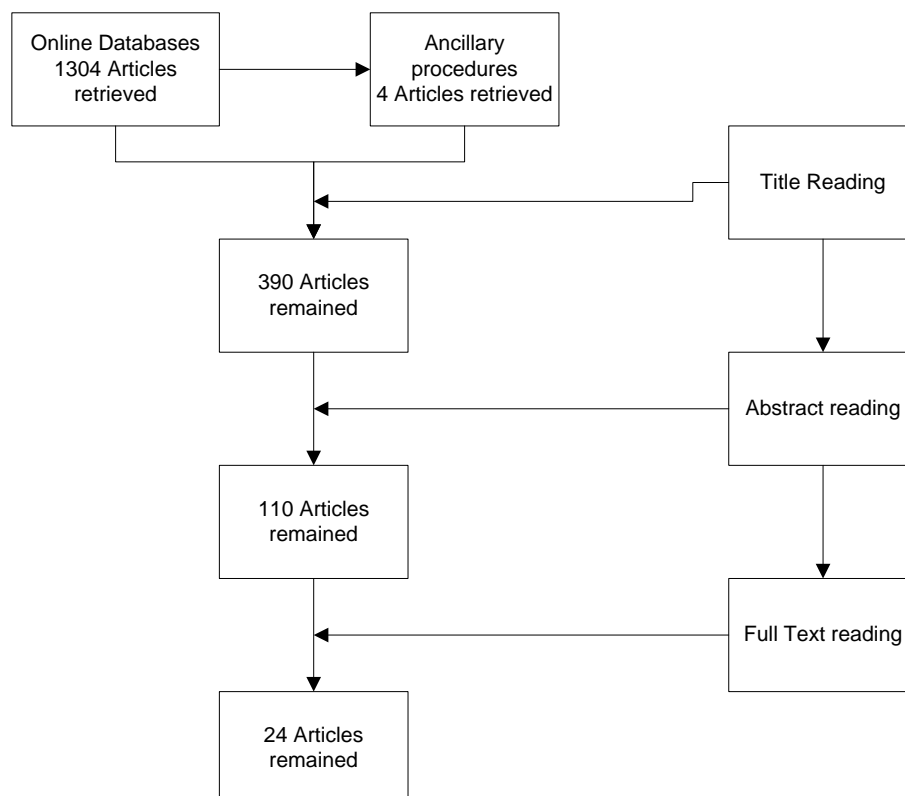
### Ancillary procedures during search

The references of all articles that fulfilled the selection criteria were screened to identify other articles within the review period that are relevant with the research question.

### The aggregate outcome of the search strategy

The sum of the results retrieved from the literature search are illustrated in Figure 1 as a flow diagram.

Figure 1 : Selection Process



### Selection Criteria

The selection criteria of the remaining 24 articles from the screening process are analyzed below:

#### Time frame

As already mentioned, the time period for investigation of the existing literature was set from the inception of Cause-related marketing concept in 1983 until 2011 in order to identify and document all factors that drive a CRM program into success.

#### Language

The paper language must be English or Greek, due to the language limitations of the researcher.

**Study topic**

Included research papers is necessary to meet the aim of this study. Thus, studies that were irrelevant with the research question, excluded from the final selection.

**Study type**

Towards the desire to include research papers on the best-quality evidence, this study excluded any relevant literature that was not classified as primary.

**Methodology adopted**

As it is mentioned in the previous section, research papers that adopted both qualitative and quantitative methodology approach were included for 2 reasons: to limit the possibility of excluding significant and highly relevant studies, and to maximize the possibility of finding and documenting all the researched CRM success factors.

All studies retrieved by the search engines from the first until the third stage were read by two researchers in order to limit the possibility of selection bias. In addition, 22 out of 24 studies that passed the third stage of the selection process, were verified by two researchers that met the inclusion/exclusion criteria. The other two studies were rejected because they weren't research papers.

**Quality Assessment**

A Quality checklist was developed in order to evaluate the quality of the selected studies, and includes four basic components: Validity, Reliability, Credibility and Integrity, each one graded with three marks. An explanation of these elements of quality measurement is given below:

**Validity**

Validity refers on how successful and accurate is the study measurement towards its research question. In other words, it concentrates on the study's successfulness at measuring what the researcher intends to investigate and measure (Caldwell et al., 2010; Collis & Hussey, 2003).

**Reliability**

Reliability refers to the consistency and the degree of replication of the results and how generalizable they are (Caldwell et al., 2010; Collis & Hussey, 2003). However, the difficulty with reliability, is that it cannot be measured, it can only be assumed.

**Credibility**

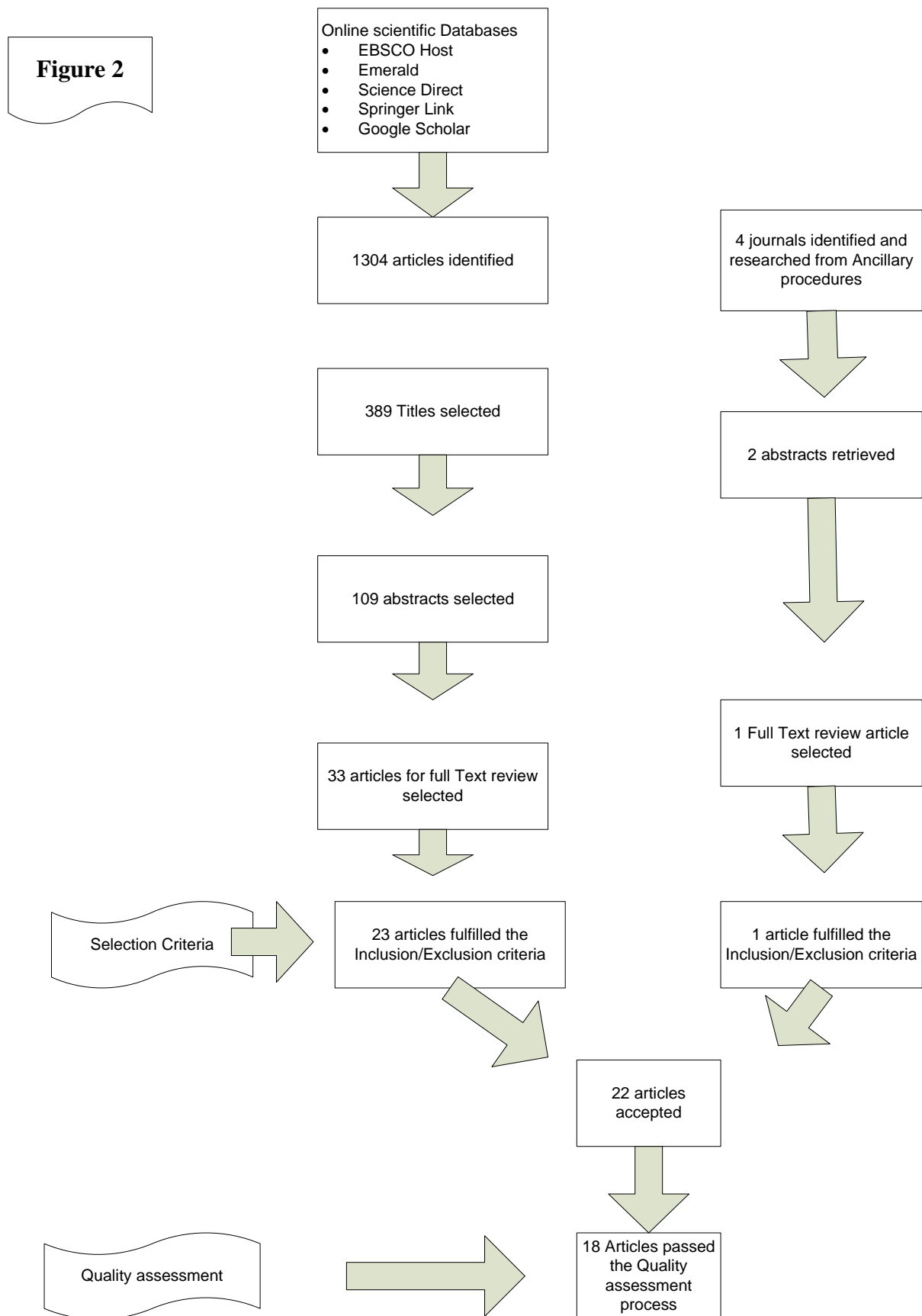
Credibility reflects the researchers appropriate academic qualifications in order to be able to undertake the research project along with the writing style of the paper (Caldwell et al., 2010). In addition, this study measures credibility of the research papers according to the ranking of the journal into which they are published. The selected studies will pass the Quality assessment only if they are published within journals that are included at the Harzing quality list of journals. The reason for selecting Harzing quality list of journals relays on the fact that is based on the analysis and ranking of 19 business and management official journal rankings (Mingers and Harzing, 2007). By applying

Harzing quality list of journals as a credibility measure, the quality of this paper will raise because it will include studies published within the best journals worldwide. Furthermore, apart from the articles, this study also included grey literature that met all the Quality criteria except their inclusion in the Harzing quality list of journals.

### **Integrity**

Integrity is translated on how robust is the research study and if there is a strict adoption of the chosen research process. It can be measured by evaluating if the methodology adopted by the researcher of the study, is identified and justified (Caldwell et al., 2010).

From the Quality assessment process, 18 out of 22 studies have passed. The other four studies were rejected because their Grade was lower than twelve. Figure 2 illustrates the selection of the remained studies from the initial process selection until the Quality Assessment process.

**Figure 2**

**Data Extraction**

In this systematic review, a developed data extraction form was used in order to extract the data from the selected studies and to document the data extraction process. Regarding the elements that have been extracted from the studies concern:

- General details: Title of the paper, Author's name and publication details.
- Features of the study: methodological approach, population characteristics, sample size.
- Key results.

This process is done through a data extraction form that reduces human error and documented this process (Magarey, 2001; Tranfield et al., 2003; White and Schmidt, 2005). Table 2. illustrates the developed data extraction form along with the data extracted from each of the selected studies.

Table 2. Data extracted from the selected studies

Number of study	Title	Author/s	Publication details	Year of publication	Methodology adopted	Population characteristics	Sample size	Key results
1	The effect of fit and dominance in cause marketing communications	Sridhar Samu, and Walter Wymer	<i>Journal of Business Research</i> , Volume 62, Issue 4, Pages 432-440	April 2009,	Quantitative approach	students	2 studies: Study 1: 240 Study 2: 120	Perceived fit and dominance for the brand and the cause are success factors for a CRM campaign
2	Consumer perceptions of cause related marketing campaigns	Dirk C. Moosmayer, Alexandre Fuljahn	<i>Journal of Consumer Marketing</i> , Volume: 27, Issue: 6, Pages 543-549	June 2010	Quantitative Approach	students	306 students	The impact of gender and donation size towards a CRM campaign
3	Brand credibility in cause-related marketing: the moderating role of consumer values	Enrique Bigné-Alcañiz, Rafael Currás-Pérez, Isabel Sánchez-García	<i>Journal of Product &amp; Brand Management</i> , Volume: 18, Issue: 6 Pages 437-447	June 2009	Quantitative Approach	consumers of insurance and personal hygiene products	595 consumers	Brand credibility of CRM campaign through cause-brand fit and altruistic attributions

4	Modeling strategic management for cause-related marketing	Shu-Pei Tsai	<i>Marketing Intelligence &amp; Planning</i> , Volume: 27 Issue: 5 pp. 649-665	February 2009	Quantitative Approach	consumers	690 consumers	prior brand experience, making positive motivational attribution about the donor brand emerge, constructing persuasive messages Evaluation of campaign, Internal locus of causality, Stability of efforts, Controllability of outcome, are positive factors for CRM success
5	Overcoming skepticism towards cause related claims: the case of Norway	Sangeeta Singh, Lene Kristensen, Erika Villaseñor	<i>International Marketing Review</i> , Vol. 26, (3), pp. 312-326	February 2009	Quantitative Approach	Students, staff and people of campus from two universities in Norway	100 people	repetition of the CRM claim, familiarity towards the CRM claim, providing



								truthful information that increases credibility and familiarity with the CRM campaign.
6	The effect of strategic and tactical cause-related marketing on consumers' brand loyalty	Douwe van den Brink, Gaby Odekerken-Schröder, Pieter Pauwels	<i>Journal of Consumer Marketing</i> , Vol. 23, (1), pp.15–25	January 2006	Quantitative Approach	Students from a western European university	240 students	long-lasting CRM campaigns linked to the product that shows the lowest level of consumer involvement. and the adoption of strategic cause-related marketing campaign results to its successfulness regarding brand loyalty
7	Effects of price premium and product type on	Saroja Subrahmany an	<i>Journal of Product &amp; Brand</i>	2004	Quantitative Approach	young Chinese Singaporeans.	128 young Chinese	specifying the amount donated to the cause, cause-

	the choice of cause-related brands: a Singapore perspective		<i>Management</i> , Vol. 13, (2), pp. 116-124				Singapore ans.	linked brands are factors for increased CRM success.
8	Cause-related marketing: how generation Y responds	Yanli Cui, Elizabeth S. Trent, Pauline M. Sullivan, Grace N. Matiru	<i>International Journal of Retail &amp; Distribution Management</i> , Vol. 31, (6), pp. 310-320	2003	Quantitative Approach	Students from two American universities	389 students	Females, social science majors from academic background, annual income, previous donation activity, type of cause (disaster), and long term/frequent campaigns are factors for CRM success.
9	The Effects of Corporate Commitment and Cause Commercialization in Cause-Related Marketing	Yoojung Kim; Jung Lim; Sejung Marina Choi	<i>Advances in Consumer Research - North American Conference Proceedings</i> ,	2010				a company's commitment to CSR through resources invested by a company in its CRM program,

	.		Vol. 37, p834-835					including the duration of the CRM, are factors leading to positive CRM outcomes
10	The influence of gender, social cause, charitable support, and message appeal on Gen Y's responses to cause-related marketing	Hyllegard, Karen; Yan, Ruoh-Nan; Ogle, Jennifer Paff; Attmann, Julianne	<i>Journal of Marketing Management</i> , February 2011, Vol. 27 (1-2) pp. 100-123,	February 2011	Quantitative Approach	Gen Y college students	562 Gen Y college students	the amount of the charitable support is clearly communicated, female gender, and Gen Y's involvement in a social cause (e.g. volunteerism) are success factors towards a CRM campaign
11	Cause-Related Marketing (CRM): The Influence of Donation Proximity and Message-Framing Cues on the Less-	Grau, Stacy; Folse, Judith	<i>Journal of Advertising</i> , Vol. 36 (4), pp. 19-33	December 2007	Quantitative Approach	consumers	2 studies: study 1: 141 participants, study 2: 166 participant	local donations and positive message framing serve as effective variables for CRM success

	Involved Consumer						s	
12	Portraying the Cause Instead of the Brand in Cause-Related Marketing ADS: Does it Really Matter?	Lafferty, Barbara; Edmondson, Diane	<i>Journal of Marketing Theory &amp; Practice</i> , Vol. 17, (2), pp. 129-144	April 2009	Quantitative Approach	nonstudent consumers	495 nonstudent consumers	brand photo has a greater effect on purchase intentions of the CRM campaign than the cause photo. brand familiarity is also a CRM success factor
13	To donate or not to donate? Product characteristics and framing effects of cause-related marketing on consumer purchase behaviour	Chang, ChunTuan	<i>Psychology and Marketing</i> , Vol. 25, (12) pp. 1089-1110	December 2008	Quantitative Approach	students	960 part-time undergraduate students	Donation magnitude/ product price fit, product type (eg. frivolous, hedonic) donation framing in absolute dollar value are CRM success factors
14	Tickled Pink: The Personal Meaning	Anne Brodericki,	<i>Journal of Marketing Management</i>	June 2003	Qualitative approach	customers	15 customers	emotional level of individual

	of Cause Related Marketing for Customers.	Amandeep Jogi and Tony Garry	<i>nt</i> , Vol. 19, (5-6) pp. 583-610					involvement and the credibility of the partner organization are important CRM success factors
15	The Effects of Prior Impressions of a Firm's Ethics on the Success of a Cause-Related Marketing Campaign: Do the Good Look Better While the Bad Look Worse?	Strahilevitz, Michal	<i>Journal of Nonprofit &amp; Public Sector Marketing</i> , Vol. 11, (1), pp. 77-92	February 2003	Quantitative Approach	students	2 studies: study 1: 76 undergraduate business students Study 2: 76 undergraduate business students	Firms perceived as ethically neutral have positive effects on a cause-related marketing campaign
16	Consumer Response to Harmful Products with Cause-	Chun-Tuan Chang, Sun Yat-sen	<i>Advances in Consumer Research</i> - North American	January 2009				hedonic products as a product type and product-cause fit are important

	Related Marketing: Influences of Product-Cause Fit and Product Type		Conference Proceedings, Vol. 36, pp.793-794					factors for a successful CRM campaign
17	The role of brand/cause fit in the effectiveness of cause-related marketing campaigns	Pracejus, John W.; Olsen, G. Douglas	<i>Journal of Business Research</i> , Vol. 57, (6), pp. 635-640	2004	Quantitative Approach	consumers	329 respondents	Brand / cause fit is an important factor for CRM success
18	Consumer Responses to Corporate Social Responsibility (CSR) Initiatives: Examining the Role of Brand-Cause Fit in Cause-Related Marketing	Nan, Xiaoli; Heo, Kwangjun	<i>Journal of Advertising</i> , Vol. 36, (2), pp. 63-74	June 2007	Quantitative Approach	students	100 undergraduate students	Brand / cause fit is an important factor for CRM success

## Synthesis

### Narrative synthesis

The synthesis approach that is adopted in this study is the narrative one. The rationale for selecting this kind of synthesis relies on the fact that it retains the flexibility of the traditional literature reviews which allows the inclusion of a wide range of types of evidence and review questions. Furthermore, according to the ESRC guidance, the narrative synthesis has the potential to develop a more transparent and sophisticated synthesis than in the past and the steps for conducting it are clear and straightforward (ibid.).

### *Socio-demographic variables*

The first category that has been identified through the literature review has the name: socio-demographic variables and incorporates factors that are related with the socio-demographic characteristics of consumers. These factors intend to identify those consumers who are more sensitive in front of a CRM campaign and thus, to be targeted from practitioners in order to have successful CRM results.

From the literature review it is found that gender plays a crucial role for CRM effectiveness. Moosmayer and Fuljahn, (2009), state that consumer response to social marketing activities are influenced by gender and it is based largely on differences in their socially attributed roles. In other words, men and women have different values, role behaviors and attitudes and through their research study, they have found that women have more positive perceptions towards a CRM campaign. Accordingly, Cui et al., (2003), and Karen et al., (2011), through their research studies came up with the same conclusion and emphasized the fact that brands targeting women have greater opportunities to undertake a successful CRM campaign.

Moreover, Cui et al., (2003), identified three more socio-demographic factors that lead towards a successful CRM campaign and are related with: the academic background, the annual income and prior donation activities of the consumers. Regarding the academic background of the consumers, social sciences interact more positively towards a CRM campaign than consumers with natural science majors. As regards to the annual income, families that have medium to high incomes are more positive with a CRM offer and lastly, the same positive attitude occurs with consumers that made prior donation activities. Broderick et al., (2003), and Hyllegard et al., (2011), came up with the same results regarding consumers' prior donation activities. They stated that a key success factor an individuals' consumption in a CRM campaign is the consumer's level of psychological involvement with charitable organizations. Thus, people who support the act of giving to charities as personally relevant and important may be more likely to respond in cause related purchasing.

### CRM design and structure

This category concentrates all the identified success factors that are related with the design methodology and the structure of a CRM campaign. As a starting point, Singh et al., (2009), through their research activity, found that repeating claims helps in overcoming consumer skepticism towards CRM offers and thus, promote CRM success. Consumers usually use simple buying heuristics

in their decision-making process due to the fact that they are not willing to go through all the alternatives the market has to offer. Thus, through repeating CRM claims a company can gain familiarity among consumers and create positive attitudes by making the brand or the company a part of the customers' evoked set of alternatives (Chang, 2008). In other words, when customers become familiar with a CRM offer, they perceive the message as one they have knowledge of, and thus consider it more honest and truthful. Consequently, the knowledge a consumer has about a company or a brand, affect his or her attitude towards the company's products or services and help create positive feelings towards the organization (Brown and Dacin, 1997, as cited in Singh et al., 2009). Lafferty and Edmondson, (2009), agree with Singh et al., (2009), and they add that the greater the familiarity is, the more extensive the associations are in the brain, and thus the more easily that brand will be accessed from memory. In addition, the authors through their research findings introduce another CRM success factor, the use of the brand photo ad, that has a positive effect on attitude toward the CRM alliance.

In addition Grau and Folse (2007), referred to the donation proximity of a CRM campaign which deals with the distance between the donation activity and the consumer, and can be divided as local, national, or regional (Varadarajan and Menon 1988). Through the results, it is shown that when CRM campaigns emphasizing specific donations distributed to communities and implemented locally, have positive results. Furthermore, another CRM success factor found by the researchers has to do with the positive message framing which serves as effective message cues to produce favorable CRM outcomes, a success factor with which Tsai's (2009) research results seems to align. Moreover, another key success factor of CRM refers to the donation framing of the CRM offers, in the form of a dollar value per unit which are found more effective than those as a percentage of the sale price (Subrahmanyam, 2004; Chang, 2008). Hyllegard et al., (2011), came up with the same results and they suggested that consumers are more likely to form positive attitudes towards a CRM offer when the amount of the charity is clearly communicated.

Chang (2008), refers at another one CRM success factor, related with the product type. Specifically, the CRM offers related with frivolous products are more effective than those bundled with practical products. Chang, and Sen, (2009), move in the same wave and state that a CRM campaign is more likely to be effective in promoting hedonic products than utilitarian ones. In addition, another CRM success factor is the low donation magnitude. Chang (2008), states that consumers accept a CRM offer easily when the donation magnitude is perceived as low than when it is high. Furthermore, one more CRM success factor stated in the literature review relates with the product price. Low-priced items have more success within a CRM campaign than high-priced items (ibid.). Moreover, Cui et al., (2003), came up with another success factor of CRM practice: the type of cause. Disaster can have more positive results on a CRM campaign than an ongoing cause. Therefore, causes related with disasters or people in need as a result of a disaster have positive outcomes in the success of a CRM campaign. In addition, Brink et al., (2006), referred to another CRM success factor, the set up of a long-lasting CRM campaigns. Subrahmanyam (2004), states the same success factor and adds that frequent support leads to positive evaluation of the CRM campaign by the consumer.



Continuing, Kim et al., (2010), introduced a new CRM success factor, the company's commitment to CSR. Through the past research it is suggested that the amount of resources invested by an organization in its CRM program, including the duration of the CRM campaign, affects consumer perceptions of the organization's overall commitment to a social cause. The results shows that an organizations strong CSR commitment, leads consumers to ascribe more altruistic and less self serving motives to a company's CRM activity, and to hold more positive perceptions of and favorable attitudes than towards a weaker CSR activity of another company.

Also, one of the most important CRM success factors is brand / cause fit that can cause positive impact on consumer choice (Pracejus et al., 2007). In CRM, brand/cause fit originates from multiple sources. A brand could fit with a social cause if both serve a similar consumer base, or fit could be high if a brand and a social cause share alike values. Regarding brand/cause fit, several scholars conducted research that confirm this success factor (Pracejus et al., 2007; Chun-Tuan Chang, Sun Yat-sen, 2009; Samu and Wymer, 2009). Lastly, cause dominance is also an important success factor, due to the fact that it leads to higher audience responses, suggesting that the ideal combination is high perceived fit and cause dominance. The research study conducted by Samu and Wymer, (2009), also confirm that cause dominance led to higher values of consumer positivism towards a CRM campaign than brand or equal dominance, showing thus the power of the cause. Consequently, the results of these studies affirm Authenticity that is analyzed in the next subsection, as a crucial category of CRM success.

### **Authenticity**

The category of Authenticity relates to the perceived trustworthiness and honesty of the CRM campaign by the consumers. Thus, this category, is structured by factors that influence the above mentioned values of the consumers. One of the success factors belonging to this category is brand credibility. Alcaniz et al., (2009), define brand credibility in the context of CRM as the extent to which consumers perceive that the brand communicates honesty and goodwill in terms of trustworthiness and has the necessary skills and experience to colligate with the specified social cause. According to Varadarajan and Menon, (1988), and Webb and Mohr, (1998), as cited in Alcaniz et al., (2009), this reasoning suggests that altruistic attribution is a pointer which helps consumers to evaluate honesty, sincerity and good faith of the brand's social commitment, and will positively influence the CRM campaign. Broderick et al., (2003), seem to agree with Alcaniz et al., (2003), and they also highlight the importance of the brand/company credibility to customers and their overall positive view in Cause Related Marketing campaigns.

Another factor that has to do with perceived values is the ethical characterization of a company. Drumwright (1996), as cited in Strahilevitz (2003), has indicated that a factor which affects the effectiveness of a CRM campaign is whether customers perceive the Cause-Related Marketing relationship to be beneficial or exploitative towards the charity. In his research paper, the author examined whether the effectiveness of a Cause-Related Marketing campaign is influenced by the ethics of the organization involved. In other words, the author examined if the firm is perceived as a "ethical," "unethical," or "neutral" and what is the outcome from these perceptions upon the CRM

campaign. The results showed that companies initially perceived as ethically neutral gained the most from a CRM campaign (ibid.).

Furthermore, Tsai (2009), referred to another key success factor for conducting a CRM campaign, called the positive motivational attribution about the donor brand, and refers to the consumer's perception that the donor brand is motivated thus, it performs the CRM campaign with more altruism than egotism. Specifically, when the perception of altruistic-orientation is higher, it causes positive motivational attribution about the brand. Hereupon, the customers feel stronger moral pleasure for participating in the CRM campaign or stronger moral displeasure for their non participation. In parallel, positive motivational attribution can be achieved through the three dimensions of the causal attribution theory discovered by Weiner et al. (1991), as cited in Tsai (2009): 1. Locus of causality: the perceiver's belief that the cause of a behavior or event comes from internal factors (within the actor) or external factors (in the external environment). 2. Stability: the perceiver's belief that a behavior or event happens either frequently or infrequently. 3. Controllability: the perceiver's belief that the actor can or cannot control the consequence of an event or behavior. In the context of a CRM campaign, it is possible to conceptualize positive attribution of the donor brand's motivation through the three dimensions of charity behavior: 1. Internal locus of campaign causality: driven by a real concern of the donor brand for the beneficiaries. 2. Stability of campaign efforts: not a single shot but a recurrence of charity that the donor brand has been performing or has already done for the society. 3. Controllability of campaign results: with a gratifying consequence within the donor brand's competence to achieve. Towards this end, positive motivational attribution has direct impact on purchase intentions of consumers when they are dealing with a CRM offer (ibid.).

### **Experience**

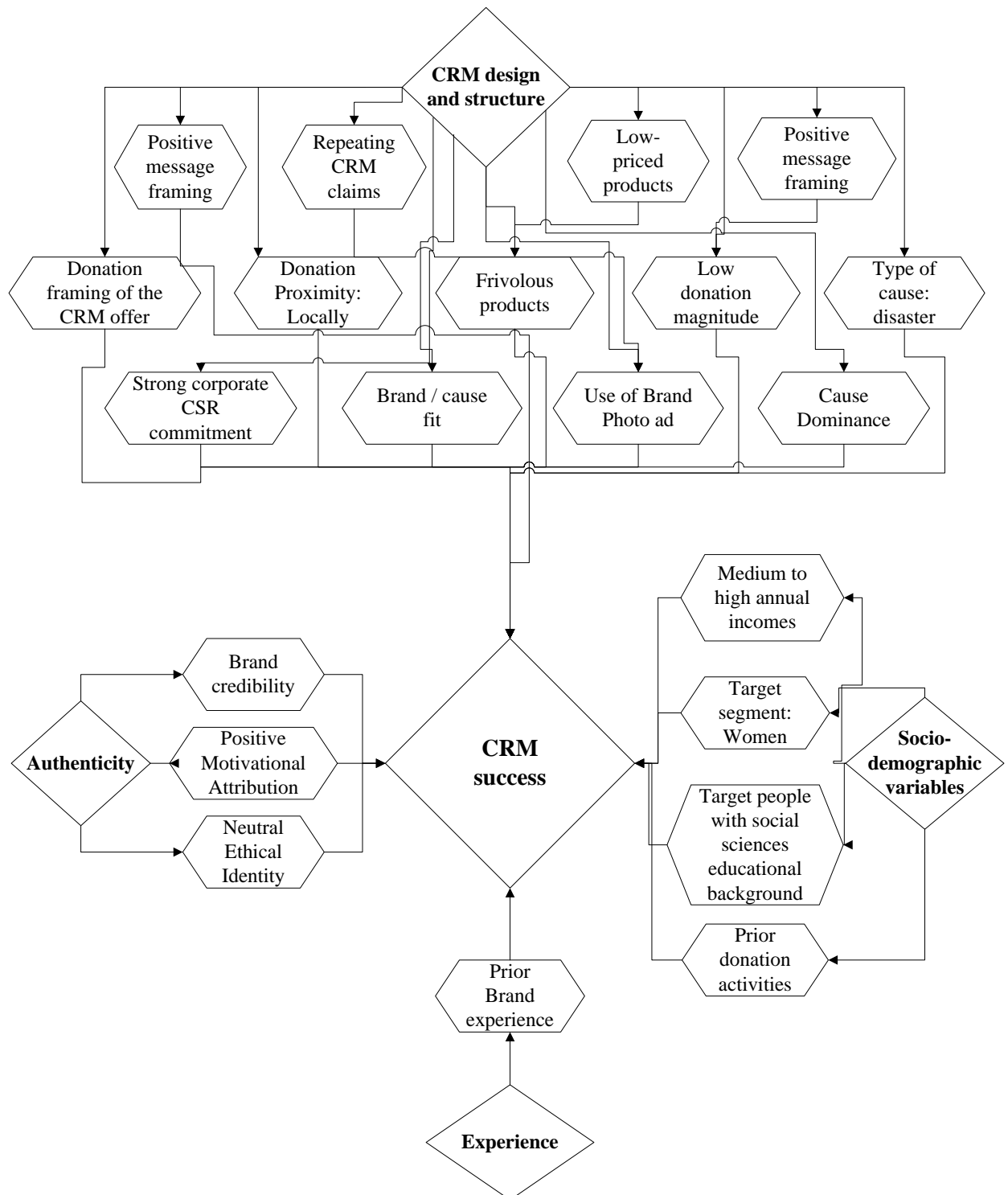
Lastly, this category comprises with a single factor that involves experience. According to Tsai (2009), various scholars found that prior experience (confirmation bias), exert influence in a higher degree than a systematic processing of freshly availed evidence (diagnosticity). Various scholars such as, Johnson (2001), Nickerson (1998), Wiley (2005), Holbrook et al., (2005), and Pronin and Kugler (2007), as cited in Tsai (2009), conducted several experiments regarding on how prior experience retrieved from memory creates impact on responses to persuasion attempts and they found that the power of mental antecedents created by prior experience affects the rendition of newly availed evidence, which results to unfavorable or favorable responses. Hereupon, as regards the concept of Cause Related Marketing, prior brand experience has a greater weight on positive outcomes than a brand that has recently introduced in CRM activities.

### **Initial conceptualization of the CRM success Index**

The literature review findings, and especially the CRM key success factors identified above, allow their elaboration and figural representation through a conceptual framework illustrated in figure 4. The framework integrates and interrelates all the identified factors that constitute the CRM success index. Specifically, the framework lists 21 success factors that are divided

according to their relevance into four main categories that are combined together in order to form the vehicle towards the CRM success.

Figure 3: A preliminary conceptualization of the CRM success index



## Limitations

The present study does not analyze in depth all the variables comprising the CRM success index due to the existence of a word limit. In addition, the CRM success index developed needs to take into consideration demographic and cultural parameters as these influence CRM success factors in order to be applicable in general.

## Conclusion

In the present study, a thorough review of the existing literature on cause related marketing has been conducted in order to identify the key factors that lead to CRM success. From the review, 21 CRM success factors have been identified and documented into four main categories, according to their area of influence. Moreover, from the literature scoping, it has been revealed that no research on the concentration and documentation of CRM success factors has been done until now. It is suggested that further research should focus on testing the CRM success index through case studies. As far as concerns the practical implications of a CRM success index, practitioners will have a guide for doing successful CRM campaigns. Thus, in terms of the financial perspective, money savings towards unsuccessful CRM campaigns will be eliminated and companies will gain all the fruitful outcomes that the CRM practice has to offer.

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## ANALYZING THE RELATIONS BETWEEN INTELLECTUAL CAPITAL AND PERFORMANCE IN LOCAL GOVERNMENTS

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### Abstract

This paper examines the relation between intellectual capital (IC) and organizational performance in local governments (LGs) in Greece. Existing research literature argues that public organizations seem to be more intellectual capital idiosyncratic than private sector organizations. Therefore, it is expected that effective intellectual capital management would have a positive effect on their performance. However, empirical evidence in this field is lacking. We address this issue within the context of two intellectual capital epistemological views proposed by Mouritsen (2006); the IC1-ostensive view and the IC2-performative view. We employ a dual approach in our research by combining published and survey data. We have gathered financial information through accrual accounting financial statements in order to measure inferred intellectual capital (according to IC1-ostensive view). Additionally, we have collected data suitable for analyzing the perceived intellectual capital through a structured questionnaire addressed to a sample of Greek LGs (according to IC2-performative view). Our sample refers to 92 LGs. Our empirical evidence advocates the existence of significant positive relations among the sub categories of intellectual capital. Further, data analysis reveals that the sub categories of intellectual capital are related with improved performance measured both with financial ratios and perceptions of performance. Therefore, our empirical findings hold irrespectively of the intellectual capital epistemological view and offer corroborating evidence that LGs with high IC perform better than low IC LGs.

**Keywords:** Intellectual Capital, Financial Performance, Local Governments, Greece

### Introduction

The sunrise of knowledge economy has increased the economic significance of intangible assets for the operational performance of organizations (McGrattan and Prescott, 2007). Initially, research efforts for establishing empirical relationships of intangibles with operational performance and subsequently with market performance focused on specific types of intangibles associated, primarily, with advertising and research and development (R&D) expenses (e.g. Hirschey and Weygandt, 1985; Chauvin and Hirschey, 1993; Sougiannis, 1994; Lev and Sougiannis, 1996; Eberhart *et al.* 2004). Progressively, the relationship of intangibles with operational performance started to be examined

under the prism of human capital (Hanson, 2004; Pantzalis and Park, 2009) or organizational capital (Lev *et al.* 2009).

A growing number of recent research efforts examines the economic significance of intangibles within the context of a broader and more abstract concept, that of intellectual capital (Steward, 1991). Intellectual Capital (IC) is a broad concept including the knowledge and the learning capabilities of an organization. It is manifested as the synergy of knowledge resources associated with the human assets (i.e. human capital), the organizational structures (i.e. structural or organizational capital) and the external social partners (i.e. customer, or relational or social capital) of an organization.

Existing empirical research has, primarily, focused on investigating the relations between IC and operational and financial performance of profit seeking organizations. The relationship of IC and intangibles with operational and subsequent market performance has been confirmed across different industrial settings, national economies, firm characteristics and other environmental or organizational contingencies (e.g. Lin and Edvinsson, 2008). At the same time, an emerging literature argues that public organizations are intellectual capital idiosyncratic and, thus, effective intellectual capital management is expected to improve the efficiency of the public sector organizations as well (Kong and Thomson, 2006; Kong, 2007; Kong and Prior, 2008; Kong, 2010). This strand of literature can be viewed through the lances of New Public Management, in the sense that intellectual capital is a source of economic efficiency for public sector organizations. However, empirical evidence for the relation of intellectual capital with the operational efficiency of public sector organizations is lacking.

The scope of this study is to analyze the relation between intellectual capital and performance within the context of the public sector organizations and Local Governments in particular. In order to attain a more holistic approach to this investigation the aforementioned relationship is examined under the two principal intellectual capital epistemological views recognised by Mouritsen (2006). These are the IC1-ostensive view and the IC2-performative view. Our analysis is based on a sample of 92 Greek local governments.

We believe that our study is timely by taking into account the financial problems faced in the public sector in Europe and in Greece in particular. Unrevealing the relations between IC and financial performance is expected to have useful implications for public sector management.

We believe that our study contributes to literature in several aspects. Firstly, we attempt to apply in practice the two epistemological views of IC as recognised by Mouritsen (2006). Therefore we adopt a dual approach in our research by combining financial statements and survey data in order to operationalize and measure IC under the two different IC approaches. Secondly, we propose an approach in order to assess the level of IC sub-domains (i.e. human capital, organizational capital and social capital) in local governments by using accrual based financial data. Our approach is innovative in the sense that tries to adapt to the idiosyncratic characteristics of local governments that deviate from those of private sector companies. Finally, we develop a categorization scheme to distinguish local governments according to their IC intensity.

The remaining of the paper is organized as follows. Section 2 presents the background and Section 3 the theoretical framework, the research objectives and the hypotheses of the study. Section 4 analyses the methodology of this research initiative. In Section 5 we present the empirical results. The last section of the paper includes our conclusions.

## **Background**

This section provides the theoretical background for the study. Initially, the term intellectual capital is defined by reviewing a variety of theoretical propositions (Mouritsen, 2006; Swart, 2006; Martín-de-Castro *et al.*, 2011). Then, the idiosyncratic role of intellectual capital in public sector is analyzed.

### **Definition of Intellectual Capital**

The term intellectual capital is usually employed by the research community as a synonym for intangible assets (Steward, 1991) which can be transformed to economic value. Yet, there is not a common accepted unified definition for intellectual capital.

Table 1  
Definitions of Intellectual Capital

Author(s)	Intellectual capital definitions
Galbraith (1969)	The difference of an organization's market value and book value.
Bontis (1996)	The difference between the market value of the company and the replacement cost of assets.
Brooking (1996)	The combination of market assets, human-centred assets, intellectual property assets, and infrastructure assets.
Sveiby (1997)	The gap between market and book value of the firm.
Edvinsson and Malone (1997)	The gap between a firm's market value and its financial capital (book value of a firm's equity).
Nahapiet and Ghoshal (1998)	Knowledge and knowing capability of a social collectivity.
Granstrand (1999)	Essentially comprises all immaterial resources that could be considered as assets, being possible to acquire, combine, transform and exploit, and to which it is possible to assign, in principle, a capitalized value.
Dzinkowski (2000)	Intellectual assets, knowledge assets, total stock of knowledge-based equity possessed by a firm.
Teece (2000)	Includes knowledge, competence and intellectual property. Also includes other intangibles such as brands, reputations, and customer relationships.
Bontis et al. (2002)	Represents the stock of knowledge that exists in an organization at a particular point in time.
Subramaniam and Youndt (2005)	The sum of all knowledge firms utilize for competitive advantage.
Martínez-Torres (2006)	Includes those intangible assets of an organization that are not recorded in financial statements but which may constitute 80% of the market value of the organization.
Reed et al. (2006)	Basic competences of intangible character that allow creating and maintaining competitive advantage.
Cabrera and Bontis (2008)	The knowledge assets that can be converted into value. Is a matter of creating and supporting connectivity between of sets of expertise, experience and competences inside and outside organization.
Chang et al. (2008)	Represents knowledge-related intangible assets embedded in an organization.
Hsu and Fang (2009)	The total capabilities, knowledge, culture, strategy, process, intellectual property, and relational networks of a company that create value or competitive advantages and help a company achieve its goals.
Source: Martín -de-Castro et al. (2011).	

In the endeavour to clarify intellectual capital, related literature demonstrates a proliferation of theoretical propositions and possible reporting frameworks for visualising intellectual capital to both internal and external agents. A diversity of theoretical propositions for the nature of intellectual capital is observed within the relevant literature (Swart, 2006; Martin-De-Castro *et al.*, 2011). Yet, by reviewing Table 1, which presents various definitions of intellectual capital, we can draw some conclusions. Firstly, intellectual capital refers to three dimensions; the organizational knowledge of the human assets, the organizational structures and the external social partners of an organization. Secondly, intellectual capital is transformed to economic value through organizational action. Thirdly, intellectual capital is related to the existence of competitive advantage because intellectual capital

enhances the environmental responsiveness of the firm. The ability to manage knowledge for improving environmental responsiveness is associated with organizational learning (Argyris and Schön, 1996). For the purposes of this study, we define intellectual capital as the stock of organizational knowledge and the collective ability to transform this knowledge to action by leveraging organizational learning phenomena.

As already mentioned, intellectual capital is usually analysed to, at least, three dimensions: human capital, structural capital and relational (or social capital) (Martín-de-Castro *et al.*, 2011). Human capital refers to the knowledge, capabilities and behaviours of the human factor (Cabrita and Bontis, 2008; Hsu and Fang, 2009). Structural capital includes the knowledge incorporated into technological infrastructures (e.g. Edvinsson and Malone, 1997; Sveiby, 1997) and organizational forms (Chang *et al.* 2008); and the ability to improve it. Relational capital which remains rather under explored relatively to the other two aforementioned dimensions of intellectual capital (Swart, 2006; Martín-de-Castro *et al.*, 2011), concerns the knowledge and the ability of an organization to manage its relations with external social partners to create economic value. Customers, suppliers, allies, other social agents as well as corporate reputation can be considered as variables associated with external environment. In the case of local governments and public organizations relational capital is referred as social capital. The three dimensions of intellectual capital are highly interrelated. Human capital is an input to structural and social capital. Structural capital is an input to social capital. Finally, the interaction of intellectual capital with the environment goes through social capital.

The implied causal relationship between intellectual capital and organizational performance (Lev *et al.* 2009) and the absence of sufficient information within the context of traditional financial accounting paradigm (Canibano *et al.* 2000) stimulated the development of a number of intellectual capital reporting frameworks (see e.g. Kaplan and Norton, 1992; Brooking, 1996; Edvinsson and Malone, 1997, Roos *et al.*, 1997, Sveiby, 1997; Bontis *et al.*, 1999; Andriessen, 2005). Intellectual capital reporting frameworks are classified as: (a) return-on-assets, (b) market capitalization, (c) balanced scorecard, and (d) direct measurement methods. The information provided by intellectual capital reporting frameworks is market oriented, i.e. it is addressed to stakeholders external to the organization. Yet, intellectual capital reporting frameworks have been developed within the context of management control systems. Existing research initiatives for developing and analysing intellectual capital reporting frameworks are primarily oriented towards private sector (see e.g. Kaplan and Norton, 1992; Brooking, 1996; Edvinsson and Malone, 1997, Roos *et al.*, 1997, Sveiby, 1997; Bontis *et al.*, 1999; Andriessen, 2005). They emphasize on the provision of qualitative information that is not accounted for in traditional financial statements in order to access the effects of intellectual capital on economic performance.

### **Intellectual capital in Non-Profit Sector**

Intellectual capital has been mainly studied within the context of the private sector (Kong, 2010). However, the rise of the new management paradigm for public sector organizations and the idiosyncratic nature of the public sector triggered research initiatives to investigate intellectual capital

within its context. More specifically, the changes in the public sector since 1980s, such as the extensive use of commercialization, the increased levels of competition and the demand for improved efficiency in service delivery, posed requirements for a new management philosophy for public organizations usually described with the umbrella term of New Public Management (Hood, 1995). New Public Management (NPM) dismantles the distinction between private and public sector by proposing ideas borrowed from the conceptual framework of private administrative practise (Power, 1997). NPM provides a theoretical rationalization for intellectual capital, as a private sector oriented metaphor, to be viewed as a new conceptual framework for public strategic management (Kong, 2007; Kong and Prior, 2008; Kong and Thomson, 2006).

Preliminary research initiatives indicate that the role of intellectual capital in non-profit sector is more critical than in the case of private sector. Ramírez (2010) argues that the growing significance given by literature to the application of models for intellectual capital management in the non-profit sector is due to the fact that intangibility is even more present than in the case of private organizations. The intangibility of the public sector organizations concerns their goals, production process and their outputs. Public organizations tend to have multiple objectives of non-financial nature (Ramírez, 2010). Moreover, the public sector has always been human capital-intensive in its production process (Serrano *et al.*, 2003). Finally, public sector organizations focus on intangible outcomes (Wall, 2005).

### **Theoretical Framework, Research Objectives and Hypotheses Development**

The research objective of this study is to investigate the relationship between intellectual capital and performance within the context of the public sector. The relationship of intellectual capital with operational performance has been documented in the private sector (e.g. Lev *et al.*, 2009) albeit not extensively. In our study we choose a typical public sector setting, that of local governments to test the relation between intellectual capital and performance. As local governments are more intellectual capital intensive than private organizations (Cinca *et al.*, 2003, Kong, 2007; Kong and Prior, 2008) we expect that this relation will be evident as well.

This leads to the following hypothesis:

*H<sub>1</sub>: In the case of local governments, Intellectual Capital is positively correlated with performance.*

In our study, we operationalize the value of Intellectual capital under the two prisms that correspond to the two different epistemological views developed by Mouritsen (2006). Mouritsen (2006) distinguishes two central themes within intellectual capital (IC) research: IC1-ostensive view and IC2-performative view. IC1-ostensive research stream adopts a positivistic view and argues that intellectual capital can be analyzed to its components (i.e. human, organizational and relational capital) and the contribution of these components to organizational performance can be measured in terms of their implications on financial fundamentals (e.g. risk and returns, market-to-book, etc.). On the other hand, IC2-performative research stream recognises that intellectual capital is part of a configuration of knowledge management and, consequently, the nature of intellectual capital is,

idiosyncratically, defined within the specific organizational context and its effects on performance are realised by interpreting its role on making organizations capable of performing towards endogenously defined values. IC2-performative research stream emphasises on narratives, qualitative information and descriptions.

Under the prism of IC1 ostensive research stream, the positive effects of intellectual capital on the performance of local governments can be measured in terms of improved financial performance. Yet, IC1 ostensive stream has not developed common accepted unified metrics for measuring the value of the intellectual capital of an organization (see, e.g. Bontis, 1998, Swart, 2006). Only inferences of the economic value of intellectual capital can be derived which are expected to be homeostatic to its latent true value. For this reason, consistently with the IC1 ostensive perspective, we use the term “inferred intellectual capital” to denote the value of the intellectual capital that could be captured through publicly available financial information reported in financial statements.

Following hypothesis H<sub>1</sub>, it is expected that higher values of inferred intellectual capital would be positively correlated with financial performance. Further, as IC1-ostensive research stream theorizes intellectual capital as the sum of discrete but interrelated components (e.g. human capital, structural capital, social capital), it is expected that all these components of inferred intellectual capital affect financial performance in a positive manner. Summarizing the above analysis, the following hypotheses are derived:

*H<sub>11</sub>: In the case of local governments, Inferred Intellectual Capital and its Components are positively correlated with Financial Performance.*

Financial performance is assessed in terms of efficiency, liquidity and debt management. The criteria used for the selection of these dimensions are that they constitute both commonly encountered and distinctive aspects for financial performance assessment. Thus, from hypothesis H<sub>11</sub>, the following hypotheses are derived:

*H<sub>11.1</sub>: In the case of local governments, Inferred Intellectual Capital and its Components are positively correlated with efficiency.*

*H<sub>11.2</sub>: In the case of local governments, Inferred Intellectual Capital and its Components are positively correlated with liquidity.*

*H<sub>11.3</sub>: In the case of local governments, Inferred Intellectual Capital and its Components are positively correlated with debt management.*

Adopting the IC2-performative epistemological view, the research question of the relationship between intellectual capital and performance should be examined by interpreting its role on making organizations capable of performing towards endogenously defined values. Decoding the intra organizational role of intellectual capital requires analysing the perceptions of the internal agents of the organization towards perceived intellectual capital. Perceived intellectual capital, in contrast to inferred intellectual capital, reflects the qualitative characteristics that internal agents attribute to the intellectual capital. Further, perceived intellectual capital is evaluated by its ability to make

organizations capable of achieving endogenously defined values. This implies that IC2-performative epistemological view opposes to the direct linkage between intellectual capital and financial performance and attempts to visualise the effects of perceived intellectual capital on perceived performance using narratives, qualitative information and descriptions. Perceived performance refers to what extent internal agents believe that the perceived intellectual capital serves organizational goals. Perceptions are views that do not necessarily correspond to reality.

In the case of local governments, IC2-performative epistemological view is valuable in examining H<sub>1</sub> hypothesis from a multifaceted perspective. Empirical research documents the diversity that exists in terms of the awareness and the perceptions of non-profit organizations regarding intellectual capital (e.g. Scheimer and Samkin, 2008, Guthrie *et al.*, 2009, Benevene and Cortini, 2010). Public sector is characterised by lower motivation to adopt new management practises, bureaucracy and less urgency to quantify economic values than private sector (Cinca *et al.*, 2003). These idiosyncratic organizational contingencies of public sector formulate an unfriendly internal environment for intellectual capital cultivation. Under these conditions, inter organizational perceptions towards intellectual capital have significant implications on the organizational behaviour, attitudes and abilities of these organizations to manage the available intellectual capital for creating organizational value. Yet, the relationship between perceived intellectual capital and its perceived effects on performance has not been consistently investigated in literature. Nevertheless, we expect that the factors synthesizing perceived intellectual capital are positively associated with perceived performance. This is because this relationship is existent on the collective cognitive maps of the members of the local governments and that higher (lower) levels of perceived intellectual capital are associated with higher (lower) levels of perceived performance. The level of perceived intellectual capital can be only captured through analysing the views of the actors in local governments. Therefore as this type of information is not reported in financial statements, it should be collected through survey instruments. Based on the aforementioned analysis, the following hypothesis is stated:

*H<sub>12</sub>: In the case of local governments, Perceived Intellectual Capital and its Factors are positively correlated with Perceived Performance.*

Perceived performance is analysed in terms of cost, quality and quantity of the services provided by local governments to the local communities. Thus, from hypothesis H<sub>12</sub>, the following hypotheses are derived:

*H<sub>12.1</sub>: In the case of local governments, Perceived Intellectual Capital and its Factors are negatively correlated with Perceived Cost of Services Provided by Local Governments.*

*H<sub>12.2</sub>: In the case of local governments, Perceived Intellectual Capital and its Factors are positively correlated with Perceived Quality of Services Provided by Local Governments.*



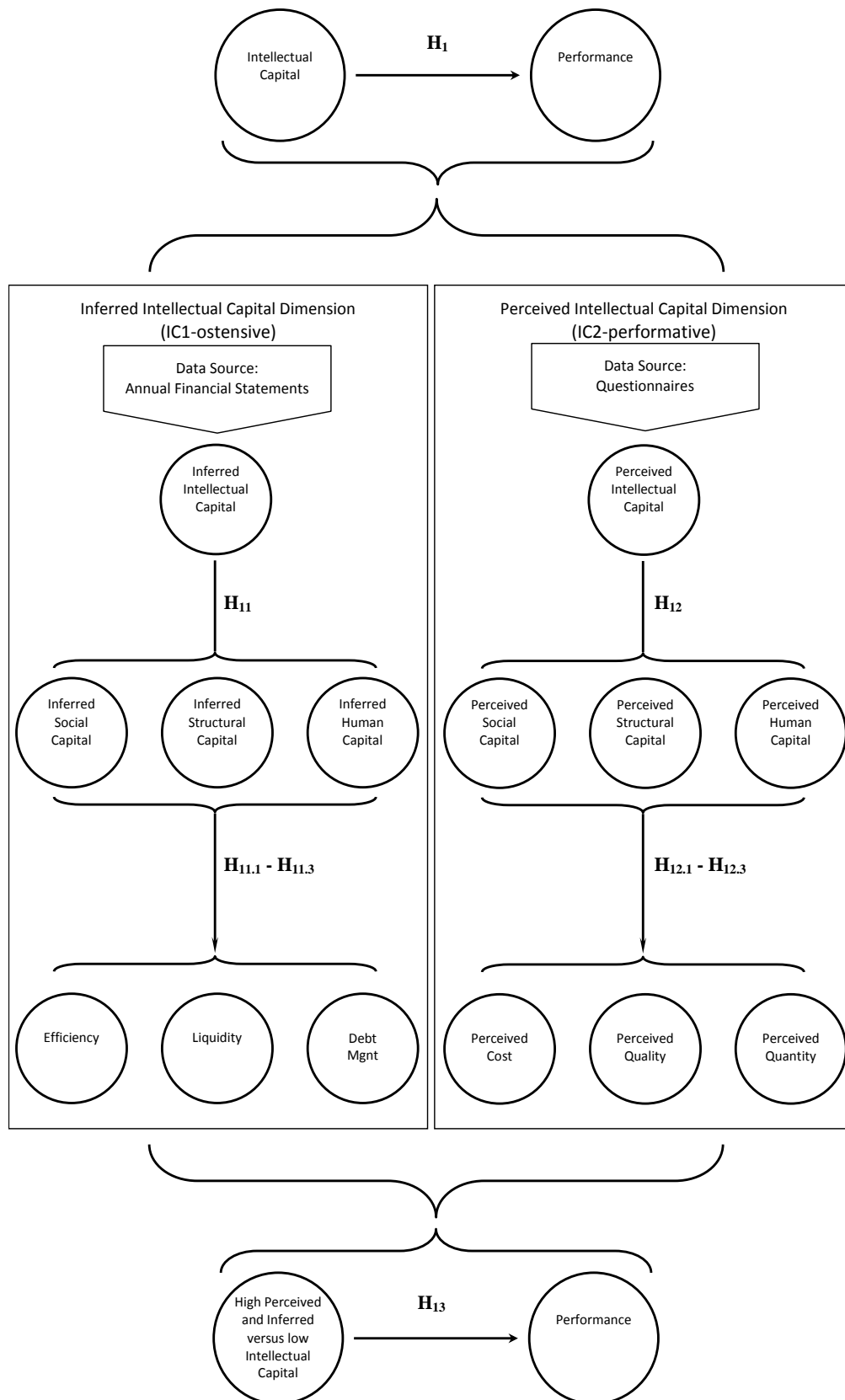


Figure 3: Research Hypotheses

H<sub>12.3</sub>: In the case of local governments, Perceived Intellectual Capital and its Factors are positively correlated with Perceived Quantity of Services Provided by Local Governments.

Both inferred intellectual capital and perceived intellectual capital are theoretical constructs that allow studying the relationship between intellectual capital and performance under the two different epistemological views. Since each of the above theoretical constructs examines different perspective of the organization's reality, a more holistic approach is required in order to capture the breadth of the interaction between intellectual capital and performance.

A local government may be classified in a different rank in terms of its inferred intellectual capital and its perceived intellectual capital. For simplicity reasons, local governments may be classified as high or low intensive in terms of either their inferred or perceived intellectual capital. This categorization creates a matrix of four quarters in which all local governments can be plotted to. Figure 2 is a graphical presentation of the above classification.

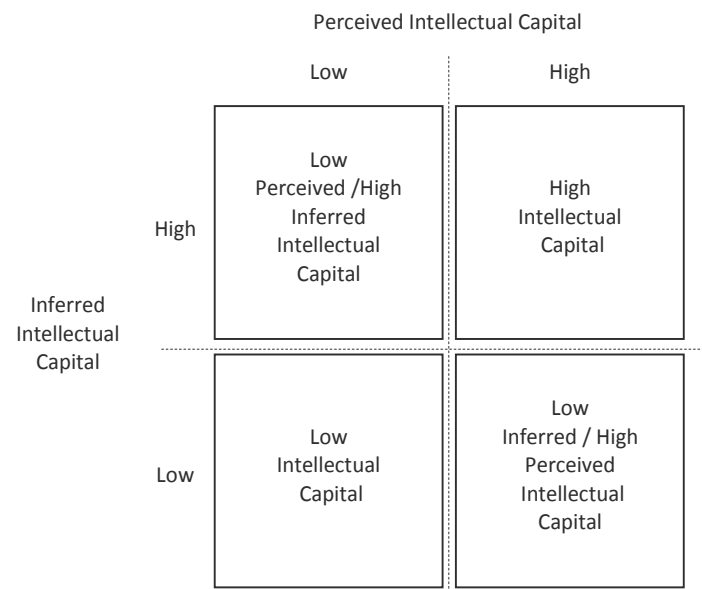


Figure 2: Classification of Local Governments According to the Different Dimensions of Intellectual Capital

Local governments with high both perceived and inferred intellectual capital are classified as high intellectual capital local governments. Local governments with low both perceived and inferred intellectual capital are classified as low intellectual capital local governments. These two groups represent local governments which are classified uniformly under both IC1-ostensive and IC2-performative views. Therefore there is unanimity in local government categorization irrespectively of the IC theoretical perspective. For all other local governments the two theoretical views (IC1-ostensive and IC2-performative) result into different categorizations. Therefore their classification is reliant on the theoretical view employed; they can be classified either as low (high) perceived or high (low) inferred intellectual capital intensive.

Using the aforementioned classification schema and the implied positive effect of intellectual capital on performance the following hypothesis is derived:

H13: Local governments with high Intellectual Capital show better performance both financial and perceived than local governments with low intellectual capital.

## **Methodology**

In the present study, the relation between intellectual capital and performance is examined under the two different epistemological views of the intellectual capital research, the IC1- ostensive and IC2- performative. In order to accommodate the differences in intellectual capital quantification as well as the methodological requirements considering the nature of data, variables employed in the analysis and data processing dictated by the two intellectual capital viewpoints, we adopt a twofold methodological approach.

Under IC1-ostensive research stream, we calculate inferred intellectual capital by using data found in the annual financial statements of local governments. Moreover, financial statements data is used in order to calculate financial ratios commonly used to evaluate the financial performance of an organization.

Under IC2-informative research stream, we calculate perceived intellectual capital by using data gathered through questionnaires in a field survey. The questionnaire serves a dual scope; firstly to write down the perceptions of local governments in terms of several propositions related to intellectual capital within the local government and secondly to gather information in relation to the perceived level of performance.

### **Definition of Variables for the Inferred Intellectual Capital**

This section analyses the proxy measures used to visualize the components of the inferred intellectual capital using the financial statements data of local governments. These proxy measures rely only merely on measures that have been previously proposed within the strand of existing intellectual capital reporting literature. The reason is that the measures encountered in literature have been analysed through the lens of the private sector and, they therefore correspond to measurement techniques with a strong market orientation, which does not fit to the public sector (Guthrie *et al.*, 2009). Inferred intellectual capital is analysed into inferred human capital, inferred organizational capital and inferred social capital.

#### **Inferred Human Capital**

Human capital includes knowledge, skills, innovativeness and the ability to response effectively at task performance (Edvinsson and Malone, 1997, Martin-de-Castro *et al.*, 2011). Under the assumption of a homogeneous production function, differences on the level of human capital are associated positively with productivity differentials (Aliaga, 2001, Becker, 1964) and, for a given level of resource consumption, with abnormal production.

We consider two main inputs in the production function of local governments: capital and labour. As a proxy of capital the amount of total assets is used, whereas as a proxy of labour we use the number of employees. A local government with higher levels of human capital is expected to record higher average per employee productivity.

Assuming that there is a homogenous Cobb-Douglas production function across the local governments of the research site, the inferred human capital of  $j$  local government  $IN\_HC^j$  is measured in terms of the abnormal output  $Q^j$  over the number of employees  $N^j$ .

$$IN\_HC^j = \frac{Q^j}{N^j} \quad (1)$$

Abnormal output  $Q^j$  is the estimation error of the following OLS model:

$$\log(S^j) = \log(a_0^j) + a_1^j \log(TA^j) + a_2^j \log(N^j) + e^j \quad (2)$$

where:

$S^j$  denotes revenues from own operations of the  $j$  local government,

$TA^j$  corresponds to the total assets of the  $j$  local government, and

$N^j$  is the number of employees in the  $j$  local government.

We use revenues from own operations as a surrogate for output. Local governments are service-oriented organizations and thus the level of revenues represents the output for a given fiscal year. Revenues correspond to the sales of goods and services as well as the taxes imposed by local governments to citizens and businesses. We exclude government subsidies from revenues, as subsidies are granted to local governments on the basis of a set of political and social criteria that are not directly controlled or affected by the actions of local governments (e.g. population, location).

### **Inferred Organizational Capital**

According to Subramaniam and Youndt (2005) organizational capital is defined as the institutionalized knowledge and codified experience residing within and utilized through databases, patents, manuals, systems, and processes. Prior literature uses selling, general and administrative (SGA hereafter) expenses as an accounting fundamental associated with organizational capital (see, e.g. Edvinsson and Malone, 1997, Roos and Roos, 1997, Lev et al., 2009). The underlining rationale is that the normal operation of each organization requires a minimum level of SGA expenses and the remaining part represents investments on developing organizational capital. This rationale has been heavily used in the IC private sector literature.

Following, the same paradigm, the inferred organizational capital  $IN\_OC^j$  of the  $j$  local government is measured in terms of abnormal SGA expenses scaled by the number of employees:

$$IN\_OC^j = \frac{AB\_SGA^j}{N^j} \quad (3)$$

where:

$AB\_SGA^j$  denotes the abnormal SGA expenses of the  $j$  local government, and

$N^j$  is the number of employees of the  $j$  local government.

Using the number of employees as a measurement variable for the level of SGA expenses in a local government, the level of abnormal SGA expenses  $AB\_SGA^j$  of the  $j$  local government is defined as the estimation error of the following OLS model:

$$\frac{SGA^j}{TA^j} = b_0 + b_1 \frac{N^j}{TA^j} + e_{AB\_SGA}^j \quad (4)$$

Both dependent and independent variable of the OLS model of Eq. (4) are scaled with the total assets  $TA^j$  of the  $j$  local government. The reason is to take into consideration the size effect of the local government on the level of SGA expenses.

### Inferred Social Capital

The third component of intellectual capital refers to the ability of an organization to absorb, exploit and explore new knowledge from its environment so as to obtain and sustain competitive advantage positions (Martin-de-Castro *et al.*, 2011). Within the context of private sector, it is referred as relational capital. However, the term social capital seems more appropriate to describe the third component of the intellectual capital of the local governments due to their social oriented physiognomy.

High levels of social capital indicate that the local government has increased ability to obtain economic benefits on behalf of its citizens. Local governments provide monopolistic services to the local communities and their relationship with their citizens can be viewed within the context of an agency model. Citizens represent the principal site which supply their local government with capital through taxation, bear risk in case that local government fails to serve local community and construct incentives ranging from social acceptance of specific policies to the approval of economic benefits obtained by public servants. Local government represents the agent site that makes decisions on behalf of the citizen relying on superior knowledge about the social environment. This superior knowledge is the social capital.

Within the context of the above agency model, local governments are expected to maximize citizens' economic welfare. The internal economic value of the services provided, the economic sacrifices required to produce and to deliver services, equals the cost of goods sold. The higher the levels of social capital indicates that local government has increased ability to absorb, exploit and explore new knowledge from its environment in order to provide better and, thus, more valuable services.

Abnormal levels of cost of goods sold for a given quantity of services indicate that local government either provides to the citizenry services of higher internal economic value or operates inefficiently. A local government is efficient if the abnormal revenues exceed the abnormal cost of goods sold. In that case social capital enables local government to improve its efficiency and to reserve higher levels of economic wealth for its citizens.

Based on the aforementioned analysis, the inferred social capital of  $j$  local government  $IN\_SOC^j$  is measured as the difference between abnormal own revenues from operations  $AB\_S^j$  and abnormal cost of goods sold  $AB\_COGS^j$  scaled with the number of employees of the  $j$  local government  $N^j$ :

$$IN\_SOC^j = \frac{AB\_S^j - AB\_COGS^j}{N^j} \quad (5)$$

Abnormal cost of goods sold  $AB\_COGS^j$  is the estimation error of the following OLS model:

$$\frac{COGS^j}{TA^j} = c_0 + c_1 \frac{P^j}{TA^j} + e_{AB\_COGS}^j \quad (6)$$

where

$COGS^j$  denotes the cost of goods sold of the  $j$  local government, and

$P^j$  is the population of  $j$  local government.

Both dependent and independent variables of the OLS model of the Eq. (5) are scaled with the total assets  $TA^j$  of the  $j$  local government.

Abnormal own revenues from operations  $AB\_S^j$  is the estimation error of the following OLS model:

$$\frac{S^j}{TA^j} = d_0 + d_1 \frac{P^j}{TA^j} + e_{AB\_S}^j \quad (7)$$

where  $S^j$  denotes revenues from own operations of the  $j$  local government, and

$P^j$  is the population of  $j$  local government.

Both dependent and independent variables of Eq. (5) are scaled with the total assets  $TA^j$  of the  $j$  local government.

Eq. (5) can, alternatively, restated in terms of the estimations errors of the estimated OLS models of Eqs. (6) and (7):

$$IN\_SOC^j = \frac{e_{AB\_S}^j - e_{AB\_COGS}^j}{N^j} \quad (8)$$

### Definitions of Variables of Financial Performance

Various financial ratios can be employed in order to measure the financial performance of a local government. The ratios used in this study correspond to ratios used in traditional financial analysis to evaluate (i) profitability, (ii) liquidity and (iii) debt management.

The financial ratio selected to evaluate the profitability of local governments is the following:

- Return on Assets: the ratio of net income over total assets for a given fiscal year.
- The financial ratios that are used to evaluate the liquidity of a local government are the following:
- Liquidity: the ratio of current assets over current liabilities.
- Total Assets Turnover (Total Sales Revenue): the ratio of total revenues (own revenues plus subsidies) over total assets.

- Plant, Property, Equipment Turnover (Total Sales Revenue): the ratio of total revenues over Plant, Property and Equipment.
- Total Assets Turnover (Own Revenues from Operations): the ratio of own revenues from operations over total assets.
- Plant, Property, Equipment Turnover (Own Revenues from Operations): the ratio of own revenues from operations over Plant, Property and Equipment.

Finally, the financial ratios that are calculated in order to evaluate the quality of debt management of a local government are the following:

- Liabilities over Total Assets: the ratio of liabilities over total assets.
- Debt over Total Assets: the ratio of long-term debt over total assets.

### **Definition of Factors Identified for the Perceived Intellectual Capital**

This section analyses the factors that constitute the perceived intellectual capital. These factors emerged from an analysis of the answers obtained through the questionnaire that was developed for the purpose of the study. The survey instrument, requested the respondents to express on a Likert scale the extent of their agreement (where 5 corresponded to totally agree) or disagreement (where 1 corresponded to totally disagree) on sixty one (61) statements. A translated copy of the statements included in the questionnaire is found in the appendix. The selection of the statements was based on previous literature properly adjusted for the setting of local governments and Greek reality. The questionnaire has been pilot tested in one local government where we sought at spotting unclear questions or sources of possible misunderstanding. The statements corresponding to different intellectual capital sub-dimensions were scattered in the questionnaire. Moreover there were six (6) reverse coded statements. The questionnaire was addressed to 340 randomly selected local governments out of the 577 that are obliged to issue accrual accounting financial statements. The questionnaire was addressed to the Mayor of the local government. A total of 92 local governments participated in the survey by returning completed questionnaires. Thus, the response rate of our research study was 27%. The field study took place during the summer of 2010. A non-response bias analysis did not reveal any statistically significant differences between early and late respondents.

The questionnaires were mainly answered by either the Mayor or the Vice Mayor (25%) or the Officer of Administrative Services (64%). The experience of the respondents was indicative of their knowledge regarding local government operations. The 33% of respondents had working experience in the local government for 6-10 years while 51% had more than 11 years of experience.

The answers that we received were grouped together so as to create factors that are coded as (i) perceived human capital (factors HC\_1 to HC\_6), (ii) perceived structural capital (factors SC\_1 to SC\_4), (iii) perceived social capital (factors SOC\_1 to SOC\_4) and (iv) perceived performance (factors Qual., Quant. and Cost). A Cronbach's Alpha test was used to assess the validity of the identified factors. Table 2 presents a brief summary of the factors, their definition and the Cronbach's Alpha value for each factor.

Table 2:  
Factors Identified for Perceived Human Capital, Perceived Structural Capital, Perceived Social Capital and Perceived Performance

Perceived Human Capital			
Factor		Definition	Cronbach's Alpha
Code	Name		
HC_1	Knowledge & Skills	The knowledge, experience and skills of the human resources to perform required tasks (Statements 1, 4, 28 and 44).	0.751
HC_2	Learning, Adaptation & Human Resource Development	The ability to renew available knowledge, experience and skills of the human resources through individual learning, informal and formal organizational processes (Statements 7, 9, 36 and 49).	0.751
HC_3	Synergy with Environment	The ability of human resources to collaborate effectively (i) within the organizational boundaries of the local government and (ii) with agents operating within the social and economic environment of the local government (Statements 8, 10, 45, 52 and 59).	0.771
HC_4	Commitment	The commitment of human resources towards the organizational goals and values of the local government (Statements 13, 18, 23 and 31).	0.673
HC_5	Motivation	The level of motivation of human resources of the local government (Statements 2, 20, 26 and 38).	0.667
HC_6	Satisfaction	The level of satisfaction of human resources at task performance (Statements 5, 32, 34 and 55).	0.681
Perceived Organizational Capital			
Factor		Definition	Cronbach's Alpha
Code	Name		
OC_1	Knowledge Management	IT investments and the available codified knowledge of the local government and the collective ability to manage for serving the goals of the organization (Statements 12, 37 and 53).	0.683
OC_2	Innovation	Orientation towards the adoption of new management systems and the development of innovative culture amongst employees of the local government (Statements 6, 19 and 40).	0.775
OC_3	Internal Integration	Management policies aiming to improve the integration of human resources with the organization of the local government (Statements 22 and 51).	0.671
OC_4	E-governance	The intensity of electronic services for supporting the operation of local governments (Statements 57 and 58).	0.698
Perceived Social Capital			
Factor		Definition	Cronbach's Alpha
Code	Name		
SOC_1	Knowledge of Social Environment	The available knowledge sources outside local governments (Statements 3, 15, 17 and 39).	0.698
SOC_2	External Integration	The level of social integration of the local government with local community (Statements 11, 33, 35 and 46).	0.737
SOC_3	Economic Relations	The intensity of economic integration of the local government with local economy (Statements 21, 25, 42 and 48).	0.737



SOC_4	<i>Collaboration with Central Government</i>	<i>The level of collaboration of the local government with central government (Statements 43, 60 and 61).</i>	0.616
SOC_5	<i>Communication</i>	<i>The level of communication of the local government with its external environment (Statements 14, 24, 30 and 56).</i>	0.634
SOC_6	<i>Social Culture</i>	<i>Efforts devoted for the creation of social culture (Statements 41, 47, 50 and 54).</i>	0.763
<i>Perceived Organizational Performance</i>			
<i>Factor</i>		<i>Definition</i>	
<i>Code</i>	<i>Name</i>		
<i>Qual.</i>	<i>Quality</i>	<i>The quality of services provided by local government to its social environment (Statement 16).</i>	
<i>Quant.</i>	<i>Quantity</i>	<i>The quantity of services provided by local government to its social environment (Statement 27).</i>	
<i>Cost</i>	<i>Cost</i>	<i>The cost of services provided by local government to its social environment (Statement 29).</i>	

The factors presented in Table 2 are consistent with the intellectual capital theory. According to Martin-de-Castro et al., (2011) human capital is an amalgamation of knowledge, abilities (including learning and collaboration) and behaviours (including motivation, commitment and thus satisfaction). The following factors for perceived human capital are defined: Knowledge & Skills (HC\_1), Learning, Adaptation & Human Resource Development (HC\_2), Synergy with Environment (HC\_3), Commitment (HC\_4), Motivation (HC\_5) and Satisfaction (HC\_6). As far as organizational capital is concerned, Subramaniam and Youdnt (2005) define it as the institutionalized knowledge and codified experience residing within and utilized through databases, patents, manuals, systems, and processes. The factors recognized in the case of organizational capital are Knowledge Management (OC\_1), Innovation (OC\_2), Internal Integration (OC\_3) and e-governance (OC\_4). Knowledge Management and Innovation refer to the codified knowledge, the ability to manage this knowledge and the supporting IT infrastructure. In order local governments to efficiently manage organizational capital they must support its dissemination within organizational boundaries. A necessary condition for this to happen is the existence of Internal Integration (OC\_3). Finally, special reference is made to the ability of local governments to employ IT infrastructure for supporting their operations, that is, e-governance (OC\_4). Definitions for social capital approximate those for relational capital. Chang et al. (2008) argue that relational capital represents the knowledge embedded in the relationships with the outside environment. The first factor of social capital is defined as Knowledge of Social Environment (SOC\_1). However, the ability of a local government to utilize the available Knowledge of Social Environment depends on the level of its integration with its social environment. Three different aspects of integration have been recognized: social (External Integration SOC\_2, Communication SOC\_5 and Social Culture SOC\_6), economic (Economic Relations SOC\_3) and governmental (Collaboration with Central Government SOC\_4).

Additional empirical evidence provides support for the theoretical validity of the factors described above. Recognizing the distinct factors within each dimension of perceived intellectual capital is a

process that enables its study in a systematic way. Moreover, the factors found in each dimension of perceived intellectual capital are expected to be positively correlated with each other since they all constitute fundamental elements of a broader entity (i.e. either perceived human capital or perceived organizational capital or perceived social capital) and operate with the same teleological way. Tables 3, 4 and 5 provide empirical evidence that the factors of perceived human capital, perceived organizational capital and perceived social capital are positively correlated at 1% statistical significance level. Further, each of the dimensions of the perceived intellectual capital is expected to be positively correlated with the other two. This is empirically verified by the correlation statistics that are presented in Table 6.

*Table 3: Descriptives and Correlations between the Factors of Perceived Human Capital*

*Section A reports simple statistics for the factors of Perceived Human Capital. Section B reports the correlation statistics for the factors of Perceived Human Capital.*

Section A: Descriptives						
	Mean	Std. Deviation	N			
Knowledge & Skills	3.6576	0.62097	92			
Learning, Adaptation & Human Resource Development	3.3859	0.78307	92			
Synergy with Environment	3.7261	0.58982	92			
Commitment	3.6413	0.45889	92			
Motivation	3.5272	0.60612	92			
Satisfaction	3.4565	0.42518	92			
Section B: Correlations						
Pearson	Knowledge & Skills	Learning, Adaptation & Human Resource Development	Synergy with Environment	Commitment	Motivation	Satisfaction
Knowledge & Skills		0.485(**)	0.595(**)	0.413(**)	0.463(**)	0.333(**)
Learning, Adaptation & Human Resource Development	0.477(**)		0.603(**)	0.361(**)	0.490(**)	0.455(**)
Synergy with Environment	0.620(**)	0.585(**)		0.457(**)	0.607(**)	0.445(**)
Commitment	0.422(**)	0.314(**)	0.388(**)		0.514(**)	0.275(**)
Motivation	0.481(**)	0.438(**)	0.575(**)	0.472(**)		0.292(**)
Satisfaction	0.349(**)	0.445(**)	0.460(**)	0.236(*)	0.296(**)	
<i>Pearson correlations about the diagonal; spearman correlations below the diagonal.</i>						
<i>* and ** indicate statistical significance at 5%, and 1% levels respectively.</i>						

*Table 4: Descriptives and Correlations between the Factors of Perceived Organizational Capital*

*Section A reports simple statistics for the factors of Perceived Organizational Capital. Section B reports the correlation statistics for the factors of Perceived Organizational Capital.*

Section A: Descriptives				
	Mean	Std. Deviation	N	
Knowledge Management	3.6014	0.75470	92	
Innovation	3.4094	0.88964	92	
Internal Integration	3.3859	0.90512	92	
e-governance	3.0761	0.87581	92	
Section B: Correlations				
Pearson	Knowledge Management	Innovation	Internal Integration	e-government
Knowledge Management		0.688(**)	0.598(**)	0.593(**)
Innovation	0.701(**)		0.768(**)	0.643(**)
Internal Integration	0.632(**)	0.775(**)		0.593(**)
e- governance	0.608(**)	0.646(**)	0.617(**)	
Pearson correlations about the diagonal; spearman correlations below the diagonal.				
* and ** indicate statistical significance at 5%, and 1% levels respectively.				

Table 5: Descriptives and Correlations between the Factors of Perceived Social Capital

Section A reports simple statistics for the factors of Perceived Social Capital. Section B reports the correlation statistics for the factors of Perceived Social Capital.

Section A: Descriptives						
	Mean	Std. Deviation	N			
Knowledge of Social Environment	3.1304	0.72388	92			
External Integration	3.4348	0.69225	92			
Economic Relations	2.9783	0.74739	92			
Collaboration with Central Government	3.4783	0.64867	92			
Communication	3.4438	0.72849	92			
Social Culture	3.6549	0.74110	92			
Section B: Correlations						
Pearson	Knowledge of Social Environment	External Integration	Economic Relations	Collaboration with Central Government	Communication	Social Culture
Knowledge of Social Environment		0.631(**)	0.377(**)	0.441(**)	0.615(**)	0.524(**)
External Integration	0.602(**)		0.322(**)	0.704(**)	0.497(**)	0.617(**)
Economic Relations	0.368(**)	0.324(**)		0.252(*)	0.216(*)	0.322(**)
Collaboration with Central Government	0.433(**)	0.691(**)	0.292(**)		0.388(**)	0.467(**)
Communication	0.659(**)	0.538(**)	0.255(*)	0.425(**)		0.637(**)
Social Culture	0.566(**)	0.630(**)	0.334(**)	0.485(**)	0.641(**)	
Pearson correlations about the diagonal; spearman correlations below the diagonal.						
* and ** indicate statistical significance at 5%, and 1% levels respectively.						

### Definition of Factors of Perceived Performance

Except for the factors identified in relation to perceived intellectual capital, factors proxying for the perceived organizational performance of the local governments were calculated as well. Local governments, primarily, provide services to the citizenry. Assessing the performance of a service oriented organization is a multidimensional and difficult task. For simplicity reasons, the emphasis was given on three basic dimensions, those of, quantity, quality and cost. The factors that constitute the perceived performance are therefore: the perceived Quality of services (Qual.), the perceived Quantity of service provision (Quant.) and the perceived Cost of services rendered (Cost). These factors correspond to the self assessment of local governments in respect to the level of quantity, quality and the cost of the services provided. The values of these perceived measures were retrieved from the questionnaire where local governments made their (self) assessments.

Table 6: Correlations between the Factors of Perceived Intellectual Capital (i.e. Perceived human capital, perceived organizational capital and perceived social capital)

Perceived Organizational Capital Factors						Perceived Social Capital Factors					
Pearson		Knowledge Management	Innovation	Internal Integration	e-governance	Knowledge of Social Environment	External Integration	Economic Relations	Collaboration with Central Government	Communication	Social Culture
Perceived Human Capital Factors	Knowledge & Skills	0.517(**)	0.427(**)	0.233(*)	0.532(**)	0.351(**)	0.294(**)	0.198	0.436(**)	0.462(**)	0.231(*)
	Learning, Adaptation & Human Resource										
	Development	0.633(**)	0.595(**)	0.563(**)	0.610(**)	0.544(**)	0.537(**)	0.260(*)	0.428(**)	0.500(**)	0.517(**)
	Synergy with Environment	0.685(**)	0.670(**)	0.476(**)	0.489(**)	0.513(**)	0.583(**)	0.364(**)	0.488(**)	0.426(**)	0.468(**)
	Commitment	0.410(**)	0.222(*)	0.251(*)	0.401(**)	0.405(**)	0.371(**)	0.259(*)	0.389(**)	0.397(**)	0.222(*)
	Motivation	0.492(**)	0.346(**)	0.269(**)	0.420(**)	0.440(**)	0.443(**)	0.292(**)	0.386(**)	0.382(**)	0.298(**)
	Satisfaction	0.425(**)	0.474(**)	0.380(**)	0.203	0.360(**)	0.415(**)	0.176	0.332(**)	0.301(**)	0.253(*)
Perceived Organizational Capital Factors	Knowledge Management					0.641(**)	0.656(**)	0.2	0.461(**)	0.547(**)	0.559(**)
	Innovation					0.629(**)	0.656(**)	0.266(*)	0.520(**)	0.607(**)	0.681(**)
	Internal Integration					0.593(**)	0.562(**)	0.323(**)	0.409(**)	0.539(**)	0.672(**)
	e-governance					0.628(**)	0.528(**)	0.257(*)	0.470(**)	0.805(**)	0.643(**)
Perceived Organizational Capital Factors						Perceived Social Capital Factors					
Spearman's rho		Knowledge Management	Innovation	Internal Integration	e-governance	Knowledge of Social Environment	External Integration	Economic Relations	Collaboration with Central Government	Communication	Social Culture
Perceived Human Capital Factors	Knowledge & Skills	0.491(**)	0.454(**)	0.281(**)	0.539(**)	0.305(**)	0.325(**)	0.198	0.451(**)	0.485(**)	0.258(*)
	Learning, Adaptation & Human Resource										
	Development	0.638(**)	0.598(**)	0.577(**)	0.618(**)	0.525(**)	0.530(**)	0.261(*)	0.435(**)	0.493(**)	0.560(**)
	Synergy with Environment	0.673(**)	0.664(**)	0.467(**)	0.494(**)	0.459(**)	0.590(**)	0.333(**)	0.493(**)	0.470(**)	0.462(**)
	Commitment	0.376(**)	0.214(*)	0.256(*)	0.403(**)	0.385(**)	0.387(**)	0.257(*)	0.411(**)	0.392(**)	0.230(*)

	<i>Motivation</i>	0.426(**)	0.334(**)	0.283(**)	0.458(**)	0.384(**)	0.423(**)	0.276(**)	0.387(**)	0.410(**)	0.323(**)
	<i>Satisfaction</i>	0.444(**)	0.453(**)	0.358(**)	0.205(*)	0.297(**)	0.370(**)	0.192	0.285(**)	0.266(*)	0.258(*)
<i>Perceived</i>	<i>Knowledge Management</i>					0.632(**)	0.648(**)	0.199	0.467(**)	0.542(**)	0.561(**)
<i>Organizationa</i>	<i>Innovation</i>					0.649(**)	0.648(**)	0.242(*)	0.516(**)	0.645(**)	0.681(**)
<i>l Capital</i>	<i>Internal Integration</i>					0.628(**)	0.582(**)	0.322(**)	0.440(**)	0.576(**)	0.689(**)
<i>Factors</i>	<i>e-governance</i>					0.658(**)	0.544(**)	0.278(**)	0.490(**)	0.842(**)	0.654(**)

*Pearson correlations about the diagonal; spearman correlations below the diagonal.*

*\* and \*\* indicate statistical significance at 5%, and 1% levels respectively.*

## Results

This section presents the empirical results of the study. Initially, the relationship between inferred intellectual capital and inferred financial performance as it is assessed in terms of efficiency, liquidity and debt management is discussed. Secondly, the relationship of perceived intellectual capital with perceived performance is examined. As a final step, the empirical relation between intellectual capital and performance is examined irrespectively of the theoretical perspective on intellectual capital (i.e. IC1-ostensive view or IC2-performative view).

### Inferred Intellectual Capital and Financial Performance

The data used to calculate the inferred intellectual capital is based on public available information included in the financial statements of Greek local governments. Local governments in Greece that satisfy specific size or revenue criteria are obliged to publish yearly audited financial statements that mainly include a Balance Sheet and a Profit and Loss Account. Our data is obtained by the financial statements published at the end of 2008 and corresponds to the fiscal year of 2007. Data about the employees in local governments corresponds to the same period and was retrieved by the National Statistical Authority. Population information refers to the 2001 census.

Table 7 presents the results of the estimated OLS models of Eq. (2), Eq. (4), Eq. (6) and Eq. (7). Further, Table 8 presents basic descriptives of the ratios used to evaluate the financial performance of local governments and summary statistics of the basic variables retrieved by the OLS models.

Inferred human capital and inferred social capital seem to be positively correlated with Return on Assets at 1% and 5% significance level respectively. All three components of inferred intellectual capital are positively correlated with turnover ratios at 1% level of significance but they are no correlated with liquidity. Furthermore, they are positively correlated with Liabilities over Total Assets and Debt over Total Assets ratios at 1% significance level.

Summarizing the aforementioned analysis, inferred intellectual capital seems to be positively correlated with both efficiency and liquidity but presents no correlation with debt management. This indicates that the presence of inferred intellectual capital improves efficiency and turnover ratios without undermining the financial structure of local governments.

Table 7: OLS Estimations and Residuals Statistics

This table presents the OLS estimations and the residuals statistics for the following OLS estimated models:

$$\log(S^i) = \log(a_0) + a_1 \log(TA^i) + a_2 \log(N^i) + e^i$$

Model 1,

$$\frac{SGA^i}{TA^i} = b_0 + b_1 \frac{N^i}{TA^i} + e_{AB\_SGA}^i$$

Model 2

$$\frac{COGS^i}{TA^i} = c_0 + c_1 \frac{P^i}{TA^i} + e_{AB\_COGS}^i$$

Model 3 and

$$\frac{S^i}{TA^i} = d_0 + d_1 \frac{P^i}{TA^i} + e_{AB\_S}^i$$

Model 4

Section A: OLS Estimations				
	Model 1	Model 2	Model 3	Model 4
Independent Variables	$\log(S^i)$	$SGA^i/TA^i$	$COGS^i/TA^i$	$S^i/TA^i$
Constant	1.193 (1.522)	0.041** (5.136)	0.031** (2.411)	0.013 (0.693)
$\log(TA^i)$	0.59** (4.784)			
$\log(N^i)$	0.421** (4.145)			
$N^i/TA^i$		6144.057** (3.000)		
$P^i/TA^i$			280.204** (14.044)	197.664** (29.116)
Adjusted R Square	0.694	0.096	0.727	0.375
Number of Obs.	76	76	76	76
F	86.089**	9.001**	197.237**	46.087**
Section B: Residuals Statistics				
	$Q^i$	$AB\_SGA^i$	$AB\_COGS^i$	$AB\_S^i$
Mean	0.000	0.000	0.000	0.000
Std. Deviation	0.301	0.040	0.058	0.055
* and ** indicate statistical significance at 2%, and 1% levels respectively. t values are in brackets				



Table 8: Descriptives of Variables

	<i>Minimum</i>	<i>Maximum</i>	<i>Mean</i>	<i>Std. Deviation</i>
<i>Inferred Human Capital</i>	-0.0491	0.2129	0.0031	0.0341
<i>Inferred Organizational Capital</i>	-0.0040	0.0209	0.0005	0.0032
<i>Inferred Social Capital</i>	-0.0083	0.0090	-0.0002	0.0022
<i>Return on Assets</i>	-0.0600	0.1200	0.0013	0.0259
<i>Liquidity</i>	0.2500	23.8400	2.5942	3.6798
<i>Total Assets Turnover (Total Sales Revenue)</i>	0.0400	0.7300	0.2195	0.1219
<i>Plant, Property, Equipment Turnover (Total Sales Revenue)</i>	0.0100	0.4400	0.1074	0.0847
<i>Total Assets Turnover (Revenues from Own Operations)</i>	0.0445	1.0235	0.2513	0.1632
<i>Plant, Property, Equipment Turnover (Revenues from Own Operations)</i>	0.0100	0.5600	0.1233	0.1080
<i>Liabilities over Total Assets</i>	0.0100	0.4700	0.1132	0.0894
<i>Debt over Total Assets</i>	0.0000	0.2200	0.0513	0.0474

Table 9: Correlations between Inferred Human Capital, Inferred Organizational Capital, Inferred Social Capital and Financial Performance

	Inferred Human Capital	Inferred Organizational Capital	Inferred Social Capital	Return on Assets	Liquidity	Total Assets Turnover (Total Sales Revenue)	Plant, Property, Equipment Turnover (Total Sales Revenue)	Total Assets Turnover (Revenues from Own Operations)	Plant, Property, Equipment Turnover (Revenues from Own Operations)	Liabilities over Total Assets	Debt over Total Assets
Inferred Human Capital		0.875(**)	0.213	0.083	0.006	0.512(**)	0.455(**)	0.527(**)	0.476(**)	0.236(*)	0.244(*)
Inferred Organizational Capital	0.432(**)		0.117	0.037	0.031	0.543(**)	0.422(**)	0.564(**)	0.456(**)	0.216	0.191
Inferred Social Capital	0.493(**)	0.107		0.158	-0.045	-0.015	0.127	-0.063	0.061	0.056	0.161
Return on Assets	0.314(**)	0.027	0.253(*)		0.176	0.331(**)	0.458(**)	0.334(**)	0.445(**)	0.190	0.168
Liquidity	0.096	0.071	0.014	0.200		0.086	0.010	0.106	0.027	-0.317(**)	-0.180
Total Assets Turnover (Total Sales Revenue)	0.631(**)	0.662(**)	0.210	0.205	0.179		0.892(**)	0.991(**)	0.907(**)	0.566(**)	0.461(**)
Plant, Property, Equipment Turnover (Total Sales Revenue)	0.898(**)	0.465(**)	0.493(**)	0.293(*)	0.118	0.810(**)		0.886(**)	0.992(**)	0.582(**)	0.484(**)
Total Assets Turnover (Revenues from Own Operations)	0.631(**)	0.649(**)	0.217	0.241(*)	0.230(*)	0.995(**)	0.814(**)		0.914(**)	0.541(**)	0.434(**)
Plant, Property, Equipment Turnover (Revenues from Own Operations)	0.890(**)	0.477(**)	0.467(**)	0.293(*)	0.155	0.832(**)	0.995(**)	0.839(**)		0.559(**)	0.456(**)
Liabilities over Total Assets	0.422(**)	0.332(**)	0.326(**)	-0.080	-0.502(**)	0.437(**)	0.525(**)	0.417(**)	0.503(**)		0.864(**)
Debt over Total Assets	0.340(**)	0.340(**)	0.315(**)	-0.063	-0.273(*)	0.382(**)	0.451(**)	0.367(**)	0.428(**)	0.883(**)	

Pearson correlations about the diagonal; spearman correlations below the diagonal.

\* and \*\* indicate statistical significance at 5%, and 1% levels respectively.

### **Perceived Intellectual Capital and Perceived Performance**

The correlation between the factors of each dimension of the perceived intellectual capital and the perceived organizational is presented in Table 10. It seems that the effects of perceived intellectual capital on perceived performance are realised through the provision of superior quality services and to a lesser extent through cost savings. Further, the presence of a high level of perceived intellectual capital seems not to be associated with the level of the quantity of service provision.

Within the context of perceived human capital, all factors are positively correlated with the perceived quality of the services rendered at 1% level of statistical significance with the exception of the factor entitled Commitment (HC\_4) which is, also, positively correlated albeit at 5% significance level. The factors Synergy with Environment (HC\_3) and Satisfaction (HC\_6) present the highest correlation values with perceived quality of service rendering relatively to the other factors of the perceived human capital. A possible reason for that is that the level of synergy with environment and the satisfaction of human assets are both critical factors that mediate so as the core dimensions of perceived human capital (i.e. Knowledge & Skills and Learning, Adaptation & Human Resource) to be transformed into improved performance. As far as the relationship between perceived human capital and perceived cost is concerned, only the factors Learning, Adaptation & Human Resource Development (HC\_2), Synergy with Environment (HC\_3) and, Satisfaction (HC\_6) exhibit negative correlations with perceived cost of service provision. Negative relations mean that human IC is related with cost savings. Finally, there is no significant correlation between the factors corresponding to perceived human capital and those related to perceived quantity of service provision.

A similar pattern in terms of the existing correlations is observed in the case of the two other dimensions of perceived intellectual capital as well. Both perceived organizational and perceived social capital have no correlation with perceived quantity of service provision. However, they exhibit a positive correlation with perceived quality of service rendering and a negative correlation with perceived cost of service provision.

More specifically, in the case of perceived organizational capital, the factors Knowledge Management (OC\_1) and Innovation (OC\_2) have the strongest positive correlation with perceived quality at 1% significance level. Contrary to the relations revealed in relation to the factors corresponding to perceived human capital, the factors capturing the essence of perceived organizational capital are all negatively correlated with perceived cost. That can be interpreted as a positive contribution of intellectual capital on resource consumption and efficiency improvement. Moreover, the factor Internal Integration (OC\_3) exhibits the strongest negative correlation with that of perceived cost amongst the other factors of perceived organizational capital.

In the case of perceived social capital, the factors External Integration (SOC\_2) and Collaboration with Central Government (SOC\_4) have the strongest positive correlation with perceived quality and the strongest negative correlation with perceived cost at 1% significance level amongst all other factors of perceived social capital. However, the factors Knowledge of Social Environment (SOC\_1), Economic Relations (SOC\_3) and Social Culture (SOC\_6) of the perceived social capital are negatively correlated with perceived quantity.

The aforementioned analysis implies that in the case of local governments perceived intellectual capital is positively correlated with perceived performance. More specifically, the perceived intellectual capital is positively correlated with perceived quality of service rendering across all factors that correspond to the three sub domains of intellectual capital. Nevertheless, perceived intellectual capital is in some cases negatively correlated with perceived cost. Moreover, perceived intellectual capital is only sparsely correlated with perceived quantity. The lack of correlation of perceived intellectual capital with perceived quantity of service rendering does not undermine the overall conclusion that the perceived intellectual capital is correlated with performance. A plausible explanation for that is that the quantity of services required by citizens is stable and, thus, the utility that citizens obtain by those services is mainly affected by their quality. Thus, local governments may employ the available intellectual capital so as to offer services of higher quality to their citizens.

### **Intellectual Capital and Financial Performance**

This section attempts to examine the relationship between intellectual capital and financial performance irrespectively of the epistemological view used in studying intellectual capital (i.e. IC1-ostensive and IC2-performative). By analysing the results of each epistemological view without taking into consideration the results of the other limits the generalization of the research findings. It is therefore required to examine the empirical findings presented on previous paragraphs under an integrated perspective. For this reason, for each component of intellectual capital (i.e. human capital, organizational capital, social capital), we categorise local governments as high or low intensive for each dimension (i.e. inferred versus perceived). The median values of inferred human capital, inferred organizational capital and

Table 10: *Perceived Intellectual Capital and Perceived Performance*

Presents the correlation statistics between the factors of perceived human capital, perceived organizational capital, perceived social capital and the factors of perceived performance.

\* and \*\* indicate statistical significance at 5%, and 1% levels respectively.

	Pearson	Perceived Quantity	Perceived Quality	Perceived Cost
Perceived Human Capital	Knowledge & Skills	0.093	0.375(**)	-0.099
	Learning, Adaptation & Human Resource Development	-0.017	0.364(**)	-0.318(**)
	Synergy with Environment	0.083	0.566(**)	-0.246(*)
	Commitment	-0.170	0.242(*)	-0.163
	Motivation	-0.067	0.341(**)	-0.104
	Satisfaction	-0.135	0.445(**)	-0.197
	Spearman's rho			
	Knowledge & Skills	0.018	0.376(**)	-0.117
	Learning, Adaptation & Human Resource Development	-0.079	0.348(**)	-0.281(**)
	Synergy with Environment	0.081	0.594(**)	-0.239(*)
	Commitment	-0.185	0.214(*)	-0.155
	Motivation	-0.074	0.326(**)	-0.104
	Satisfaction	-0.133	0.430(**)	-0.205(*)
Perceived Organizational Capital	Pearson			
	Knowledge Management	0.006	0.483(**)	-0.292(**)
	Innovation	-0.162	0.438(**)	-0.359(**)
	Internal Integration	-0.202	0.240(*)	-0.425(**)
	e- governance	-0.113	0.301(**)	-0.212(*)
	Spearman's rho			
	Knowledge Management	-0.054	0.488(**)	-0.336(**)
	Innovation	-0.176	0.443(**)	-0.332(**)
	Internal Integration	-0.207(*)	0.258(*)	-0.366(**)
	e- governance	-0.098	0.320(**)	-0.186
Perceived Social Capital	Pearson			
	Knowledge of Social Environment	-0.276(**)	0.217(*)	-0.269(**)
	External Integration	-0.166	0.485(**)	-0.348(**)
	Economic Relations	-0.186	-0.100	-0.221(*)
	Collaboration with Central Government	-0.118	0.457(**)	-0.293(**)
	Communication	-0.189	0.331(**)	-0.128
	Social Culture	-0.192	0.398(**)	-0.266(*)
	Spearman's rho			
	Knowledge of Social Environment	-0.261(*)	0.234(*)	-0.238(*)

<i>External Integration</i>	-0.145	0.542(**)	-0.350(**)
<i>Economic Relations</i>	-.225(*)	-0.115	-0.198
<i>Collaboration with Central Government</i>	-0.147	0.457(**)	-0.314(**)
<i>Communication</i>	-0.177	0.347(**)	-0.116
<i>Social Culture</i>	-.218(*)	0.417(**)	-0.250(*)

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*Pearson correlations about the diagonal; spearman correlations below the diagonal.*

*\* and \*\* indicate statistical significance at 5%, and 1% levels respectively.*

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inferred social capital are used as corresponding critical values for classifying local governments as high (above or equal to median value) versus low (below median value) intensive for each IC sub category. In the case of the factors of perceived intellectual capital a two stage procedure is followed in order to separate local governments as high versus low. Initial, for each dimension of perceived intellectual capital (i.e. perceived human capital, perceived organizational capital and perceived social capital) the numerical values of the related factors are added to formulate a total score. Then, the median values of the total score of perceived human capital, perceived organizational capital and perceived social capital are used as critical values for classifying local governments as high (above or equal to median value) versus low (below median value) intensive.

To examine the relationship of intellectual capital with both financial and perceived performance, we compare the mean values of financial ratios and factors of perceived performance of the high IC group and the low IC group. The test is performed by using the 2 independent-samples t test. Therefore, we define three pairs of two independent samples (high IC LGs and low IC LGs) for each IC subcategory i.e. human capital, organizational capital and social capital.

High human capital local governments seem to perform better than low human capital ones as far as turnover ratios are concerned at 1% significance level. Further, high human capital is equated with improved perceived quality of the services provided by local governments at 1% level of significance (Table 11).

The relationship of organizational capital with financial performance and perceived organizational performance is examined in Table 12. Organizational capital seems to improve total assets turnovers at 1% level of significance and the perceived quality of services rendered at 4% level of significance.

Finally, social capital seems to have effects on efficiency, turnover ratios and perceived organizational performance. More specifically, local governments with high social capital report higher mean values for Return on Assets and Plant, Property and Equipment turnover ratios at a, at least, 3% level of significance. As far as perceived organizational performance is concerned, social capital is equated with higher levels of perceived quality but with lower levels of perceived quantity and perceived cost of the provided services (Table 13).

Table 11: Independent-samples T test between high and low human capital local governments

Section A: Group Statistics					
		N	Mean	Std. Deviation	Std. Error Mean
Return on Assets	High human capital	20	0.0010	0.01944	0.00435
	Low human capital	21	-0.0067	0.01932	0.00422
Liquidity	High human capital	20	3.0955	4.22474	0.94468
	Low human capital	21	3.2429	5.33925	1.16512
Total Assets Turnover (Total Sales Revenue)	High human capital	20	0.2510	0.13506	0.03020
	Low human capital	21	0.1576	0.06024	0.01315
Plant, Property, Equipment Turnover (Total Sales Revenue)	High human capital	20	0.1430	0.07828	0.01750
	Low human capital	21	0.0448	0.01806	0.00394
Total Assets Turnover (Revenues from Own Operations)	High human capital	20	0.2949	0.19609	0.04385
	Low human capital	21	0.1707	0.07256	0.01583
Plant, Property, Equipment Turnover (Revenues from Own Operations)	High human capital	20	0.1675	0.11276	0.02521
	Low human capital	21	0.0490	0.01998	0.00436
Liabilities over Total Assets	High human capital	20	0.1195	0.07309	0.01634
	Low human capital	21	0.0800	0.05745	0.01254
Debt over Total Assets	High human capital	20	0.0515	0.04870	0.01089
	Low human capital	21	0.0390	0.03986	0.00870
Perceived Quantity	High human capital	20	2.0000	0.72548	0.16222
	Low human capital	21	2.2381	0.88909	0.19401
Perceived Quality	High human capital	20	3.9500	0.51042	0.11413
	Low human capital	21	3.4762	0.60159	0.13128
Perceived Cost	High human capital	20	3.0000	0.97333	0.21764
	Low human capital	21	2.6667	0.73030	0.15936
Section B: Independent Samples Test					
		Levene's Test for Equality of Variances			
				t-test for Equality of Means	
		F	Sig.	t	Sig. (2-tailed)
Return on Assets	Eq. Var. Assum.	0.000	0.983	1.266	0.213
	Eq. Var. Not Assum.			1.266	0.213
Liquidity	Eq. Var. Assum.	0.521	0.475	-0.098	0.923
	Eq. Var. Not Assum.			-0.098	0.922
Total Assets Turnover (Total Sales Revenue)	Eq. Var. Assum.	2.708	0.108	2.883	0.006
	Eq. Var. Not Assum.			2.835	0.009
Plant, Property, Equipment Turnover (Total Sales Revenue)	Eq. Var. Assum.	8.419	0.006	5.600	0.000
	Eq. Var. Not Assum.			5.475	0.000
Total Assets Turnover (Revenues from Own Operations)	Eq. Var. Assum.	2.896	0.097	2.714	0.010
	Eq. Var. Not Assum.			2.663	0.014
Plant, Property, Equipment Turnover (Revenues from Own Operations)	Eq. Var. Assum.	8.713	0.005	4.739	0.000
	Eq. Var. Not Assum.			4.629	0.000
Liabilities over Total Assets	Eq. Var. Assum.	2.274	0.140	1.929	0.061

	<i>Eq. Var. Not Assum.</i>			1.918	0.063
<i>Debt over Total Assets</i>	<i>Eq. Var. Assum.</i>	0.418	0.522	0.898	0.375
	<i>Eq. Var. Not Assum.</i>			0.893	0.377
<i>Perceived Quantity</i>	<i>Eq. Var. Assum.</i>	1.791	0.189	-0.937	0.355
	<i>Eq. Var. Not Assum.</i>			-0.941	0.352
<i>Perceived Quality</i>	<i>Eq. Var. Assum.</i>	6.555	0.014	2.713	0.010
	<i>Eq. Var. Not Assum.</i>			2.724	0.010
<i>Perceived Cost</i>	<i>Eq. Var. Assum.</i>	0.163	0.689	1.244	0.221
	<i>Eq. Var. Not Assum.</i>			1.236	0.225



Table 12: Independent-samples T test between high and low organizational capital local governments

Section A: Group Statistics					
		N	Mean	Std. Deviation	Std. Error Mean
Return on Assets	High organizational capital	20	-0.0060	0.02088	0.00467
	Low organizational capital	20	0.0050	0.02417	0.00540
Liquidity	High organizational capital	20	3.2790	4.21208	0.94185
	Low organizational capital	20	2.0380	2.18183	0.48787
Total Assets Turnover (Total Sales Revenue)	High organizational capital	20	0.2710	0.10452	0.02337
	Low organizational capital	20	0.1810	0.12070	0.02699
Plant, Property, Equipment Turnover (Total Sales Revenue)	High organizational capital	20	0.1330	0.07255	0.01622
	Low organizational capital	20	0.0955	0.09660	0.02160
Total Assets Turnover (Revenues from Own Operations)	High organizational capital	20	0.3181	0.14316	0.03201
	Low organizational capital	20	0.2011	0.15029	0.03361
Plant, Property, Equipment Turnover (Revenues from Own Operations)	High organizational capital	20	0.1555	0.09185	0.02054
	Low organizational capital	20	0.1055	0.11870	0.02654
Liabilities over Total Assets	High organizational capital	20	0.1405	0.10880	0.02433
	Low organizational capital	20	0.0960	0.06159	0.01377
Debt over Total Assets	High organizational capital	20	0.0660	0.05325	0.01191
	Low organizational capital	20	0.0395	0.03980	0.00890
Perceived Quantity	High organizational capital	20	2.3500	0.74516	0.16662
	Low organizational capital	20	1.9500	0.88704	0.19835
Perceived Quality	High organizational capital	20	4.0000	0.56195	0.12566
	Low organizational capital	20	3.6000	0.59824	0.13377
Perceived Cost	High organizational capital	20	3.1500	0.93330	0.20869
	Low organizational capital	20	2.8500	0.87509	0.19568
Section B: Independent Samples Test					
		Levene's Test for Equality of Variances		t-test for Equality of Means	
		F	Sig.	t	Sig. (2-tailed)
Return on Assets	Eq. Var. Assum.	0.355	0.555	-1.540	0.132
	Eq. Var. Not Assum.			-1.540	0.132
Liquidity	Eq. Var. Assum.	1.908	0.175	1.170	0.249
	Eq. Var. Not Assum.			1.170	0.252
Total Assets Turnover (Total Sales Revenue)	Eq. Var. Assum.	0.179	0.674	2.521	0.016
	Eq. Var. Not Assum.			2.521	0.016
Plant, Property, Equipment Turnover (Total Sales Revenue)	Eq. Var. Assum.	0.083	0.775	1.388	0.173
	Eq. Var. Not Assum.			1.388	0.174
Total Assets Turnover (Revenues from Own Operations)	Eq. Var. Assum.	0.370	0.547	2.521	0.016
	Eq. Var. Not Assum.			2.521	0.016
Plant, Property, Equipment Turnover (Revenues from Own Operations)	Eq. Var. Assum.	0.008	0.929	1.490	0.145
	Eq. Var. Not Assum.			1.490	0.145
Liabilities over Total Assets	Eq. Var. Assum.	2.730	0.107	1.592	0.120

	<i>Eq. Var. Not Assum.</i>			1.592	0.122
<i>Debt over Total Assets</i>	<i>Eq. Var. Assum.</i>	1.849	0.182	1.783	0.083
	<i>Eq. Var. Not Assum.</i>			1.783	0.083
<i>Perceived Quantity</i>	<i>Eq. Var. Assum.</i>	0.013	0.911	1.544	0.131
	<i>Eq. Var. Not Assum.</i>			1.544	0.131
<i>Perceived Quality</i>	<i>Eq. Var. Assum.</i>	4.235	0.046	2.179	0.036
	<i>Eq. Var. Not Assum.</i>			2.179	0.036
<i>Perceived Cost</i>	<i>Eq. Var. Assum.</i>	0.008	0.931	1.049	0.301
	<i>Eq. Var. Not Assum.</i>			1.049	0.301

Table 13: Independent-samples T test between high and low social capital local governments

Section A: Group Statistics					
		N	Mean	Std. Deviation	Std. Error Mean
Return on Assets	High social capital	20	0.0105	0.02438	0.00545
	Low social capital	22	-0.0059	0.01469	0.00313
Liquidity	High social capital	20	2.4035	2.20103	0.49217
	Low social capital	22	2.6150	4.06790	0.86728
Total Assets Turnover (Total Sales Revenue)	High social capital	20	0.2305	0.15014	0.03357
	Low social capital	22	0.1941	0.09277	0.01978
Plant, Property, Equipment Turnover (Total Sales Revenue)	High social capital	20	0.1315	0.10505	0.02349
	Low social capital	22	0.0700	0.04721	0.01006
Total Assets Turnover (Revenues from Own Operations)	High social capital	20	0.2667	0.18927	0.04232
	Low social capital	22	0.2183	0.12699	0.02707
Plant, Property, Equipment Turnover (Revenues from Own Operations)	High social capital	20	0.1515	0.13283	0.02970
	Low social capital	22	0.0805	0.05972	0.01273
Liabilities over Total Assets	High social capital	20	0.1235	0.09980	0.02232
	Low social capital	22	0.0868	0.06622	0.01412
Debt over Total Assets	High social capital	20	0.0565	0.04416	0.00987
	Low social capital	22	0.0400	0.03952	0.00843
Perceived Quantity	High social capital	20	1.6500	0.67082	0.15000
	Low social capital	22	2.2273	0.81251	0.17323
Perceived Quality	High social capital	20	4.0500	0.51042	0.11413
	Low social capital	22	3.5455	0.67098	0.14305
Perceived Cost	High social capital	20	3.3000	1.26074	0.28191
	Low social capital	22	2.5455	0.73855	0.15746
Section B: Independent Samples Test					
		Levene's Test for Equality of Variances			
				t-test for Equality of Means	
		F	Sig.	t	Sig. (2-tailed)
Return on Assets	Eq. Var. Assum.	2.451	0.125	2.670	0.011
	Eq. Var. Not Assum.			2.610	0.014
Liquidity	Eq. Var. Assum.	0.915	0.345	-0.207	0.837
	Eq. Var. Not Assum.			-0.212	0.833
Total Assets Turnover (Total Sales Revenue)	Eq. Var. Assum.	2.455	0.125	0.955	0.345
	Eq. Var. Not Assum.			0.934	0.357
Plant, Property, Equipment Turnover (Total Sales Revenue)	Eq. Var. Assum.	7.276	0.010	2.486	0.017
	Eq. Var. Not Assum.			2.407	0.024
Total Assets Turnover (Revenues from Own Operations)	Eq. Var. Assum.	2.021	0.163	0.981	0.332
	Eq. Var. Not Assum.			0.963	0.342
Plant, Property, Equipment Turnover (Revenues from Own Operations)	Eq. Var. Assum.	7.678	0.008	2.271	0.029
	Eq. Var. Not Assum.			2.198	0.037
Liabilities over Total Assets	Eq. Var. Assum.	0.896	0.349	1.416	0.165

	<i>Eq. Var. Not Assum.</i>			1.389	0.174
<i>Debt over Total Assets</i>	<i>Eq. Var. Assum.</i>	0.439	0.512	1.278	0.209
	<i>Eq. Var. Not Assum.</i>			1.271	0.211
<i>Perceived Quantity</i>	<i>Eq. Var. Assum.</i>	0.046	0.830	-2.496	0.017
	<i>Eq. Var. Not Assum.</i>			-2.519	0.016
<i>Perceived Quality</i>	<i>Eq. Var. Assum.</i>	7.331	0.010	2.721	0.010
	<i>Eq. Var. Not Assum.</i>			2.757	0.009
<i>Perceived Cost</i>	<i>Eq. Var. Assum.</i>	3.872	0.056	2.393	0.021
	<i>Eq. Var. Not Assum.</i>			2.337	0.026

## Conclusions

The research motivation of this study was to analyse the relationship of intellectual capital with organizational performance within the context of local governments.

We have analysed intellectual capital from two epistemological stances recognised by Mouritsen (2006): IC1-ostensive view and IC2-performative view. We proxied for inferred intellectual capital which is consistent with IC1 –ostensive view by using information retrieved by accrual accounting financial statements. We assessed perceived intellectual capital of local governments that is compliant with IC2 - perspective view by using survey data collected through questionnaires. We built a classification scheme that allocates local governments to a matrix according to their scores in terms of the two intellectual capital views. Within this matrix local governments that are considered intellectual capital intensive under both views are distinguished from those that are less intellectual capital intensive.

Empirical evidence indicates that intellectual capital is equated with improved financial and perceived performance. This has been confirmed irrespectively of the theoretical view adopted for the study of intellectual capital. More specifically, intellectual capital seems to improve the efficiency and turnover ratios without creating serious debt management issues. Further, local government officers positively associate perceived intellectual capital with perceived quality and negatively with perceived cost of the services rendered.

Our study therefore verifies that the positive relation between IC and financial performance hold in the public sector as well. Apart from that, our findings have significant practical implications for the public sector especially at this period in time where there is a need for all efforts to be motivated towards performance improvement and 3Es (efficiency, effectiveness and economy) attainment.

However, our results are subject to the following limitations. Firstly, our analysis is based on a sample of Greek municipalities. Therefore there is always the question whether the results can be generalized to the entire population. Secondly, we have used some proxies in order to operationalize inferred IC. There may be other proxies that could better encapsulate inferred IC through the information presented in financial statements. Finally, the statements used in the questionnaire are considered suitable for addressing the scope of our study.

Nevertheless, the reliability of answers gathered is subject to the limitations embedded in any field study.

The above research findings might be the starting point for various other research initiatives. A replication of this study to local governments in other European countries would improve our understanding on the way IC is translated into financial performance. Moreover, further research is required to recognize and analyze the organizational mechanisms that enable local governments to realize economic benefits from intellectual capital. This knowledge will improve the management of intellectual capital and will contribute towards the implementation of New Public Management in local governments. Another important research issue is to analyze in a more explicit way how local governments perceive the relationship of intellectual capital with performance. This would enable the recognition of behavioral issues that are responsible for the lack of motivation on behalf of public sector organizations to exploit their available intellectual capital for improving their performance.

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## Appendix: Questionnaire

Questionnaire consists of 61 statements. The response scale for each statement was from (1) totally disagree to (5) totally agree. The questionnaires indicated with R where reverse coded.

Statements:

1. Local government personnel have sufficient capabilities to successfully perform their duties.
2. Local government personnel are willing to perform their duties.
3. Citizenry is a source of knowledge and skills for local government.
4. Local government personnel are sufficiently experienced for the execution of their duties.
5. Local government personnel are satisfied with the working environment.
6. Local Government management minds for the introduction of innovative management styles.
7. There is a medium term (2-5 years) training programme for local government personnel.
8. Local government personnel rely on their peers when they need help.
9. Local government cares for the training of the new employees.
10. The level of cooperation among the local government employees is high.
11. Citizenry and local organizations (e.g. athletic organizations, social associations, local businesses, citizen associations, etc.) cooperate for the implementation of local government decisions.
12. Local government utilizes the experience of municipal employees with several years in service.
13. Local government employees directly abide by local government decisions.
14. Local government offers citizenry and local businesses direct information and support for the activities they want to develop.
15. Local Government gets the necessary information and know-how for the support of its operations by the Ministry of Interior.
16. The quality of services would be improved if they were assigned to a private company (R).
17. Suppliers constitute a source of know-how for the Local Government.
18. Some employees, in order to hide their deficient productivity, negatively affect the performance of their peers (R).
19. Local Government rewards employees performing actions that improve its operations.
20. Local Government personnel want to actively participate in decision making.
21. Local government financial health is directly related with the financial health of the businesses in the area.
22. The level of cooperation between the Local government personnel and the local organizations is high.
23. Local government personnel are willing to undertake more responsibilities.
24. Local government offers services through the internet.
25. The financial survival of a considerable number of local businesses relies on local government expenditures.
26. Local government personnel seek moral recognition from their social surroundings.
27. The quantity of services offered by the Local government could be considerably increased (R).



28. The educational level local government personnel is higher to what needed for tasks execution.
29. Citizenry considers local tax burden to be excessive (R).
30. Local Government uses both local and national Media as a means of communication with the citizens.
31. Local Government personnel feel responsible for the success of the Local Government programmes.
32. Local Government personnel are satisfied with the duties assigned to them.
33. The cooperation of Local Government with the Ministry of Interior for local government policy issues is satisfactory.
34. Some employees express their dissatisfaction on a systematic basis (R).
35. Citizenry participates actively in decision-making.
36. Local Government personnel have the ability to adjust to the changes that take place in their working environment.
37. Local Government utilizes the experience and the capabilities of local organizations (e.g. athletic organizations, social associations, local businesses, citizen associations, etc.) to improve its operations.
38. Local Government personnel want to get specific and precise directions for performing their tasks.
39. Local authorities are a source of knowledge for Local Government.
40. Local government encourages its personnel to cooperate and share knowledge and experiences.
41. Local Government cares about the promotion of culture within the local society.
42. The financial health of the majority of citizenry is influenced by local government expenditure.
43. Local Government is effectively supported by the central government in order to confront problems.
44. Local Government is familiar with new technology and internet use.
45. Local government personnel and citizenry cooperate successfully.
46. Suppliers are consistent with their contractual obligations.
47. Local Government cares for the quick integration of immigrants in the local community.
48. Local Government employees are encouraged to take initiatives.
49. The financial health of the local government is directly related with the financial health of the citizenry.
50. Local government has in place and implements a short term yearly programme for personnel training and education.
51. Cultural and educational expenditure corresponds to a significant percentage of local government expenses.
52. Local government encourages the participation of employees in decision-making.
53. The quality and the quantity of service provision could be substantially improved if tighter control was in place (R).
54. Local government personnel mind to be informed about changes in the legislation and the statutory framework.
55. Local government employees are willing to openly express their views.
56. Local government employees are satisfied with the level of safety in their working environment.

57. Both citizenry and local businesses are consistent with their financial obligations towards the local government.
58. Citizenry uses the internet to submit their complaints.
59. Local government implements e-governance programmes.
60. Local government personnel cooperates with citizenry in harmony.
61. Local government cooperates with relevant Ministries for financial issues in a satisfactory manner.

## THE ROLE OF SICILY IN THE MARITIME TRAFFIC OF AGRI-FOOD PRODUCTS IN THE MEDITERRANEAN BASIN

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### Abstract

This paper shows the results of a survey on trade flows to agri-food products among Sicily and the non-EU countries of the Union for the Mediterranean, through maritime transport. The aim of this paper is to outline the role that Sicily plays in respect of trade in agricultural products through the maritime mode considering its strategic location in the Mediterranean basin. Political reference scenario is that of the Union for the Mediterranean and EU Mediterranean Transport Policy (motorways of the sea).

The work contains an analysis of the evolution of maritime trade in agri-food of Sicily, in the main ports of departure and arrival, with non-EU countries of the Union for the Mediterranean, estimated on the basis of data provided specifically by the Customs Agency of the Italian Ministry of Economy and Finance.

The relative geographical orientation index has allowed to estimate the geographic specialization of the island, compared to Italy, in the maritime trade of agri-food products with non-EU Countries bordering the Mediterranean Sea.

The results highlight how Sicily, thanks to its particular geographical position is one of the most specialized partner in the maritime trade with the other Mediterranean countries. These trades are gradually increased over the last decade, both in terms of absolute value and in relative terms, concerning the traffic of agri-food products. It is evident, therefore, as the creation of motorways of the sea linking Sicily with the coastal countries of the South and East of the Mediterranean could constitute an further factor of economic integration.

**Keyword:** Agri-food trade; Maritime traffic; Euro-Mediterranean Policy; Sicily.

### Introduction

By the declaration signed by 43 States and the European Commission, is launched in Paris in 2008, the Union for the Mediterranean with the desire to pursue a dialogue between North and South banks already started, first with the agreement of Barcelona (1995) and subsequently with the European Neighbourhood Policy (2004) a complementarity and cooperation. The Paris Declaration defines a new regional plan of action identifying six priority projects considered strategic to reunite Europe and Africa to Countries bordering the Mediterranean (Aliboni, 2008). The development of motorways of the sea and terrestrial, with

the aim of supporting the movement of goods and persons, integrating the system of transport of the European Union with the countries of the South, is the priority objective of the new policy in the field of transport. The interest for the motorways of the sea was established following the recognition of the centrality of the Mediterranean for the traffic of goods not only among countries but also for international maritime trade with the Far East. The Mediterranean is, in fact, one of the areas in which the transit of goods by sea, crossing the Suez Canal, the strait of Gibraltar and the Bosphorus, is the heaviest (Vallouis, 2010). In this context, the creation of a trans-Mediterranean transport network is considered one of the factors capable of promoting euro-Mediterranean integration, contributing to the socio-economic development of coastal countries, from European, Middle Eastern ones, to those in Africa and the Balkans.

In this context, Italy and particularly Sicily, can play a strategic role by exploiting their geographical location in the Centre of the Mediterranean, assuming the function of catalysts of maritime trades involving both countries of the South and East Mediterranean, both Asian countries. Motorways of the sea, as well as designed, may, therefore, represent preferential corridors to intensify the exchange of goods between the two shores of the Mediterranean, contributing to accelerating the integration process, which we should have to have already in 2010 by the creation of the Free Trade Area but that it is still hard to materialize. In this context, the agri-food trade, cannot remain outside the process of integration, especially in order to the strong similarity and completion of the Agriculture of the two shores of the Mediterranean (Crescimanno, 2007). On these considerations, the present work that aims to outline the role that Sicily plays in the context of maritime trade of food products with non-EU countries of the Union for the Mediterranean and to verify if the location of the island at the Centre of the Mediterranean could have a strong commercial vocation towards the area of reference. On the basis of the results of this study we highlight the opportunities that the new euro-Mediterranean policy can provide, as concern the transport, first of all through the creation of motorways of the sea corridors, which would contribute to the consolidation of preferential flow of trade between the two shores of the Mediterranean, in particular in Sicily.

### **Methodological approach**

In order to define the reference background of the sea traffics of the agro-food products between Sicily and the extra EU Countries of the Union for Mediterranean, we have referred to the data suitably provided by the Office of Economic and Fiscal Studies - Custom Agency of Rome concerning the trade volumes, expressed in customs value and quantity, passed in the main harbours of the Island and in the origin and destination Country. The partners taken into account are the Countries which underwrote the institutive document of the Union for the Mediterranean and Albany, Algeria, Bosnia-Herzegovina, Croatia, Egypt, Jordan, Israel, Lebanon, Libya, Morocco, Tunisia, Turkey and Montenegro in particular, to which Serbia joins, whose datum appears, for the whole reference period, related to the Montenegro's one.

The data showed in this paper, in particular, refer to the 2001-2010 period and to the group of agro-food goods (chapter 01-24 of the customs tariff of integrated use), entering and going out from 8 of the Sicilian harbours (Augusta, Catania, Marsala, Palermo, Pozzallo, Siracusa, Termini Imerese and Trapani).

Beginning from available data, we have analyzed the market quota (market of share) hold by Italy and Sicily comparing with the extra EU Countries of the Union for Mediterranean, allowing to draw the map of the main trade partners.

Then, to appreciate the importance of the maritime traffic in the whole agro-food exchange area, the relationship between the volumes exchanged by Sicily by sea with the Countries of the Union for the Mediterranean and the ones with the rest of the world has been calculated, in this case for the 2000-2009 period, compared with the same relationship concerning the whole agro-food exchange (which comprehends the several transport systems), analyzed through the data bank of the National Institute of Agricultural Economics Research (INEA).

Finally, to identify the Countries of the Union for the Mediterranean with which the maritime traffics of agro-food products from and to Sicily are more intensive, the Relative Geographical Orientation Index has been used (Iannone, Varrone, 2006; Lombardi, 2000) which allows, in this case in particular, to measure Sicily's specialisation, compared to Italy's one, and then to calculate the more or less propensity of the island to deal with the Countries of the reference area. More specifically, the index used allows to estimate how much Sicily trade weight is higher than Italy's one in the same reference context. The indicator is calculated normalizing the quota of Sicily's mutual exchange - meant as sum of exports and imports towards a specific Country on the trade volume with the whole reference area- for the corresponding quota of Italy's maritime exchanges from and to the same Countries.

An index value above (under) one indicates a higher (lower) geographical concentration of Sicily's trade flows with the extra EU Countries of the Union for Mediterranean, than the trade flows with Italy. This kind of analysis, in particular, allows to verify the trend effects caused by the market differentiated growing and particularly evident in the foreign trade (Lombardi, 2000; Mori, Rolli, 1998).

$$I_{jt}^{Sicily} = \frac{X_{jt}^{Sicily} + M_{jt}^{Sicily}}{X_{Medt}^{Sicily} + M_{Medt}^{Sicily}} \bigg/ \frac{X_{jt}^{Italy} + M_{jt}^{Italy}}{X_{Medt}^{Italy} + M_{Medt}^{Italy}}$$

Where,  $I_{jt}^{Sicily}$  is Relative Geographical Orientation Index of Sicily in the maritime traffic to/from the j countries at the time t, X is export value, M is import value, j is a country, Med are the Mediterranean partners and t is year of reference (2001, ..., 2010).

The index, obtained starting with the trade volumes expressed in customs value, has been calculated for each of the Mediterranean partner and for the years of which we had the statistic datum.

### 3. The Euro-Mediterranean Policy scenario

Since 1972 the Mediterranean Policy of the European Union has caused deep changes, due, firstly, to the changes in the strategic aims of the Union and the neighbouring areas and, secondly, to the fact that they haven't achieved the aims of the Euro-Mediterranean partnership plan and of the latest European Neighbourhood Policy (Galati, 2010).

The enterprise of an Union for the Mediterranean comes from the awareness of the importance that the Euro-Mediterranean policy has got in the European communitarian cohesion, weakened firstly by the enlargement of the European Union towards the neighbouring Middle-East Europe Countries, and secondly by the introduction in the European Neighbourhood Policy of the East-Europe and Caucasian Countries, causing a stronger and stronger rejection of the North-African and East partners, influencing the home political balance of the European Union itself (Aliboni, 2008).

The Union for Mediterranean opens, then, a new political phase which, as it was written in Rome Declaration in December 2007, it doesn't intend to *"replace the cooperation and dialogue procedures in which the Mediterranean Countries have been associated, but to complete them, giving them a further impulse in a complementary and cooperation spirit with all the existing institutions"*. In other words, the Declaration of Barcelona (1995) and the Neighbourhood Policy in 2004, keep on maintaining their central position, but a bigger dynamism is given to them.

The 13th July 2008 the Euro-Mediterranean Heads of State and the Prime Ministers met in Paris and launched officially the "Process of Barcelona: Union for the Mediterranean" with a declaration underwritten by 43 Countries and the European Committee, laying the foundations for a new policy addressed to a strategic area for the EU both from political and trade point of view, but well-grounded on the *acquis* of the Process of Barcelona.

With reference to the Euro-Mediterranean partnership, two new important elements concerning the new geo-political configuration of the area and a new institutional structure are introduced.

About the first matter, the geo-political configuration appears completely new because it is addressed not only to the Northern-Africa Countries and to the Near East (Algeria, Palestine, Egypt, Jordan, Israel, Lebanon, Morocco, Syria, Tunisia, Turkey), but to other countries of the Southern Europe which don't take parts in the EU and, in particular, to the area of the West Balkans (Croatia, Bosnia-Erzegovina, Montenegro and Albany) and some Mediterranean Countries left out before, as Monaco and Mauritania. This fact led to the loss of centrality of the Northern-Africa and the Near East Countries, kept until the summit in Paris, involving a strong heterogeneity concerning requirements and aims, not always the same, of this new

geo-political area which can be a strong obstacle to the Euro-Mediterranean cooperation process.

Another innovative element concerns the institutional structure of the Union meant as Inter-Government Organization headed by a Coo-Presidency (a President from the EU and one from the Partner Countries) and by a Secretariat which deals with the policies and the plans passed by the Union for the Mediterranean. This involves the passage from a European Union policy coordinated by the Presidency to an inter-government Policy in which the EU is one of the members and not the only one to take decisions, reducing, that way, the role of the Committee and giving more emphasis to the inter-government principle (Zallio, 2008). The aim is to give an answer to the lack of mutual and equal relationship so much emphasised but never realized in the Mediterranean policy of the European Union.

The Union for the Mediterranean works on two pillars. The first provides, as we have already said, a joined participation of the European Union and its partners, while the second is based on the focalization of some strategic aims shared by the Euro-Mediterranean citizens, and partly provided in the Communication of the European Committee in 2008 – COM (2008) 319 final-, through which the Union for Mediterranean should give a tangible foundation to the Euro-Mediterranean solidarity and to its views of political cooperation (Aliboni 2009).

The priority projects regarding the second pillar, in brief, concern six significant matters of strategic interest as environment, transport, solar energy, civil protection, higher education and the entrepreneurial development. The following enterprises have been found, in particular: fight against the Mediterranean pollution; sea and land highways; civil protection; development of alternative energies; education and research; Mediterranean enterprises for business development.

The implementation of maritime and land highways represents one of the major initiatives identified in the Union for the Mediterranean with the desire to give new impetus to the euro-Mediterranean policy in a spirit of complementarity and cooperation. The project originated with the aim of improving the movement of goods and people through the integration of the transport system between the two shores and within countries of the South it is considered one of the necessary conditions for achieving economic and social integration, has long advocated, and especially for the success of the planned free trade area, scheduled for 2010, but who have not yet realized.

### **The motorways of the Sea and the Euro-Mediterranean integration process**

The word sea highways appears for the first time in the White Book of the European Transport Policy - COM(2001) 370 final- in which, among the several enterprises in view, the development of sea short-distance connections between the harbours of the European Union Countries is particularly emphasised, identifying just in the sea highways a competitive alternative to the land transport, heading among the several systems, looking at the question

through a transport system which can be met from the economical, social and environmental point of view (Foschi, 2004). The need to ensure mutual ways, in particular, is due to the necessity to solve some gaps of the European transport system related to the strong imbalance among the several transport systems, to the traffic in the main transport routes, but above all to the consequences of the environmental pollution due to the several transport systems.

Nevertheless, in the integration process of the Euro-Mediterranean transport system, the sea highways have got a different role, not concerning the need to reduce the road traffic anymore, but, as we can see in the Blue Paper (Blue Paper, 2005), the necessity to improve the service quality and to reduce the environmental impact.

According to these considerations, we have to distinguish the Mediterranean highways, which link up two of the European Union harbours on the Mediterranean sea, and the trans-Mediterranean highways which, instead, link up the harbours of the Coast Countries (Weigert M., 2010).

In the last years, the European Union attention towards the Euro-Mediterranean cooperation about transport has become higher and higher. In the Declaration underwritten in Barcelona in 1995, the importance of an efficient transport system was considered necessary to reach the Euro-Mediterranean partnership aims and to create a Free Trade Area in particular. The necessity of a reform in the transport system of the Mediterranean Partner Countries and the introduction of this aim among the national economical settlement programs, was later confirmed again in the Meeting of Lisbon and Helsinki in 1997, where the principles for the development of a multi-way transport network and for efficient transport services were established. The establishment of a Euro-Mediterranean Transport Forum in 1998, with the aim to increase the cooperation in the transport sector, led to work out a regional action plan concerning all the transport modalities without any distinction. Referring to the carriage by sea, in particular, for the period 1999-2001, 11 projects concerning the harbours management and the manipulation of dangerous goods were defined. Later, in 2001, the Euromed Transport project passed by the European Committee, aimed to create an integrated multi-modal transport system on regional-scale in order to encourage the cooperation with the South-Mediterranean Countries.

The European Neighbourhood Policy itself started up in 2004 after the enlargement of the European Union to the Middle-East Europe Countries and, in particular, towards two Mediterranean islands, Cyprus and Malta, has offered to its neighbouring partners some cooperation opportunities through bilateral action plans about transport as well, favouring the integration of the transport networks. The transfer of the trans-European transport network towards the neighbouring countries led to the determination, by the High Level Group, of transport corridors and priority projects along these routes.



The importance of transport short sea shipping appears in the Blue Paper (Blue Paper, op.cit.), on the transport system integrated Euro-Mediterranean, conceived with the desire to remove obstacles to the development of the transport system determining the transition from a fragmented system to a well harmonized and integrated. In particular, the axis 3 of the plan carefully the shipping as arrangements can ensure a continuous flow of goods connecting the different modes of transport, and identifies the motorways of the sea preferential corridors to strengthen the multimodality in the region.

The tangible carrying out of the sea highways project assumes, however, the solution of the regional transport infrastructural gaps and, in particular, it requires: *“measures to improve the quality of infrastructure and services in ports, to ensure good connections from the ports to their hinterland but also to stimulate more frequent and reliable shipping services are essential. Good intermodal connections between ports and the road, rail and inland waterway networks are also necessary”*(Blue Paper, op.cit.).

The guidelines contained in the Blue Paper and previously supplied by High Level Group have been formally adopted at the Ministerial Conference in Marrakech on December 2005 and subsequently included in the Regional Transport Action Plan for the Mediterranean Region 2007-2013 (RTAP), developed in 2007. With special reference to transport infrastructure, the objective of the RTAP is to modernize existing structures, rather than creating new ones, improving logistics services afforded to them, taking into account the different conditions of development of countries in the area. In particular, the project 21 of the RTAP deals specifically with the motorways of the sea recognizing their importance for the entire Mediterranean region, in particular to create conditions for a real Euro-Mediterranean integration which, however, can not in any way be realized without the enhancement of other modes of transport, port, road and rail.

A specific project for motorways of the Sea, the MEDA-MoS launched in 2006 in the context of EuroMed Transport, identifies two MoS pilot projects aimed at widening the trans-European transport network to the West Mediterranean area and East Mediterranean area region. The goal is to create an effective network of intermodal freight transport between the two sides in a perspective of integration and cohesion of the transport networks between the Mediterranean's countries. Implemented are planned 11 projects of motorways of the sea, which Sicily is actually out of, linking the ports of Southern and Eastern Mediterranean with those of the Mediterranean countries of the European Union; of the works planned, 5 motorways of the sea would connect some of the Mediterranean partner countries with the Italian ports of Trieste, Genoa and Livorno.

### **The maritime exchanges of Sicily's agro-food products with the extra EU Countries of the Union for Mediterranean**

Italy's trade relationships with the Countries of the Southern and Eastern side of Mediterranean Sea have straightened in the last years because of the geographical nearness which characterizes the Countries of the area taken into account, and also of a growing demand for Mediterranean agriculture products which the neighbouring partners are able to offer in the European market at sometimes competitive prices.

Since earliest antiquity, the maritime modality has served as a channel for trade both between the countries bordering upon it and later, with refinement of navigation techniques, with the other regions of the world (Quéguiner, 1979).

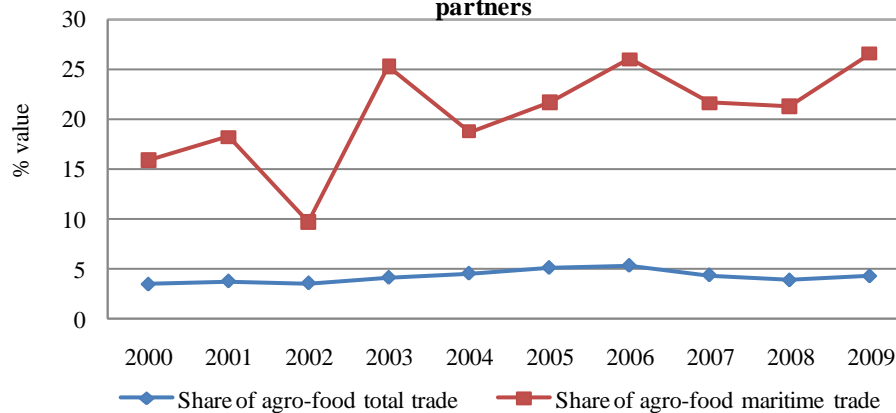
Italy, during the last decade (2001-2010), has significantly developed the maritime traffic of agro-food products with the Countries of the Southern and Eastern side of Mediterranean Sea, doubling the trade volume both from quantity and value point of view. In fact, the quantities exchanged have passed from 455,6 thousand tons in 2001 to more than a million in 2010 and the corresponding value, in the same period, has raised from 436,5 millions Euros to 714,7 millions Euros, recording, respectively, a yearly average growth rate of 12,1% and 6,4 %.

Italy's privileged partners are, in order, Turkey (25,4%), Israel (21,9%), Tunisia (16,9%), Morocco (13,4%) and Egypt (12,0%), which currently (2010) cover the 89,8% of the maritime agro-food traffics with the whole area.

Like the national trend, Sicily also has better developed its role of logistic platform for exchanges of agro-food products by sea with the other Coast Countries, though its weight from the national point of view don't go over the 11% in the reference period, for the inadequacy of the port structures as well. The maritime traffic of agro-food products from and to the extra- EU Countries of the Union for the Mediterranean has reached in 2010 a volume of 96,2 thousand tons compared with the 9 thousand tons of 2001, recording a yearly average growth rate of 96,9% a lot over the national one, highlighting, therefore, a growing tendency of the Island to deal with the Countries of the area. From the customs value point of view the dynamics are positive as well. In fact, they have passed from 18,3 million Euros of 2001 to a value of 63,4 millions Euros in 2010, recording, in the reference decade, a yearly average growth rate of 24,7%, in this case above the same national datum too.

Besides, by analysing the data, we can notice that the mutual maritime agro-food exchange between Sicily and the extra-EU Countries of the Union for Mediterranean shows a higher weight than what we found considering all the transport systems (Figure 1), giving importance to this system for the exchanges between the two areas. We can see, therefore, that maritime exchanges of agro-food products of Sicily with the Countries taken into account have recorded in the reference period a growing trend with an effect on the exchanged volumes, on the whole, which goes from 15,9% in 2000 to 26,6% in 2009.

**Figure 1 - Relationship between maritime traffic and total trade in agri-food products among Sicily and the Mediterranean partners**

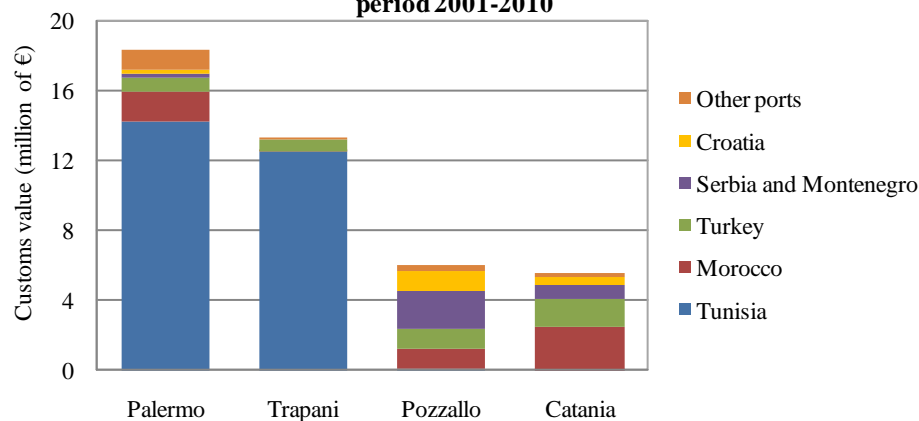


Source: Our elaboration on Data Warehouse Custom Agency, Rome and INEA, Rome.

For what the main partner Countries are concerned, Tunisia represents the most important reference market, having in 2010 the 58,7% of the value of the maritime traffics on the whole, keeping its leadership in the reference period. Also Turkey is important, whose trade with Sicily represents the 16,7% of the exchanges with the whole area, and Morocco as well (8,4%). More in details, in the reference decade Turkey's importance grows both in goods supplying and market in the agro-food sector but, on the contrary, Tunisia and Morocco's weight is lower, countries that in 2001, had respectively the 72,6% and the 16,4% of Sicily's maritime traffics with the whole area.

With reference to the trade volumes of the agro-food products passed in the Sicilian harbours (departure and arrival harbours) (Figure 2), in the decade 2001-2010, for the quantities dealt with, Pozzallo's port is the most operative, which is in the Southern Sicily with the 45,9% of the volumes passed in the ports of the Island, followed by Catania (22,5%); on the other hand, as for the value, Palermo's port, with the 42,3% of the exchanged volumes with the whole area, and Trapani's one (30,5%) are important. This asymmetrical distribution between quantities dealt with and product value is due to the kind of the goods exchanged and consequently to its unit value.

**Figure 2 - Maritime traffic of agri-food products among sicilian ports and major Mediterranean countries partners - Average period 2001-2010**



Source: Our elaboration on Data Warehouse Custom Agency, Rome.

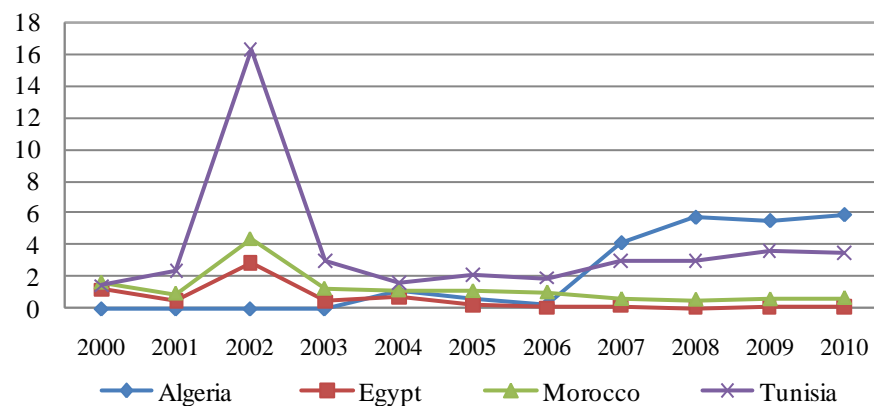
The leaving and the arriving goods in Palermo's port, in particular, are exchanged almost exclusively with Tunisia which, in the decade 2000-2010, covers the 77,4% of the maritime agro-food trade. The situation of Catania's port is different: it shows a higher value in the exchanges with Morocco (43% of the amount) and Turkey (28,9%). The exchanges of agro-food products of Pozzallo's Port are carried out above all with Serbia and Montenegro. (36,0% of the amount) and a bit less with Morocco (19,4%) and Croatia (18,3%). In the end, about Trapani's Port, the analysis underlines that the maritime exchanges of agro-food products are catalyzed almost completely with Tunisia (94% of the total trade).

### Geographical specialization of Sicily

The analysis of Sicily's geographical specialization in maritime traffics of agro-food products with the extra-EU Countries of the Union for the Mediterranean compared with Italy's one, has been carried out by calculating the relative geographical orientation index.

The indicator highlights, for 2010, value higher than one for Algeria, Serbia, Montenegro, Tunisia and Lebanon, towards which Sicily shows a higher propensity to exchange agro-food products than Italy does (Figure 3a and 3b). Turkey shows, on the contrary, values below one, though it has got considerable quotas of the maritime traffic in the whole (16,7%), and Egypt, with which the maritime traffic of agro-food goods is rather more modest than the trade volumes concerning the national territory. Algeria shows the highest index, considering that the maritime traffics with Sicily represent the 52,4% of the national exchanges. Also for Serbia and Montenegro the Sicilian trade specialization is higher than the Italian one (4,9): the volumes exchanged between the two areas represent, in fact, the 43,3% of the corresponding Italian maritime traffics. Tunisia and Lebanon are other important trade partners, with which Sicily shows a significant tendency to trade, even considering the importance that the maritime exchanges with these Countries themselves have got in the national background.

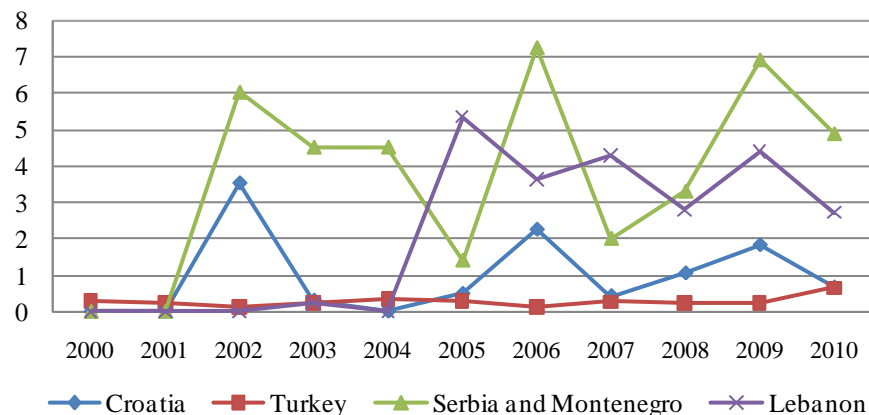
**Figure 3a - Relative Geographical Orientation Index of Sicily with the main Mediterranean partners**



Source: Our elaboration on Data Warehouse Custom Agency, Rome.

The indicator trend shows, in the whole, in the last decade an increase of the tendency of Sicily, compared with the Italy's one, to trade agro-food products with the area, though some Countries show wavering index values, since they are related to the trend of the maritime exchanges and consequently to the corresponding mutual exchange quotas. More specifically, reading Algeria's index, it shows an increasing specialization of Sicily in the reference period. As far as Serbia and Montenegro are concerned, the time analysis, shows an increasing geographical specialization of the Island in the agro-food trade, though in the reference period we can observe a strong variability related to strongly wavering maritime traffics values. About Tunisia, we can notice, on the whole, a growing tendency to trade which seems particularly noticeable in the period 2000-2002, but it goes roughly reducing in 2003, when it starts having an increasing trend again. Sicily's maritime exchanges with Lebanon, though covering a low quota of the traffics with the entire area (0,6%), are important from the national point of view (24,2% of the national traffics value). The trend of the relative geographical direction index, in particular, shows, on the whole, an increasing specialization of Sicily, although since 2005 we can notice a descending trend of the index value, highlighting a progressive loss of the regional specialization for the agro-food productions exchanged with the Country.

**Figure 3b - Relative Geographical Orientation Index of Sicily with the main Mediterranean partners**



Source: Our elaboration on Data Warehouse Custom Agency, Rome.

Turkey, Morocco, Croatia and Egypt, moreover, as we have already underlined, are important trade partners, with which Sicily doesn't show, concerning 2010, a geographical specialization, compared with Italy, even if the Countries themselves have got considerable market quotas. While in the maritime traffics with Turkey and Egypt, in particular, Sicily seems to be de-specialized, also because of a low weight which the maritime traffics with the two Countries cover in the national traffics system, for Morocco and Croatia, we can see, in the whole, a fall-off of the tendency to trade since 2002.

## Conclusion

In the last few years the Euro-Mediterranean transport policy has repeatedly emphasized the importance of maritime transport and in particular the motorways of the sea for the Euro-Mediterranean integration process and the success of the free trade which in 2010 is still difficult to take place. The Union for the Mediterranean, recognizing the importance of an integrated transport system between North and South shores, considered the motorways of the sea as a part of a package of six priority initiatives.

The commercial relations between Italy (especially Sicily) and the other Mediterranean partners are now well established for decades, due to, firstly, the geographical proximity between the countries of the area, secondly, to growth of Cross-application of agro-food. As to trade, maritime transport has always been the primary way of connection between the two sides, especially in the last decade, but especially from Italy to Sicily, which has a significant increase in maritime trade products agro-food partners with neighbors. In this scenario, Sicily has played a role significant during the above years, but a marginal one in cooperation of its geographical position. The reasons could be found through a further investigation traced to point out the inadequate port infrastructure, the lack of logistics services in ports of the island, which created a low frequency of maritime links with neighboring partners. These

factors, seen as a whole, are likely to marginalize further Sicily on in the great maritime trade of the Mediterranean basin.

The results of the analysis highlight that the presence of Sicily within Italy has significant role, especially with some partners of the southern and eastern Mediterranean, particularly with Algeria, Serbia and Montenegro, Tunisia and Lebanon. In the last decade a consolidation of geographical specialization respect to Italy turns out to occur. With other partners, such as Turkey, Morocco, Croatia and Egypt, it is clear, however regard to that Sicily is more specialized than Italy as a whole. Finally, the position of Sicily in the circuit of the motorways of the sea connecting the countries bordering one southern and eastern shores of the Mediterranean could be an important opportunity for the economy of the Island.

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## EVALUATION OF SCALABILITY AND PERFORMANCE OF SOLARIS TRUSTED EXTENSIONS USING CONTAINERS VIRTUALIZATION TECHNOLOGY

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### Abstract

Server and system administrators have been concerned about the Techniques on how to better utilize their computing resources. Today, there are many technologies in use for this purpose, which consists of running multiple applications and multiple operating systems on the same hardware, like VMWARE, Linux-VServer, VirtualBox, Xen etc. These systems try to solve the problem of resource allocation from two main aspects: running multiple Operating system instances and Virtualizing the operating system environment. Our study presents an evaluation of scalability and performance of an operating system virtualization technology known as Solaris Containers, with the main objective on measuring the influence of a security technology known as Solaris Trusted Extensions. Solaris Trusted Extensions provides today a special configuration of the Solaris operating system aiming in providing multi-level security functionality. We will study its advantages and disadvantages and the overhead that it introduces to the scalability of the system's main advantages. To evaluate performance, we benchmark a number of metrics using the AIM benchmark. We calculate these benchmarks and effects on the entire OS, for the global Container, a non-global Container, and a large number of concurrently running non-global Containers.

**Keywords:** Solaris Containers, Virtualization, Trusted Extensions, Kernel Based Virtual Machines, Virtual Operating Systems.

### Introduction

During the latest years, a lot of projects have been looking on virtualizing operating system environments, such as FreeBSD Jail, Linux-VServer, Virtuozzo etc. This virtualization technique is based in using only one underlying operating system kernel. Using this paradigm the user has the possibility to run multiple applications in isolation from each other. The basic idea can be normally described as running groups of processes that cannot be interrupted by others in different virtual environments.

Solaris Containers are built on the same paradigm, offering virtualization on the operating system-level. Solaris approach on Virtualization, extends its virtual operating system environment to include many more features of a separate machine, such as a per-Container console, dedicated system log, packaging database, run level, identity (YP, NIS), and IPC facilities. They make it possible to run more than one instance of the operating system into

the same kernel. Many of the resources of our Server architecture are usually not properly and efficiently used, like CPU cycles, RAM, storage etc. With this technology we can better utilize these resources and make them useful for the entire.

These Containers act as completely isolated virtual machines within a computer aiming to reduce costs in both hardware and system administration. Furthermore, the Solaris Containers mechanism can provide protection through compartmentalization for separate virtual machines on a single physical machine. It is cheaper to install and to configure, because only a single copy of OS is involved, compared to several OS instances in the case of Xen. Furthermore, it is not limited for high-end systems compared to logical partitioning. Moreover, the granularity of resource allocation is fine-grained than the logical partitioning. In comparison to virtual machine monitors, Solaris Zones reduces performance overheads and reduces the cost of administration because there are no multiple operating system instances in a system.

## **Operating Systems**

Solaris/OpenSolaris are Operating Systems, which make them the main building blocks of computer systems, and provide the interface between user applications and computer hardware. An operating system is a program that acts as an intermediary between the user of a computer and the hardware. The purpose of it is to provide an environment in which a user can execute programs in a convenient and efficient manner. As stated by Silberschatz (2002) Solaris is a multiuser, multitasking, multithreading operating environment, developed by Sun Microsystems. Solaris is a Unix-based operating system introduced by Sun Microsystems in 1992 as the successor to SunOS. Solaris is known for its scalability, especially on SPARC systems, and for its features such as Zones, DTrace and ZFS. The majority of it's codebase is now open source software via the OpenSolaris project. Watters (2005) explained that OpenSolaris is an open source operating system based on Sun Microsystems' Solaris. It is derived from the Unix System V Release 4 codebase, with significant modifications made by Sun since it bought the rights to that code in 1994. It is the only open source System V derivative available.

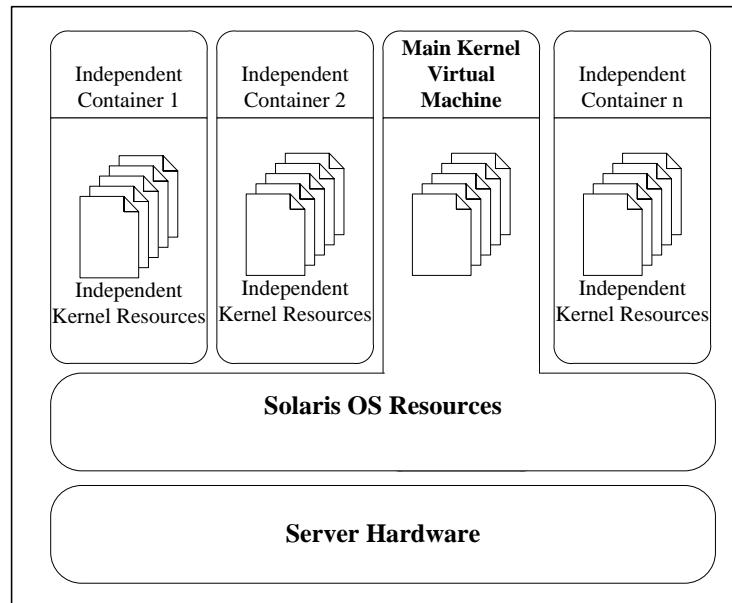
## **Containment Strategies**

A Solaris Container is a runtime environment for applications. Parts of the container are Solaris 10 Resource Manager and Solaris Zones. Zones isolate application components from one another even though they share the same instance of the Solaris OS. The container establishes limits for resource consumption, such as CPU, memory. Sun's BrandZ technology is used to run Linux applications on the Solaris Operating System. Linux applications run unmodified in the secure non-global zone environment. This enables the developing, testing, and deploying of Linux applications on Solaris. Related Containment Technologies on other operating systems are: chroot (Unix OS), FreeBSD jails , Systrace, AppArmor, Xen and VMWare.

AIM (Advanced Integration Matrix) The AIM Multiuser Benchmark, also called the AIM Benchmark Suite, is a job throughput benchmark widely used by UNIX computer system vendors. AIM is a program written in C that forks many processes called tasks, concurrently running random set of subtests called jobs. There are 53 kinds of jobs, with different aspect of the operating system, such as disk-file operations, process creation, user virtual memory operations, pipe I/O, and compute-bound arithmetic loops. Each subrun reports a metric of Jobs completed per minute, with the final report for the overall benchmark being a table of that throughput metric versus number of tasks. A given system will have a peak number of tasks  $N$  at which the jobs per minute is maximized. Either  $N$  or the value of the jobs per minute at  $N$  is the metric of interest. The peak performance is the highest jobs/minute the system achieved. The sustained performance is the square root of the total area under your performance curve up to the point of crossover. The point of crossover is that point at which the Jobs per Minute/User Load = 1.0. The JTI (job timing index) rating is the worst case JTI.

### **Solaris Zones**

Solaris Zones are a component of the Solaris Container environment. A zone is a virtualized operating system environment created within a single instance of the Solaris Operating System. When creating a zone, we produce an execution environment where processes are isolated from the rest of the system. This isolation prevents processes that are running in one zone from monitoring or affecting processes that are running in other zones. Even with superuser permissions a process cannot view or affect activity in other zones. A zone also provides an abstract layer that separates applications from the physical attributes of the machine, like physical device paths. We can create a maximum number of 8192 zones on a system. There are two types of non-global zone root file system models: sparse and whole root. The sparse root zone model optimizes the sharing of objects. The whole root zone model provides the maximum configurability.



*Kernel Virtualization Technology using the Container approach*

The commands to install, boot, halt, uninstall and clone non-global zones are `zoneadm`, `zonecfg` and `zlogin`. The cycle of zones is: Configured → Incomplete → Installed → Ready → Running.

### Advantages and Disadvantages

Zones are used for systems that integrate a number of applications on a single server. Its advantages are the lower cost and complexity of managing numerous machines. They enable more efficient resource utilization of the system. Other advantages are the isolation that this technology introduces to the services and also the security. We have a higher level of security using Zones because in case of an attacker breaking into the zone, he cannot break into the other non-global zones or into the global zone. So a zone is completely isolated and it is transparent from the rest of the system. It communicates with the rest of the system through networking API. A zone does not need a dedicated CPU, a physical device, or a piece of physical memory. These resources can be multiplexed across some zones, or allocated using the resource management feature. Some disadvantages are that the zones need some extra resources, like file system usage, processor cycles and memory usage.

### Isolation and Security

Solaris Zones partitioning technology, provides a means of virtualizing operating system services to create an isolated environment for running applications. This isolation prevents processes that are running in one zone from monitoring or affecting processes running in other zones. Basic communication between zones is accomplished by giving each zone IP network connectivity. An application running in one zone cannot observe the network traffic of another zone. This isolation is maintained even though the respective streams of packets

travel through the same physical interface. The applications are also prevented from monitoring or intercepting each other's network traffic, file system data, or process activity. Actions taken by a zone administrator in a non-global zone do not affect the rest of the system.

## Design and Implementation

The test and experiments are based on the following hardware system configuration:

*Toshiba Satellite A110, PSAB0E-00F00MGE, Genuine Intel ® CPU T2250 @ 1.73 GHz, Physical Memory 1527 MB (Kingston DDR2 PC2-5300 1024MB, Samsung DDR2 PC2-4300 512MB), RealTek RTL8139/810x Family Fast Ethernet NIC, Western Digital WDC WD2500BEVS-00UST0 ATA 250 GB (8MB buffer size), 51GB ZFS partition.*

And the operating system and software characteristics are like below:

*SunOS 5.11 snv\_101b i86pc i386 i86pc Solaris, which is OpenSolaris 2008.11 but this are also applicable to Solaris 10, AIM (advanced integration matrix) benchmark v7 and v9 Caldera International, Inc.*

We will make our experiments based on the creation, installing and booting of zones. The goal of the experiments is to minimize the overhead introduced by the zones regarding to memory, storage and processing power. The first part consists in the configuration and the installation of a zone. We estimate the zone creation with the time and du utility to measure the disk usage. We create the zone in the following way:

```
zonecfg -z zone1 "create; set
zonepath=/zones/zone1; set autoboot=true; add net; set address=192.168.0.1/24; set
physical=rge0; end; commit; exit"
```

Next we install the zone and estimate it with: *time zoneadm -z zone install*

And then we get the results of the package info and the disk usage with *pkginfo* and *du-hs*.

When installing a zone by default the whole directory tree is copied to the non-global zone thus increasing the installation time and also the disk usage. In order to decrease this we use specified directories by the global zone directory tree by inheriting them.

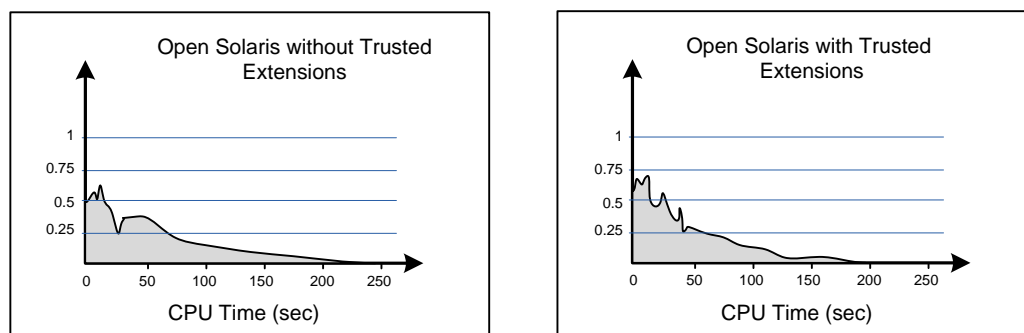
```
zonecfg -z zone1 "create; set
zonepath=/zones/zone1; set autoboot=true; add
inherit-pkg-dir; set dir=/usr; end; add inherit-
pkg-dir; set dir=/sbin; end; add inherit-pkg-dir;
set dir=/bin; end; add inherit-pkg-dir; set
dir=/platform; end; add inherit-pkg-dir; set
```

```
dir=/lib; end;add net; set address=192.168.0.1/24; set physical=rge0;
end; commit; exit"
```

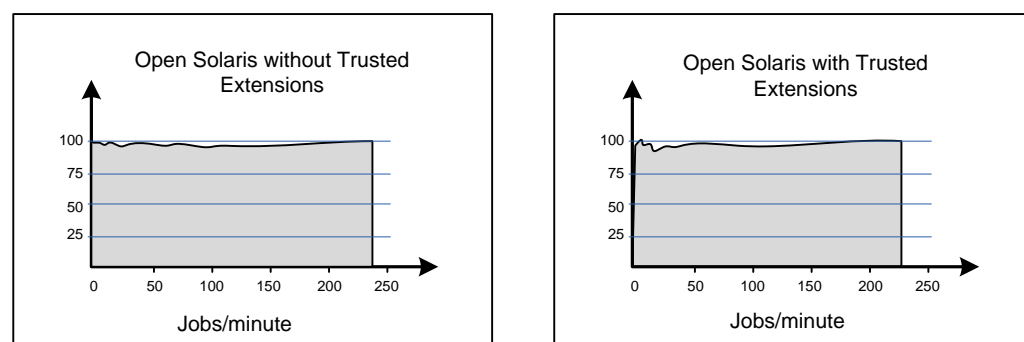
Again with the same method we will show that in this way the overhead introduced by the creation and installation of zones is lower than the first one. The next experiments that we will make are based on AIM benchmark and show the performance of the system as a whole and the overhead introduced by zones. The benchmarks will evaluate the performance of a multiuser system (aim7) for example a server, and of a single user system (aim9) based on a number of tests, like arithmetic tests, disk/fs I/O tests, IPC, function calls, algorithmic tests etc. Firstly we will execute the benchmark only on the global zone without any non-global zone installed. And then the benchmark will be executed on the global zone with the running non-global zones.

## Results

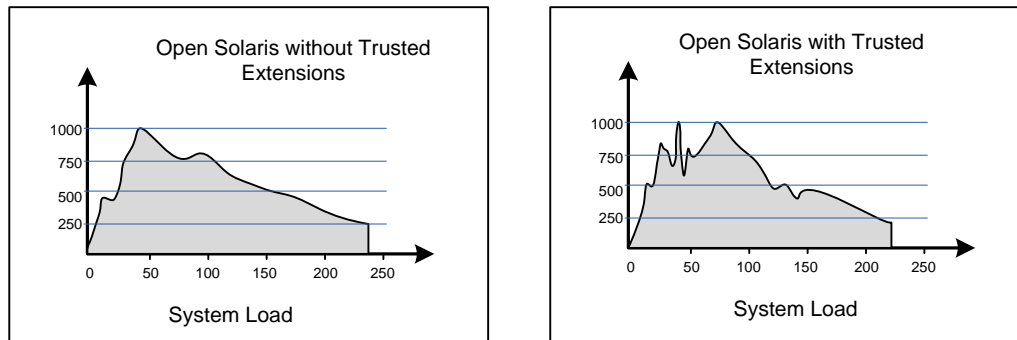
The results of the AIM benchmark in the two cases without and with Trusted Extensions running, are presented below.



*Average CPU Time tests on the containers without and with Trusted Extensions enabled*



*Jobs per Minute load tests on containers without and with Trusted Extensions enabled on them*



*System load tests on containers with and without Trusted Extensions enabled*

## Conclusion

Based on the results of the tests and experiments we can say that the sparse zone installation gives a lower overhead to the system in terms of disk usage, memory and processing power. The number of packages that the zone requires to be installed, the time needed for the zone to be installed also the storage that the zone consumes are lower. Approximately the rates of time, package and disk usage between sparse zone and whole root zone are 18/23, 1/9 and 1/3. These rates vary on the configuration of the sparse zone. The performance and the overhead that a zone introduce to the system based on the benchmark is at this rates: Peak = 976.5/993.5, Sustained = 344.4/365.6, Minimum JTI = 91/92. Also from the singleuser benchmark (aim9) results we can say that the values of the tests differ very little from each other and we can conclude that in this way we have achieved a better utilization of hardware and operating system without affecting the overall performance of our system. We have shown that with this virtualization technology we can make use of all of our resources and thus achieving a higher processing power.

While the virtualization technology using Solaris Containers provides fair isolation between independent containers, there exist many security threats which can affect the isolated container itself. These threats are not discussed on this paper and remain the same as for the non-virtualized systems which are managed by Operating System developers and implemented by System administrators through patches and system upgrades. The weak points of Containment strategies consists on implementation of virtualized device drivers using a lower software layer of Operating System which implements the sharing of Server resources among individual containers and thus opening a vulnerability issue for all Containers. This makes our Containers, even with Trusted Extensions enabled, susceptible to service denial attacks and degradation of financial services offered by the Server.

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## THE IMPACT OF MIGRATIONS: CAN URBAN PLANNING BE A TOOL TO SOLVE THE SOCIAL PROBLEM OF INTEGRATION?

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### Abstract

Immigrants, coming to Italy from different origin countries, demand for a new kind of city characterized by public spaces, services and places of worship able to satisfy their specific needs. It derives that integration, the main social problem in nowadays societies, necessary passes through the act of urban planning.

Starting from available data, provided for example by Caritas-Migrantes, ISTAT, ISMU, CENSIS, about immigrants in Italy, about their distribution over Italian Regions and about their settlement in different cities, the main focus of the present work is on normative aspects and on new project proposals connected to the housing problem.

In the last part, the case of the Campania Region, characterized by a great amount of immigrants and by the proposal of new urban policies included in the "Piano Casa", represents a new intriguing proposal to foster immigrants' urban integration.

### Introduction

Migrations, as noticed by Sartori (2002), have determined an *over-diversity* in cities due to language, traditions, religion and ethnicity. As known, multi-ethnic cities aim to guarantee the co-existence of diversities; inter-ethnic cities, instead, aim to integrate these diversities. To achieve integration in inter-ethnic cities is not easy and urban planning plays a very important role.

Urban planning has to change urban spaces by considering:

- Migrations to the destination country;
- Settlement in urban areas.

Migrations imply a new kind of city depending on the evolution of immigrants' needs in time and on heterogeneity of ethnic groups.

Immigrants' needs evolve in time: when they arrive in the destination country they try to satisfy their urgent needs; after that they have care needs; eventually they show needs related to settlement in the area (Palidda, 1996).

As noticed by Secchi (1999), it is necessary to consider groups heterogeneity since it affects choices about urban spaces to live in: for example, the Moroccans live in different urban areas from the Chinese, because of their culture and religion, their socio-economic conditions and

their mores. As notice by Beguinot, the complex mosaic of immigrants “*creates a complex demand for shelter, services, public spaces, places of worship, and opportunities for self and group realization*” (2009, pg. 61).

According to Beguinot (2006), several questions can rise up: How do immigrants use urban spaces? Can urban planning facilitate co-living between immigrants and local people?

To be sure that different spaces can be used by different ethnicity (Perrone, 2010; Sandercock, 2004), urban planning must organize the co-living, must plan the use of urban spaces and must rule relations between spaces and people, by referring to the residential aspects, including all the primary services like housing, education, etc. (Bergamaschi et al., 2009). In other words, urban planning cannot exclude social dynamics embedded in the urban context and cannot ignore further implications (Beguinot, 2004; La Cecla, 1998).

For this reason, the final aim of the present work is to underline the importance of urban planning tools to foster integration (Clemente and Esposito, 2008; Sciortino and Colombo, 2004; Stalker, 2003; Martiniello, 2000).

### **Empirical Evidences from Italy**

Urban planning activity requires starting from data about the amount of ethnic groups in Italy (Novak, 2007) where migrations are a very relevant phenomenon. The reasons of this are the political changes happened in east Europe in 1991 and the regularization procedures by Italian government both in 1995 and 1998.

The most numerous ethnic groups in Italy (Caritas-Migrantes, 2010, pg. 13) are Rumanians (887.763), followed by Albanians (466.684), Moroccans (431.000 nearly) and Chinese (188.352). Rumanians and Albanians have grown up consistently in the last ten years (in 1990 Albanians were 1.853 and Rumanians were 7.494; in 2009 Albanians were 466.684 and Rumanians were 887.763).

The Chinese case is very peculiar since they have economic resources able to guarantee an easier and faster establishment in Italy and a sort of protection by co-ethnic people. As a consequence Chinese people can easily assume co-ethnic people as employees and make their community bigger and bigger.

Despite differences in the amount of ethnic groups, there is no predominant ethnicity in Italy (ISTAT, 2008): immigrants came from all over the world. This is the reason why it is possible to define Italy as the destination of “*policentrismo migratorio*” (migratory polycentrism stands for the most numerous ethnic group and its incidence on the total amount of immigrants to Italy), that means that each 10 people, 4 are European, 3 are Africans, 2 are Asiatics and 1 is American.

In reference to the cities where immigrants decide to settle, it is important to underline that immigrants have changed their destination over the years: in the '60 and '70 immigrants went

in the North-west regions of Italy (Torino- Milano-Genova) because of the so many big firms working there; in the last decades immigrants went in the North – east regions of Italy, where many new small firms work (Harris, 2000; Carchedi, 1999; Sassen, 1999; Tonizzi, 1999).

Nowadays, as noticed by ISMU (2010), most of the 5 millions of migrants living in Italy are settle in the North Regions. In the last ten years, the presence rate has grown of nearly 13-14% per year, that is 3-4% points higher than national average.

Latest data about immigrants' presence in Italy are shown in Table 1.

<i>Italian Areas</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>
<i>North-west</i>	35.6	35.1	35
<i>North-east</i>	26.9	27	26.6
<i>Center</i>	25	25.1	25.3
<i>South</i>	8.9	9.1	9.3
<i>Islands</i>	3.6	3.7	3.8
<i>Total</i>	100	100	100

*Table 1: Immigrants' distribution over Italian Areas*  
(Source: Caritas Migrantes, 2010, pg. 13)

By splitting the above data, it emerges that most of immigrants settles in Regions like Lombardia, Veneto, Emilia Romagna e Marche, where employment rates are higher. However, Roma and Milano urban areas are still the most common choice for immigrants (Caritas-Migrantes, 2010, pg. 482 ss.).

As noticeable by the above data, the South regions still keep their importance in the migration phenomenon, especially the Campania region, that is the driver among these regions. In the '90 there were 31.801 immigrants in the Campania region, in 2000 they were 68.159, in 2009 they were 147.057 (Caritas, pag. 464).

The Campania case is very peculiar because many criticalities characterize this Region. Irregular immigrants are not considered in the estimation (Pugliese, 1996); it means that immigrants should be more than 147.057. Moreover, it sounds strange that immigrants settle in a very poor region, where unemployment rates for local people are very high (ISMU).

### **The Way Immigrants Settle in Italy**

As noticed by ISTAT (<http://www.istat.it/>), different ethnic groups follow different paths to settle in destination countries.

The hypothesis of different ethnic groups living in the same place finds its best example in cities that are places where similarities, contradictions and differences - age, ethnic group, gender, social class, religion and culture - can mix and influence each other.

According to Secchi (1999), a multiethnic city is: “a place where you can find a co-presence of thousand of social figures and metropolitan tribes [...] a multi-different city [...], a thousand dialects crossroads, where the concepts of belonging, citizenship, representation, identity, change”. The co-existing of individuals with different stories and needs mainly deals with the urban dimension and determines a strong influence in defining, modifying and using spaces.

Each ethnic group, in fact, lives a city in a different way, according to its time and ways of living by determining new spatial forms and new ways of co-living.

Generally speaking, different ethnic groups settle in the different ways (Signorelli, 1996; Beguinot, 2005). According to Lanzani (1998), immigrants’ settlement depends on ethnic needs and activities; immigrants use the urban space according to this and so they settle in specific parts of cities.

Philippines and Peruvians (whose number of women is higher than that of man) settle close to the work place, especially in the city center or in rich urban areas. This happens because Philippines and Peruvians women work as family’s help or because rich urban areas are very close to the poor ones (as it is in Naples).

The Chinese ethnic groups follow a “residential pattern” (<http://www.michelucci.it/>) characterized by extreme concentration (Fondazione Michelucci, 1996). In Toscana and Lombardia Regions this pattern has been intensely evident. In Toscana Region, for example, Chinese people live in the same building where they work. As a result these building are very crowded and unsafe in reference to working and living conditions (Ceccagno, 2003). Two very important consequences are linked to the Chinese residential pattern: the first is the continuous changing of the building structure, where spaces are always adapted to new emerging needs booth living and working (<http://www.michelucci.it/>). The second instead, is the change of the house concept. House is no more a private place where families stay together, but it is an always-changing place responding to always changing needs (<http://www.michelucci.it/>).

In Lombardia region, instead, Chinese people have created a strong Chinese community in the Canonica-Sarpi area (Bellaviti et al., 2001). Chinese houses are located very close to working laboratories and to point of sales of Chinese goods (<http://www.cestim.it/>). In contrast to the well-known Chinatown model (Cologna, 2002, pg. 31 ss), the Canonica-Sarpi area is highly characterized by ethnic services and non-ethnic services are not allowed at all.

Eventually, Moroccans immigrants instead settle in urban areas where their families already live.

Of course, immigrants’ process of settling depends on social and cultural identity of each group and, at the same time, on the opportunities offered by the destination area, especially by the house market, that strongly affect the result of the migration process (Melotti, 2004;

Bordignon, 2003). Urban planners must satisfy this new housing demand. Governments determine the rules for co-living, but technicians must receive immigrants needs and to translate them in new spaces (Petrella, 2003).

### **The Housing Problem: Normative Aspects and Project Proposals**

Housing, at very low price, concerning poor Italian people and immigrants as well, includes several criticalities like educational and working aspects that fall in the social sphere of actions and are part of political responsibilities (Reggiani, 2000, pg. 5).

The housing problem is one of the most important one when talking about urban planning. House, in fact, represents the most important parameter to measure life-quality of immigrants in Italy (Zincone, 2000; Zincone, 2001). Studies published by Fondazione Silvano Andolfi (2003), in fact, define space and time as the most important parameters to measure life-quality (Pergolotti e Gianferrari, 2004). By space they refer to both public and private spaces where interaction with others take place; by time they refer to free time and to the way it is spent (Fondazione Silvano Andolfi, 2003, pg. 68 ss. ; Tosi, 1993). House, which can mix space and time, determines a more or less intensive integration in the urban areas (Berti, 2003).

Despite the importance of houses to reach integration, immigrants have to face many difficulties to find a house when they arrive in Italy. They can aspire to houses to which local people are not interested in any longer (<http://www.unq.edu.ar>).

For this reason the analysis needs to start from a normative perspective to get to practical proposals. The premise to the analysis is that normative aspects do not always fit to emerging specific needs (Fondazione Silvano Andolfi, 2003, pg. 86 ss.).

The Testo Unico 268/98 that establishes social houses, collective or private, by offering national contributions to Regions for immigrants' and local poor peoples' residences renewal.

In the paragraph 4, art. 40 of Testo Unico 268/98 it is established that collective or private houses are provided to Italians and immigrants, who are waiting for an ordinary house. This kind of house is an effective response to immigrants seeking houses, but it is not appropriate.

Another very important point of the Testo Unico 268/98 (art. 40, paragraph 5) deals with regional contributions to renew only residences for immigrants. It is established that Regions can finance the renewal of public building only for regular immigrants, who have the permission of stay in Italy.

Moreover, the Testo Unico determines that immigrants have to be considered like Italians are in reference to public housing: brokerage services, housing rentals and subsidized credit are guaranteed to both immigrants and local people (art. 38 paragraphs 4-6).

The law n. 189/2002, so called "Bossi-Fini", still keeps the main part of the precedent articles, but does not establish any kind of financing to local authorities to renew public

building. It derives that immigrants have to face several difficulties to find a house and local authorities can destiny only residual resources to public housing problem.

The straight consequence of the above public policy is that, somehow, immigrants are considered as a new kind of poor people; it means that immigrants can be recipient of public houses since they are considered as new poor and not as new Italian people. This phenomenon recalls what happened in the '50s when working people of south regions of Italy moved to the north and they were compelled to live in public houses in the fringe areas. Some questions forcefully arise: is the housing problem only due to social classes problems? Is ethnicity a secondary aspect of the housing problems?

Actually, the housing problem is not economic but, above all, it is a cultural one, linked to origin countries. As underlined by Culotta (2004, pg 123 ss.), it is important to consider different housing solution in the origin countries. Arabian, Iranian or Moroccan houses have a main entrance that does not allow visiting people to see inside the house. Houses are developed around a open-sky area to get brightness.

According to this, Forno (2004, pg.139 ss.) maintains that the Italian way of building houses is different, and so it cannot be adapted to immigrants' needs. New houses for immigrants should be built according to the way of living in the origin countries, in order to make the integration easier and houses comfortable. Consequently, when planning new neighborhoods immigrants must be considered among the recipients of housing public offering (Tumielli, 2010; Cesareo and Bichi, 2010; Parra Spiani et al., 2010).

Such a mess about housing problem can only be solved by mixing public policies and private projects and by referring them to all the people seeking houses, including immigrants as a standing alone group.

## Conclusions

The overview of national policies (Grandi and Tanzi, 2007), as shown in the above sections, does not provide a very optimistic picture but it seems that new initiatives have been at least proposed. The "Piano Casa", approved in 2009, stimulates social housing for several social groups and immigrants are one of them.

Of course, the "Piano Casa" is different from region to region.

Among several differences, it seems extremely interesting to focus on the "Piano Casa" in Campania, the region that has half of immigrants in the South of Italy. The "Piano casa" in Campania is interesting since it represents the final point of a process started in the last years. In 2005, in fact, some urban programs offered houses for immigrants only (especially houses that were confiscated to the organized crime, see <http://resources.regione.campania.it>). In 2006, the project Caracoles, in the MIRA project, was launched to offer estate brokerage services to immigrants. In 2007, social inclusion was promoted, through: a) reception,

information and brokerage services; b) working and housing inclusion; c) cultural integration and peaceful co-living (L. 11/07 art. 35).

The “Piano Casa” (L. 19/09 and L. 1/2011) represents the last phase of the social integration process. Up to now, the most innovative aspect of this urban planning tool is theoretical more than practical. Even if immigrants are not considered as beneficiary of specific actions, for the first time immigrants’ integration does not pass for a specific urban element (house, church, park, etc. etc.) but is considered as a whole in which all the urban elements coexist. In the end it clearly results (in Social residential guide line – 572/2010) that housing must be correlated to human relationships to create a decent context where immigrants and local people can live together.

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## EXPLORING INTERRELATIONSHIPS AMONG MORALE, SATISFACTION AND COMMITMENT FROM A POSITIVE PSYCHOLOGY PERSPECTIVE: EVIDENCE FROM GREECE

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### Abstract

The purpose of the paper is twofold: (i) to contribute to commitment research by exploring the dual nature of normative commitment (Meyer et al, 2006; Meyer and Parfyonova, 2010) in a Greek setting; and (ii) to examine the mediating role of morale in the 'job satisfaction – organizational commitment' relationship, within a positive organizational behavior (POB) framework.

A total of 331 questionnaires were completed by bank employees. Data were analyzed via confirmatory factor analysis (CFA), reliability-, correlation-, and mediation analyses. Results reveal that: (i) a two-dimensional model of organizational commitment –characterized by a moral duty mindset and an indebted obligation mindset- fits the data better than the traditional three-component model, providing support to Meyer et al's (2006) and Meyer and Parfyonova's (2010) propositions; (ii) a moral duty mindset of organizational commitment is strongly associated with morale and job satisfaction; whereas, an indebted obligation mindset is relatively less strongly associated with job satisfaction and morale, in line with Meyer and Parfyonova's (2010) suggestions; and (iii) morale fully mediates the 'job satisfaction - organizational commitment' relationship – in line with expectations.

**Keywords:** happiness at work; organizational commitment; morale; job satisfaction; Greece.

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### Background

In recent years, the field of positive psychology has emerged to bring awareness to the role of psychology in making life more fulfilling, enhancing human functioning, and increasing happiness (Fisher, 2009; Schiffrin and Nelson, 2010; Seligman, 2002). Specifically, "The consideration of positive psychology in the work context raises some interesting questions about the relationship between satisfaction in life and at work. How does work contribute or take away from individual happiness? And, can organizations use learnings from positive

psychology to enhance employee well-being and performance?" (Money, Hillenbrand and da Camara, 2008, p. 24-25).

Although many definitions of happiness have been used in the literature, "ranging from life satisfaction and an appreciation of life to momentary feelings of pleasure" (Lyubomirsky, King and Diener (2005, p. 816), in the present research the term 'happiness' is used to describe "positive subjective experiences" (Schiffrin and Nelson, 2010, p. 34). Research has suggested that increasing happiness has multiple benefits. For example, Lyubomirsky et al (2005) presented evidence that positive affect is associated with multiple positive outcomes including better performance ratings at work, higher salaries, and improved health (Schiffrin and Nelson, 2010, p. 33).

Happiness-related constructs in organizational research vary in terms of: (a) the level at which they are seen to exist; (b) their duration or stability over time; and (c) their specific content (Fisher, 2009, p. 386). Most 'happiness constructs' in organizations are conceptualized at the *person* level, "where all the variance of interest occurs between individuals" (Fisher, 2009, p. 386). "Happiness-related constructs usually defined and measured at person level include dispositional affectivity, job satisfaction, affective commitment, and typical mood at work".... "The most frequently studied construct – in the family of constructs related to happiness at work- is by far job satisfaction, followed by organizational commitment" (Fisher, 2009, p. 388). *Unit-level* constructs describe the happiness of collectives such as teams, work units, organizations. Examples of unit-level happiness-related constructs include morale, unit-level engagement, group mood, group affective tone; and group task satisfaction (Fisher, 2009, p. 385; Peterson, Park and Sweeney, 2008, p.20).

The vast majority of happiness research has focused on *individual*-level variables (e.g., job satisfaction) rather than *group*-level constructs (e.g. morale) – "the acknowledged weak link of positive psychology" (Peterson et al, 2008, p. 20). A literature review of happiness-related constructs in Greece revealed ten studies on job satisfaction; eleven studies on organizational commitment; and none on morale. Moreover, previous studies examined either job satisfaction in relation to organizational commitment; or job satisfaction in relation to morale (see discussion below). No studies were traced exploring potential inter-relationships among these three constructs. Aiming to extend the commitment literature and happiness research, the present investigation explores the mediating role of morale in the job satisfaction-organizational commitment relationship in the relatively under-researched Greek context from a positive psychology perspective.

## Conceptual Framework

### Organizational Commitment

#### *Conceptualizations*

Commitment is a central concept in psychology (Morrow, 1993); it can be defined as a willingness to persist in a course of action (Cooper-Hakim and Viswesvaran, 2005, p. 241). Psychologists have devoted voluminous efforts to studying commitment in the workplace (Cohen, 2003; Cooper-Hakim and Viswesvaran, 2005). Several forms of commitment have been proposed, measured and tested for correlations with important outcomes: *organizational* commitment; *job* commitment; *career* commitment; *occupational* commitment; *union* commitment, etc.

*Organizational* commitment has been conceptualized in a number of ways (Swales, 2002) - not all of which are directly relevant to happiness (Fisher, 2009). "For instance, continuance or instrumental commitment involves staying with an organization because of the inducements offered or because of a lack of viable alternatives rather than because membership is valued or pleasant. In contrast, commitment based on personally identifying with the organization's goals and values and being affectively attached to the organization would be considered part of happiness at work" (Fisher, 2009, p. 388).

Indeed, Meyer and Allen (1984) proposed that a distinction be made between *affective* and *continuance* commitment, with affective commitment denoting an emotional attachment to, identification with, and involvement in the organization; and continuance commitment denoting the perceived costs associated with leaving the organization. Allen and Meyer (1990) later suggested a third distinguishable component of commitment, *normative* commitment, which reflects a perceived obligation to remain in the organization (Meyer, Stanley, Herscovitch & Topolnytsky, 2002).

#### **Operationalizations**

The Organizational Commitment Questionnaire (OCQ) developed by Mowday, Steers, & Porter (1979) was the commitment measure of choice for many years (Fischer, 2009). This scale was designed to tap the extent to which: (i) employees identify with and accept the organization's goals; (ii) are willing to exert effort towards organizational goal accomplishment; and (iii) strongly desire to remain part of the organization. The OCQ is regarded as predominantly assessing the *affective* dimension of organizational commitment (Fisher, 2009; Mowday, 1998).

In the 1980s and early 1990s several alternative models of commitment, all of which were multidimensional, were developed (Wasti, 2007). Of these, the *Three-Component-Model* (TCM) by Meyer and Allen has gained substantial popularity (Bergman, 2006). Meyer and Allen and their Associates (1990; 1993) developed the affective (ACS), continuance (CCS), and normative (NCS) commitment scales to measure these components.

The three-component model appears to have received considerable empirical support in the North American context (Meyer et al, 2002). However as noted by Bergman (2006), in US and Canadian studies, neither the 8-item (Allen and Meyer, 1990) nor 6-item (Meyer, Allen and Smith, 1993) NCS has been shown to have a high degree of discriminant validity with the ACS. Both versions of the scale tend to be highly correlated with the ACS - .77 for the 6-item and .54 for the 8-item version (p.648).

In non-western cultures, the NCS and ACS tend to be even *more* highly correlated (Jaros, 2007; Wasti, 2007). For example, Ko, Price and Mueller (1997) tested Meyer and Allen's (1991) model in Korea. "The three scales had acceptable reliability and convergent validity, but the AC and the NC scales lacked discriminant validity and the construct validity of NC and CC were questionable" (Wasti, 2007, p.5). Likewise, Lee, Allen, Meyer and Rhee (2001) used back-translated versions of Meyer, Allen, and Smith's (1993) scales in Korea and obtained results similar to Ko et al. (1997).

In line with previous findings, Cooper-Hakim and Viswesvaran (2005) meta-analysis also state that "there is substantial overlap between affective and normative organizational commitments" (p. 252). On the basis of these considerations, Meyer, Becker and Van Dick (2006) suggested that *normative* commitment might have 'two faces': one reflecting a 'moral imperative' and the other an 'indebted obligation'. "Therefore, although there is a need for further empirical validation of the dual nature of normative commitment, we believe that there may be a benefit to distinguishing between two basic forms of commitment within our integrative model. The first, which we refer to as *value-based commitment*, includes affective commitment and that aspect of normative commitment that reflects obligation to achieve valued outcomes. The second, which we call *exchange-based commitment*, includes continuance commitment and that aspect of normative commitment that reflects an obligation to meet other's expectations" (Meyer et al, 2006, p. 673).

Furthermore, an ongoing debate in the commitment literature relates to whether continuance commitment is uni-dimensional or bi-dimensional, consisting of two sub-components: low perceived alternatives to the current organization, and high personal sacrifice associated with leaving (Meyer et al, 2002, p. 24). Contrary to Meyer et al (2002), Ko et al (1997) argued that lack of alternatives should be treated as an antecedent to continuance commitment rather than a component of commitment. Results reported by Wasti (2003) supported the operationalization of continuance commitment as high perceived costs associated with leaving.

In sum, it may be argued that while the dominant approach to OC is multi-dimensional "there is controversy about the contribution of some of its dimensions to the understanding of commitment. Overlap between the two dimensions (e.g. normative and affective commitment) and unclear dimensionality in another dimension (e.g. continuance commitment) are some of the causes for the ambiguity in the current approach to OC"

(Cohen, 2007, p. 137). Future investigations can contribute “by refining the operationalization of the components, particularly CC and NC” (Wasti, 2007, p. 6).

### **Commitment Research in the Greek Context**

Although Greece is represented in most major studies of cross-cultural variation (Hofstede, 1980; 2001; House et al, 2004), “organizational commitment is rarely reported from a Greek perspective” (Markovits, Davis and van Dick, 2007, p. 78). Indeed, only *eleven* studies were identified in the Greek commitment literature: Bellou (2008, p. 778), examining “the way that psychological contract breach affects employee turnover intention and civic virtue, after taking into consideration the mediating role of organizational commitment and the moderating role of coping with changes”; Bourantas, (1988, p. 121), addressing “the relation between the leadership styles, need satisfaction and the organizational commitment of Greek managers”; Dimitriades (1988), exploring the link(s) between work commitment and individual success among Greek private- vis-à-vis public sector managers; Giannikis and Mihail (2008), examining organizational commitment among full-time and part-time retail employees; Markovits and Associates (2007; 2008; 2010), investigating ‘job satisfaction-organizational commitment’ links among public and private sector employees; Sahinidis and Bouris (2008, p. 63), addressing “the relationship between perceived employee training effectiveness and job satisfaction, motivation and commitment”; Simosi (2010, p. 301), exploring “the role of social socialization tactics on the relationship between task- and organization-related information (socialization content) and newcomers’ affective commitment to their work organization”; Simosi and Xenikou (2010, p. 1598), examining “the nature of relationships between organizational culture and leadership behaviours in affecting employees’ commitment to their work organization”; and Vakola and Nikolau (2005, p. 160), addressing “the linkage between employees attitudes towards organizational change and two of the most significant constructs in organizational behavior; occupational stress and organizational commitment”.

As illustrated in Table 1, the majority of existing studies adopted the Meyer et al’s (1993) six-item measure.

Table 1. Commitment research in the Greek context

		<i>Measure</i>			
		<i>Mowday et al</i> (1979)	<i>Meyer et al</i> (1993)	<i>Allen &amp; Meyer</i> (1990)	<i>Other</i>
01	<i>Bellou</i> (2008)*				
02	<i>Bourantas</i> (1988)				
03	<i>Dimitriades</i> (1988)				
04	<i>Giannikis &amp; Mihail</i> (2008)				
05	<i>Markovits et al</i> (2007)**				
06	<i>Markovits et al</i> (2008)				
07	<i>Markovits et al</i> (2010)				
08	<i>Sahinidis &amp; Bouris</i> (2008)				
09	<i>Simosi</i> (2010)				
10	<i>Simosi &amp; Xenikou</i> (2010)				
11	<i>Vakola &amp; Ioannou</i> (2005)***				

Notes: \*O'Reilly and Chatman's (1986) scale; \*\*Cook and Wall's (1980) scale; and

\*\*\*Cartwright and Cooper's (2002) scale.

Scale reliabilities correspond to meta-analytic findings reported by Meyer et al (2002, p. 26) (see Table 2).

Table 2. The Three-Component-Model (TCM) in the Greek Context: Descriptives

		AFF				CON				NRM				
		Items	<i>x</i>	<i>sd</i>	$\alpha$	Items	<i>x</i>	<i>sd</i>	$\alpha$	Items	<i>x</i>	<i>sd</i>	$\alpha$	
01	Giannikis & Mihail (2008)	8	-	-	0.89	8	-	-	0.84	8	-	-	0.88	
02	Markovits et al (2007)	6	4.76	1.19	0.82	6	4.82	1.03	0.66	6	4.27	1.18	0.75	
03	Markovits et al (2008)	6	4.56	1.28	0.84	6	4.56	1.08	0.68	6	4.29	1.28	0.83	
04	Markovits et al (2010)	6	4.69	1.28	0.84	6	-	-	-	6	4.28	1.26	0.65	
05	Simosi (2010)	6	3.47	0.98	0.82	-	-	-	-	-	-	-	-	
06	Simosi & Xenikou (2010)*	6	5.51	1.80	0.85	3	5.49	1.42	0.74	4	4.40	1.57	0.80	
	Simosi & Xenikou (2010)**					2	4.58	1.79	0.71					

Note: 7-point response format. \*High-sacrifice \*\*Limited alternatives

Inter-correlations among commitment components are reported in Table 3. Two points appear to be worth noting. The first relates to the high correlation between affective and normative commitment (with the exception of the Simosi study). Although correlations ( $r = 0.66$  to  $r = 0.73$ ) reported by Markovits et al (2007; 2008; 2010) are in line with meta-analytic correlations ( $\rho = .77$ ) reported by Meyer et al (2002, p. 29), they may be interpreted as potentially denoting a conceptual overlap between these two commitment components. The second point worth noting relates to continuance commitment and its relationship to affective commitment. Thus, while in North American studies the correlation between affective and continuance commitment was *opposite* in sign (Meyer et al, 2002, p. 29), in Greek studies affective and continuance commitment were *positively* correlated. Moreover, only the *high-sacrifice* aspect of continuance commitment was significantly positively correlated with the affective and normative components.

Table 3. The Three-Component-Model (TCM) in the Greek Context:  
Inter-correlations among commitment components

	<i>r</i>												
	<i>Markovits (2007)</i>			<i>Markovits (2008)</i>			<i>Markovits (2010)</i>			<i>Simosi (2010)</i>			
	<i>AFF</i>	<i>NRM</i>	<i>CON</i>	<i>AFF</i>	<i>NRM</i>	<i>CON</i>	<i>AFF</i>	<i>NRM</i>	<i>CON</i>	<i>AFF</i>	<i>NRM</i>	<i>CC-HS</i>	<i>CC-LA</i>
<i>NRM</i>	0.66**	-		0.73**	-		0.70**	-		0.49**	-		
<i>CON</i>	0.05ns	0.23**	-	0.20**	0.34**	-	-	-	-	-	-	-	-
<i>CC-HS</i>										0.27**	0.40**	-	
<i>CC-LA</i>										-0.14*	0.03ns	0.26**	-

Note: CC-HS = High Sacrifice Continuance Commitment; CC-LA = Low Alternatives Continuance Commitment

Since none of a/m studies explicitly addressed the issue of dimensionality of organizational commitment in the Greek context, the present research represents an attempt to fill this void via comparing the traditional three-component model [comprising affective-, normative-, and continuance commitment] with a two-component model proposed recently by Meyer et al (2006), comprising value-based and exchange-based commitment.

#### Satisfaction-Commitment Links

The importance of job satisfaction (see discussion below) and its relationship with organizational commitment has been acknowledged for many years (Markovits, Davis, Fay and Van Dick, 2010). Meyer et al's (2002) meta-analysis provide substantial insight into this



relationship. Although job satisfaction has traditionally been considered as “one of the most powerful predictors of organizational commitment, in public and private sector contexts” (Markovits et al. 2010, p. 178), Meyer et al (2002) consider job satisfaction a correlate of commitment “because there is no consensus concerning causal ordering” (p. 22) – for a review of conflicting findings see Meyer (1997).

Contributing to the debate concerning causality, Markovits et al (2010) propose that “reciprocal relationships exist between forms of organizational commitment and elements of job satisfaction. A satisfied and happy employee tends to be committed to the organization, returning back to the organization this positive affect via commitment and the concomitant organizationally relevant outcome identified earlier” (p. 178).

### **Job Satisfaction**

#### **Conceptualizations**

From the perspective of research and practice, the most focal employee attitude has been job satisfaction (Saari and Judge, 2004). In his seminal 1976 review of the job satisfaction literature, Locke observed that more than 3,300 scholarly articles had been published on the topic of job satisfaction (Cole and Cole, 2009). Whereas, the Harter, Schmidt and Hayes’ (2002) search yielded another 7,855 articles having been published between 1976 and 2000 (Cole and Cole, 2009).

One of the most frequently-used research definitions of job satisfaction is by Locke (1976), who defined it as “.... a pleasurable or positive emotional state resulting from the appraisal of one’s job or job experiences (p. 1304). It is an attitudinal variable that has been explored both as an overall evaluation of the job (global satisfaction) and as a cluster of attitudes relating to different aspects of the job (facet satisfaction) (Markovits et al, 2010, p. 178; Saari and Judge, 2004, p. 400).

#### **Operationalizations**

Recently, Fisher (2009) in her comprehensive review entitled “Happiness at Work” argued that “there has been a history of mismatch between the definition of this construct and its measurement”..... “Widely used instruments such as the Minnesota Satisfaction Questionnaire (MSQ, Weiss et al, 1967), the Job Descriptive Index (JDL, Smith et al 1969) and the Job in General Scale (Ironson et al, 1989) ask for descriptions and evaluation of job features rather than feelings about the job or emotional experiences while working. It has been demonstrated that these commonly used verbal measures do not capture affect very well, certainly not as well as a ‘faces’ scale of job satisfaction” (p. 388).

#### **Satisfaction Research in the Greek Context**

A review of the literature identified *ten* studies examining satisfaction in the Greek context: Antoniou, Davidson and Cooper (2003), investigating occupational stress, job satisfaction and health among male and female junior hospital doctors in Greece; Bellou (2009, p. 455),

examining “the impact of person-organization (P-O) fit on employee behavior” and testing “the mediating role of job satisfaction on these relationships” in three public hospitals; Bozionelos and Kiamou (2008), analyzing the effect of emotion work on emotional exhaustion and work attitudes in the Greek banking industry; Demoussis and Giannakopoulos (2007, p. 333), exploring “job satisfaction in private and public employment”; Gounaris (2008) analyzing the impact of internal marketing practices on employee job satisfaction in Greek luxury hotels; Manolopoulos (2008), addressing work motivation in the Greek public sector; Menon and Saitis (2006, p. 345), “comparing the satisfaction levels of pre-service and in-service primary school teachers with respect to school organization and administration; Nikolau and Robertson (2001), exploring the validity of the five-factor model of personality and its relationship to employee job satisfaction in occupational settings in Greece; Sahinidis and Bouris (2008, p. 63), investigating “the relationship between perceived employee training effectiveness and job satisfaction, motivation and commitment”; and Zampetakis and Moustakis (2011), examining the effect of managers’ trait emotional intelligence on group job satisfaction in public service organizations.

### **Satisfaction-Commitment Links**

Following Markovits et al (2010), in the current study job satisfaction will be examined as a *predictor* of organizational commitment, since one of the aims of the present research is to shed some light on the job satisfaction-organizational commitment link by examining the mediating role of employee morale (see discussion below) in this relationship.

### **Morale**

#### **Conceptualizations**

According to McFadzean and McFadzean (2005, p. 319), morale is an important factor in any organization. “For example, high morale can result in the achievement of organizational goals along with increased productivity, whereas low morale can result in high stress levels, active resistance, absenteeism, an increase in professional negligence, and poor professional behavior and performance (Andersson and Bateman, 1997; Castledine, 1997; Denney, 2003; Ford et al, 2003; Gilmore et al, 1996)”.

Yet, despite its importance to the organization, no agreed definition of morale actually exists (McFadzean and McFadzean, 2005). “For example, Guba (1958) suggests that definitions of morale tend to consist of two elements, that of communality of goals and a sense of “togetherness” and “belongingness”. His own definition of morale incorporates these ideas: morale is “a predisposition on the part of persons engaged in an enterprise to put forth extra effort in the achievement of group goals or objectives” (Guba, 1958, p. 198). This group aspect of morale is also reflected in Castledine’s (1997, p. 773) description of morale as “essentially ... a matter of ‘group spirit’ or cohesiveness” (p. 319). However, these definitions make no mention of individual morale (Evans, 1997, p. 832) – “an individual feature related

to beliefs about the future and anticipation of the extent to which the job will fulfill the individual" (Young, 2000, p. 161).

"As used today, morale is a cognitive, emotional, and motivational stance toward the goals and tasks of a group. It subsumes confidence, optimism, enthusiasm, and loyalty as well as a sense of common purpose. Morale is used to describe individuals as well as groups, a complexity that poses an ongoing challenge in attempts by social scientists to study it" (Peterson et al, 2008, p. 21).

### **Operationalizations**

"Research to date has treated morale in unidimensional terms" (Peterson et al, 2008, p. 22).... typically relying on self-report measures. "These face-valid questionnaires are often very brief –sometimes but single items" (Peterson et al, 2008, p. 26). One popular measure has been the morale scale developed by Hart, Conn and Carter (1992) "to measure the degree of energy, enthusiasm, team spirit and pride that teachers perceived in their school" (Hart (1994, p. 114). This measure also was adopted by Young (2000) to assess teacher morale in Australia.

### **Morale-Commitment-Satisfaction Links**

#### **Morale-Organizational Commitment**

Only one study was identified investigating the impact of supervisor-subordinate relationships upon the morale and affective commitment of nurses in Australia (Brunetto, Farr-Wharton and Shacklock, 2010). Specifically, in the Brunetto et al study, the following hypotheses were developed and tested via path analysis:

H1: There is a positive relationship between satisfaction with LMX (predictor variable) and nurses' subsequent perceptions of morale (outcome variable).

H2: There is a positive relationship between nurses' perception of morale (predictor variable) and their levels of affective commitment (outcome variable).

H3. There is a positive relationship between nurses' levels of satisfaction with LMX, their perceptions of morale (predictor variables) and their levels of affective commitment (outcome variable).

Results provided support for all three hypotheses, indicating "that both LMX and morale are important contributors to the affective commitment of nurses" (Brunetto et al, 2010, p. 218).

### **Job satisfaction-Morale**

Apart from the prominent work of Guba (1958) and Evans and Associates in Warwick U.K. (Campbell, Evans, Neill and Packwood, 1991; Evans, 1997; Evans, Packwood, Neil and Campbell, 1994), research into satisfaction and morale has been scarce (Young, 2000, p. 160).

Guba (1958) stated: "Satisfaction and morale may be related to one another in these terms as a function of time. To state the case in more qualitative terms, if an individual has found past experiences satisfying, he is likely to anticipate satisfaction in the future, and we say that he has high morale. Similarly, if his past experiences have been unsatisfying, he is likely to be unwilling or to be unable to expend effort in the production of other acts that will be equally unsatisfying to him, and we say that he has low morale. Thus it is reasonable to postulate a high positive relationship between measures of satisfaction and morale in any stable situation, and it is this hypothesis that the present study proposed to test" (pp. 199-200). According to Guba, "high satisfaction must precede high morale in point of time". "Within the limitations of method the experiment seems to validate the hypothesis that there is a critical time and energy factor in morale and satisfaction" (p. 196).

In agreement with Guba, Evans (1997) postulated: "The distinction which I recognize between morale and job satisfaction is one of temporal orientation: I perceive satisfaction as present-oriented, and as a response to a situation, and morale as future-oriented, and anticipatory (see Evans, 1992a)" (p. 832).

Following Guba (1958) and Evans (1997), job satisfaction is considered a predictor of morale in the present investigation.

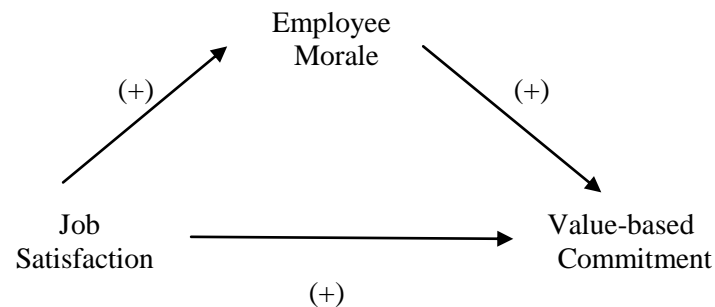
#### **Morale Research in the Greek Context**

No studies on employee morale were identified in the Greek context.

#### **Hypotheses**

Following the literature review above, a theoretical framework was developed in which one individual-level variable (job satisfaction) and one organizational-level variable (morale) are examined in relation to organizational commitment. In line with Markovits et al (2010), job satisfaction is considered a predictor of (value-based) organizational commitment. Following Guba (1958) and Evans (1997), job satisfaction also is considered a predictor of morale. Drawing on the Brunetto et al (2010) study, value-based commitment is seen as an outcome of morale.

Figure 1. *Employee Morale as a Mediator of the 'Job Satisfaction-Value-based Commitment' Relationship*



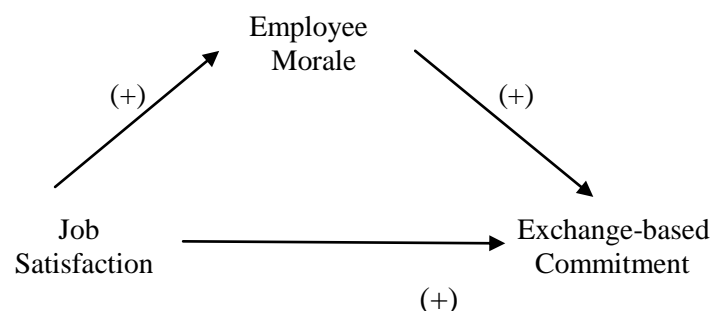
As stated earlier (see p. 4), continuance commitment has not been considered to be directly relevant to happiness (Fisher, 2009). However, Warr (2007) suggests that apart from active positive states (e.g. job satisfaction, affective commitment, job involvement, etc) that are reflected in pleasurable feelings, there are also passive positive states (for example, career prospects or money) reflected in feelings such as contentment and calm (p. 727). Exchange-based commitment may be seen as promoting these states.

Thus, the following two hypotheses will be tested:

H1: Morale will mediate the job satisfaction-value based commitment relationship.

H2: Morale will mediate the job satisfaction-exchange based commitment relationship.

Figure 2. *Employee Morale as a Mediator of the 'Job Satisfaction-Exchange-based Commitment' Relationship*



## Method

### Organizations, sample characteristics and procedure

The organizations participating in this study are seven retail banks located in the city of Athens. These organizations are all large financial corporations with national branch networks. They serve a similar mix of private and corporate customers, and provide a similar range of products and services - such as current and savings accounts, loans, mortgages, insurance, business advisory services, and automated cash withdrawal through their branch networks. Self-administered questionnaires were personally distributed by the research team to 415 employees in branches located in the cities of Athens and Thessaloniki. Participation was voluntary. By the cutoff date for data collection, 331 usable surveys were retrieved from the employees. The data were collected in early 2009.

The sample comprised 136 (41 percent) males and 195 (58 percent) females. Forty percent of the respondents were between the age of 18 and 34, and fifty six percent were between 35 and 54 years old. Little more than one-half (53%) of the co-opting employees held a university degree. Approximately one third of the respondents (33%) had tenures of 5 years or less, forty two percent had tenures between 6 and 15 years, and twenty seven percent had been with the bank for more than fifteen years.

### Measures

*Organizational commitment* was measured using Allen and Meyer's (1990) 24-item instrument. It was decided to use the 8-item ACS, CCS and NCS (instead of the 6-item version) in order to tap both the social- and moral obligation aspects of normative commitment (see Meyer et al, 2002, p. 40). Responses to the scale items were elicited on five-point scales ranging from 5 (strongly agree) to 1 (strongly disagree). The questionnaire was originally developed in English and was translated in Greek, following a process of back translation.

Prior to data collection, a pilot study was undertaken to ensure content validity. On the basis of pilot results, the following three items were excluded: item: "I do not think that wanting to be a 'company man' or 'company woman' is sensible anymore" was described as being "*too American!!!!*" to be adequately translated into Greek. Further, it was mentioned that the content of the item: "I do not feel a strong sense of belonging to my organization" was "*too strong for Greek bank employees*". Lastly, the item "One of the few serious consequences of leaving this organization would be the scarcity of available alternatives" was considered (by interviewed employees) to be *irrelevant* (at the time of data collection – e.g. before the economic crisis). Descriptives are cited in Table 4.

To compare the traditional three-component model (Allen and Meyer, 1990) with an alternative two-component model (Meyer et al, 2006; Meyer and Parfyonova, 2010), *affective commitment* was tapped with the following items of ACS (Allen and Meyer, 1990): "I enjoy

discussing my organization with people outside it”; “I really feel as if this organization’s problems are my own”; “I think that I could easily become as attached to another organization as I am to this one (R)”; “I do not feel “emotionally attached” to this organization (R)”; “This organization has a great deal of personal meaning for me”; “I do not feel like “a part of the family” at my organization (R)”.

Following Meyer and Parfyonova (2010), *continuance commitment* was operationalized as perceived high costs associated with leaving via the following items of CCS (Allen and Meyer, 1990): “It would be very hard for me to leave my organization right now, even if I wanted to”; “Too much in my life would be disrupted if I decided to leave my organization now”; “One of the major reasons I continue to work for this organization is that leaving would require considerable personal sacrifice”; “It would not be too costly for me to leave my organization now (R)”.

*‘Internalized personal norms’*, or the *‘moral imperative’ aspect of normative commitment* was assessed with the following items of NCS (Allen and Meyer, 1990): “One of the major reasons I continue to work for this organization is that I believe that loyalty is important”; “I do not believe that a person must always be loyal to his or her organization (R)”; “I believe in the value of remaining loyal to one’s organization “.

*Normative commitment as ‘indebted obligation’*, or *‘social norms’*, was measured by the following items of NCS (Allen and Meyer, 1990): “Things were better in the days when people stayed with one organization for most of their career”; “People these days move from one company to another too often”; “Jumping from organization to organization does not seem at all unethical to me (R)” .

Responses to scale items were elicited on five-point scales ranging from 5 (strongly agree) to 1 (strongly disagree).

*Morale* was tapped using five items suggested by Young (2000): “There is good team spirit in this organization”; “There is a lot of positive energy in this organization; “The morale in this organization is high”; “Employees go about their work with enthusiasm”; “Employees take pride in this organization”. Responses to the scale items were elicited on five-point scales ranging from 5 (strongly agree) to 1 (strongly disagree).

Taking into consideration Fisher’s (2009) arguments regarding the validity of widely used satisfaction measures in happiness research, *satisfaction with the job* was tapped by the following single statement (Linz, 2003): “Most people working in this organization are fairly satisfied with their jobs”. Responses to the scale items were elicited on five-point scales ranging from 5 (strongly agree) to 1 (strongly disagree). While the use of single-item measures for psychological constructs is typically discouraged, primarily because they are presumed to have unacceptable low reliability, a meta-analysis of single item measures of

overall job satisfaction found the overall mean correlation to be .67 (Wanous, Reichers and Hudy, 1997, p. 247). Descriptives are cited in Table 5.



Table 4. Three-Component Model Scale Items - Descriptives

	Mean	SD	$\alpha$
<b>Affective Commitment (AC)</b>	<b>3.34</b>	<b>1.02</b>	<b>0.88</b>
"I would be very happy to spend the rest of my career with this organization"	3.11	1.15	
"I enjoy discussing my organization with people outside it"	2.74	1.20	
"I really feel as if this organization's problems are my own"	2.94	1.20	
"I think that I could easily become as attached to another organization as I am to this one" ®	2.65	1.19	
"I do not feel "emotionally attached" to this organization" ®	3.00	1.17	
"This organization has a great deal of personal meaning for me"	3.25	1.10	
"I do not feel like "a part of the family" at my organization" ®	2.84	1.11	
<b>Continuance Commitment (CC)</b>	<b>3.53</b>	<b>0.73</b>	<b>0.78</b>
"Right now, staying with my organization is a matter of necessity as much as desire"	3.41	1.15	
"It would be very hard for me to leave my organization right now, even if I wanted to"	3.60	1.13	
"Too much in my life would be disrupted if I decided to leave my organization now"	3.69	1.14	
"I feel that I have too few options to consider leaving this organization"	3.20	1.11	
"One of the major reasons I continue to work for this organization is that leaving would require considerable personal sacrifice"	3.31	1.09	
"I am not afraid of what might happen if I quit my job without having another one lined up" ®	4.05	1.07	
"It wouldn't be too costly for me to leave my organization now" ®	3.43	1.11	
<b>Normative Commitment (NC)</b>	<b>2.88</b>	<b>0.69</b>	<b>0.74</b>
"People these days move from one company to another too often"	3.37	1.02	
"I do not believe that a person must always be loyal to his or her organization" ®	3.60	1.05	
"Jumping from organization to organization does not seem at all unethical to me" ®	2.77	1.17	
"One of the major reasons I continue to work for this organization is that I believe that loyalty is important"	2.58	1.10	
"If I got another offer for a better job elsewhere I would not feel it was right to leave my organization"	2.35	1.04	
"Things were better in the days when people stayed with one organization for most of their career"	3.07	1.03	
"I believe in the value of remaining loyal to one's organization"	2.35	1.04	

Note . All items are measured on five-point response scales. N = 331.

Table 5. Two-component Model Scale Items - Descriptives

	Mean	S.D.
<b>Affective Commitment (AC)</b>	<b>2.90</b>	<b>0.93</b>
"I enjoy discussing my organization with people outside it"	2.74	1.20
"I really feel as if this organization's problems are my own"	2.94	1.20
"I think that I could easily become as attached to another organization as I am to this one (R)"	2.65	1.19
"I do not feel emotionally attached to this organization (R)"	3.00	1.17
"This organization has a great deal of personal meaning for me"	3.25	1.10
"I do not feel like "a part of the family" at my organization (R)"	2.84	1.11
<b>High Cost Continuance Commitment (HC-CC)</b>	<b>3.50</b>	<b>0.84</b>
"It would be very hard for me to leave my organization right now, even if I wanted to"	3.60	1.13
"Too much in my life would be disrupted if I decided to leave my organization now"	3.69	1.14
"One of the major reasons I continue to work for this organization is that leaving would require considerable personal sacrifice"	3.31	1.09
"It would not be too costly for me to leave my organization now (R)"	3.43	1.11
<b>Normative Commitment - Moral Obligation</b>	<b>2.84</b>	<b>0.87</b>
"I do not believe that a person must always be loyal to his or her organization (R)"	3.60	1.05
"One of the major reasons I continue to work for this organization is that I believe that loyalty is important"	2.58	1.10
"I believe in the value of remaining loyal to one's organization "	2.35	1.04
<b>Normative Commitment - Social Obligation</b>	<b>3.07</b>	<b>0.76</b>
"People these days move from one company to another too often"	3.37	1.02
"Jumping from organization to organization does not seem at all unethical to me (R)"	2.77	1.17
"Things were better in the days when people stayed with one organization for most of their career"	3.07	1.03
<b>Employee Morale</b>	<b>2.77</b>	<b>0.84</b>
"There is good team spirit in this organization"	3.08	1.09
"There is a lot of positive energy in this organization"	2.64	1.05

<i>"The morale in this organization is high"</i>	2.63	0.98
<i>"Employees go about their work with enthusiasm"</i>	2.69	0.99
<i>"Employees take pride in this organization"</i>	2.82	0.97
<b><i>Job Satisfaction</i></b>		
<i>"Most people working in this organization are fairly satisfied with their jobs"</i>	2.60	0.86

Note: All variables are measured using a 5-point response scale. N = 331

## Data Analyses and Results

### Data Analyses

The factor structure of organizational commitment in the current sample was explored via confirmatory factor analysis (CFA). Whereas, mediation analyses were performed to test the meditational hypotheses.

### Results

#### Confirmatory Factor Analysis

Confirmatory factor analysis (CFA) using the maximum likelihood estimation procedure in AMOS 7 was conducted to test, initially, a three-dimensional factor structure of organizational commitment - in line with the traditional three component model (TCM). The following criteria were used to judge acceptable fit: a chi-square-d.f. ratio less than 4; a root mean square error of approximation (RMSEA) equal to 0.08 or less; and comparative fit (CFI) and Tucker-Lewis (TLI) indices equal to 0.90 or greater (Johnson and Chang, 2006). Fit statistics are presented in Table 6.

As may be noted, model fit statistics indicated a *poor* fit of the three factor model to the data ( $\chi^2 / \text{d.f.} = 3.42$ ; GFI = 0.84; CFI = 0.85; TLI = 0.83; and RMSEA = 0.09). Each item loaded significantly on its respective underlying concept. The magnitudes of the standardized loading estimates ranged between 0.12 to 0.86, and all loadings were significant (i.e. all t-values were larger than 2.00). However the correlation between affective and normative commitment was extremely high ( $r = 0.93$ ), denoting that research subjects were unable to distinguish the two concepts.

Table 6. Confirmatory Factor Analysis (CFA) Results – Three Component Model (TCM)

	Standardize d Loadings	t- Values	Standardize d Loadings	t-Values	Standardize d Loadings	t- Values
<b><i>Affective Commitment (AC)</i></b>						
<i>I would be very happy to spend the rest of my career with this organization</i>	0.566	8.790	-	-	-	-
<i>I enjoy discussing my organization</i>						

<i>with people outside it</i>	0.714	10.451	-	-	-	-
<i>I really feel as if this organization's problems are my own</i>	0.771	11.017	-	-	-	-
<i>I think that I could easily become as attached to another organization as I am to this one</i>	0.859	11.797	-	-	-	-
<i>I do not feel "emotionally attached" to this organization</i>	0.814	11.412	-	-	-	-
<i>This organization has a great deal of personal meaning for me</i>	0.779	11.091	-	-	-	-
<i>I do not feel like "a part of the family" at my organization</i>	0.596		-	-	-	-
<b>Continuance Commitment (CC)</b>						
<i>Right now, staying with my organization is a matter of necessity as much as desire</i>	-	-	0.766	10.251	-	-
<i>It would be very hard for me to leave my organization right now, even if I wanted to</i>	-	-	0.612		-	-
<i>Too much in my life would be disrupted if I decided to leave my organization now</i>	-	-	0.720	9.883	-	-
<i>I feel that I have too few options to consider leaving this organization</i>	-	-	0.539	7.998	-	-
<i>One of the major reasons I continue to work for this organization is that leaving would require considerable personal sacrifice</i>	-	-	0.543	8.051	-	-
<i>I am not afraid of what might happen if I quit my job without having another one lined up</i>	-	-	0.519	7.765	-	-
<i>It wouldn't be too costly for me to leave my organization now</i>	-	-	0.388	6.056	-	-
<b>Normative Commitment (NC)</b>						
<i>I think that people these days move from one company to another too often</i>	-	-	-	-	0.121	2.072
<i>I do not believe that a person must always be loyal to his or her organization</i>	-	-	-	-	0.571	
<i>Jumping from organization to organization does not seem at all unethical to me</i>	-	-	-	-	0.488	7.472
<i>One of the major reasons I continue to work for this organization is that I believe that loyalty is important</i>	-	-	-	-	0.771	10.287
<i>If I got another offer for a better job elsewhere I would not feel it was right to leave my organization</i>	-	-	-	-	0.837	10.761
<i>Things were better in the days when people stayed with one organization for most of their career</i>	-	-	-	-	0.276	4.564

<i>I was taught to believe in the value of remaining loyal to my organization</i>	-	-	-	-	0.650	9.231
<b>Fit Indices</b> X2 635.696 DF 186 Probability level 0.000 GFI 0.84 AGFI 0.80 TLI 0.83 CFI 0.85 RMSEA 0.09						

Next, CFA was conducted to test a bi-dimensional factor structure of organizational commitment in line with propositions by Meyer and Associates (Meyer et al, 2006; Meyer and Parfyonova, 2010). As may be noted from Table 7, the fit of the model was now, marginally, acceptable ( $\chi^2 / \text{d.f.} = 3.07$ ; GFI = 0.89; CFI = 0.91; TLI = 0.89; and RMSEA = 0.08). Each item loaded significantly on its respective underlying concept and all loadings were significant (i.e. all t-values were larger than 2.00). The magnitudes of the standardized loading estimates ranged between 0.54 to 0.87, with the exception of the three items tapping the social obligation aspect of normative commitment that had relatively low -yet statistically significant- loadings on exchange-based commitment. Moreover, the correlation between the two commitment components was now moderately high ( $r=0.43$ ).

Table 7. CFA – Two Component Model

	Standardized Loadings	t-Values	Standardized Loadings	t-Values
<b>Value-based Commitment (VC)</b>				
<i>Item</i>				
<i>I enjoy discussing my organization with people outside it</i>	0.593	-	-	-
<i>I really feel as if this organization's problems are my own</i>	0.733	10.604	-	-
<i>I think that I could easily become as attached to another organization as I am to this one</i>	0.761	10.875	-	-
<i>I do not feel emotionally attached to this organization</i>	0.866	11.793	-	-
<i>This organization has a great deal of personal meaning for me</i>	0.802	11.252	-	-
<i>I do not feel like "a part of the family" at my organization</i>	0.776	11.014	-	-
<i>I do not believe that a person must always be loyal to his or her</i>	0.578	8.911	-	-

<i>organization</i>				
<i>One of the major reasons I continue to work for this organization is that I believe that loyalty is important</i>	0.723	10.501	-	-
<i>I was taught to believe in the value of remaining loyal to my organization</i>	0.797	11.207	-	-
<b>Exchange-based Commitment (EC)</b>				
<b>Item</b>				
<i>It would be very hard for me to leave my organization right now, even if I wanted to</i>	-	-	0.588	-
<i>Too much in my life would be disrupted if I decided to leave my organization now</i>	-	-	0.686	8.985
<i>One of the major reasons I continue to work for this organization is that leaving would require considerable personal sacrifice</i>	-	-	0.538	7.619
<i>It would not be too costly for me to leave my organization now</i>	-	-	0.775	9.528
<i>People these days move from one company to another too often</i>	-	-	0.275	4.307
<i>Jumping from organization to organization does not seem at all unethical to me</i>	-	-	0.413	6.182
<i>Things were better in the days when people stayed with one organization for most of their career</i>	-	-	0.362	5.517
<b>Fit Indices</b>				
X2	315.778			
DF	103			
Probability level	0.000			
GFI	0.89			
AGFI	0.86			
TLI	0.89			
CFI	0.91			
RMSEA	0.08			

### Descriptive statistics and inter-correlations

Means, standard deviations, reliability estimates and inter-correlations of job satisfaction, employee morale and the two organizational commitment components are presented in Table 8. As highlighted in Table 8, the mean level of job satisfaction is fairly low ( $x = 2.60$ ,  $s.d. = 0.86$ ). This is in line with previous longitudinal findings ( $x = 2.60$ ,  $s.d. = 1.14$ ) in the Greek context (for a discussion see Demoussis and Giannakopoulos, 2007, p. 338). The fairly low level of satisfaction with the job 'corresponds' to the relatively low level of morale ( $x = 2.77$ ,

s.d. = 0.84) – in accordance with Guba (1958, p. 199). On the contrary, the mean level of exchange-based commitment is relatively high in the present sample ( $x = 3.41$ , s.d. = 0.69).

Table 8. Descriptive statistics and correlations

Variable	N of Items	Min	Max	Mean	s.d.	$\alpha$	1	2	3	4
1Employee Morale	5	1.00	5.00	2.77	0.84	0.88	-			
2Job Satisfaction	1	1.00	5.00	2.60	0.86	-	0.66**	-		
3Value Comm.	9	1.00	5.00	2.88	0.87	0.91	0.71**	0.47**	-	
4Exchange Comm.	7	1.50	5.00	3.41	0.69	0.73	0.21**	0.11*	0.43**	-

Note: All variables are measured using a 5-point response scale with higher scores indicating higher levels of morale, satisfaction and commitment.  $N = 331$ .

\*\* Correlation significant at the 0.01 level, \* Correlation significant at the 0.05 level

These results are in agreement with previous findings in Greece regarding continuance commitment (see Table 2), and may be indicative of the particular nature of exchange-based commitment [comprising high-sacrifice continuance commitment and the social obligation aspect of normative commitment] in the Greek context. Interestingly, the level of value-based commitment [comprising affective commitment and the moral obligation aspect of normative commitment] is lower ( $x = 2.88$ , s.d. = 0.87) in comparison to previous findings in Greece in relation to affective/normative commitment (see Table 2). These findings may be due to industry characteristics (see McMurry, 1958).

Job satisfaction correlates 0.47 with value-based commitment – in accordance with meta-analytic findings reported by Cooper-Hakim and Viswesvaran (2005, p. 253) and Meyer et al (2002, p. 33). On the contrary, in the current research satisfaction with the job is also (marginally) positively related to exchange-based commitment ( $r = 0.11$ ,  $p = 0.05$ ). These findings may, at least in part, be due to Greek employees' preferences for *extrinsic* rewards (Epitropaki and Ganoudis, 2005; Manolopoulos, 2008).

Lastly, morale is significantly, strongly correlated with job satisfaction ( $x = 0.66$ ,  $p = 0.01$ ) and value-based commitment ( $x = 0.71$ ,  $p = 0.01$ ) – in line with Guba (1958, p. 199) and Fisher (2009, p. 389). Yet, contrary to theoretical arguments (Fischer, 2009, p. 388), morale also was – modestly- positively associated with exchange-based commitment ( $x = 0.21$ ,  $p = 0.01$ ) – indicating potential societal and/or industry effects.

### Mediation Analysis

Mediational analyses attempt to identify the intermediary process that leads from an independent variable to the outcome or dependent variable (Muller, Judd and Yzerbyt, 2005). According to Judd and Kenny (1981) and Baron and Kenny (1986), to demonstrate mediation three different models should be estimated (Muller, Judd and Yzerbyt, 2005, p. 853):

$$Y = \beta_{10} + \beta_{11}X + \varepsilon_1 \quad (1)$$

$$M_e = \beta_{20} + \beta_{21}X + \varepsilon_2 \quad (2)$$

$$Y = \beta_{30} + \beta_{31}X + \beta_{32} M_e + \varepsilon_3 \quad (3)$$

and four conditions must be met (Muller, Judd and Yzerbyt, 2005, p. 853) :

- In Equation 1, there must be a significant effect of the independent on the dependent, or outcome, variable; that is,  $\beta_{11}$  should be significant.
- In Equation 2, there must be a significant effect of the independent variable on the mediator; that is,  $\beta_{21}$  should be significant.
- In Equation 3, there must be a significant effect of the mediator on the dependent (or outcome) variable, controlling for the independent variable; that is,  $\beta_{32}$  should be significant.
- In Equation 3, the residual direct effect of the independent variable on the dependent variable ( $\beta_{31}$ ) should be smaller (in absolute value) than the overall effect of the independent variable on the dependent variable in Equation 1 ( $\beta_{11}$ ).

The results of the three-step process are presented in Tables 9 and 10.

Table 9. Employee morale as a mediator of the job satisfaction – value-based commitment relationship

No.	Dep Var	Ind. Var	Beta	T-Value	Sig. T	F-Value	Sig. F	Adj. R square
1	VC	JS	0.47	9.667	0.000	93.442	0.000	0.22
2	EM	JS	0.66	15.916	0.000	253.331	0.000	0.43
3	VC	EM JS	0.71 0.00	13.853 -0.003	0.000 0.998	169.777	0.000	0.51

Note: JS = Job Satisfaction; VC = Value-based Commitment; EM = Employee Morale

Sobel Test Statistic = 10.42, Prob. = 0.000

As can be seen from Table 9, the independent variable (e.g. job satisfaction) affects both the dependent variable (e.g. value-based commitment – beta = 0.47, p=0.01) and the mediator (e.g. morale - beta = 0.66, p=0.01). Moreover, the mediator affects the dependent variable (beta = 0.71, p = 0.01). Thus, the first three conditions of



mediation are met. Additionally, the effect of the independent variable (job satisfaction) on the dependent variable (value-based commitment) is equal to zero in the third equation, denoting that morale *fully* mediates the ‘job satisfaction-value-based commitment’ relationship (see Kenny, 2009) – in support of hypothesis H1.

The same procedure was followed to test the mediating effect of morale on the ‘job satisfaction – exchange-based commitment’ relationship. As noted in Table 10, job satisfaction both affects exchange-based commitment (beta = 0.11, p=0.05) and morale (beta = 0.66, p=0.01). Moreover, morale affects exchange-based commitment (beta = 0.24, p=0.01). Thus, the first three conditions of mediation are met. Additionally, the effect of the independent variable (job satisfaction) on the dependent variable (exchange-based commitment) is approximately equal to zero in the third equation (beta = 0.04, p = 0.54), denoting that morale mediates the ‘job satisfaction-exchange-based commitment’ relationship – providing support to hypothesis H2.

*Table 10. Employee morale as a mediator of the job satisfaction –exchange-based commitment relationship*

No.	Dep Var	Ind. Var	Beta	T-Value	Sig. T	F-Value	Sig. F	Adj. R square
1	EC	JS	0.11	2.091	0.037	4.370	0.037	0.01
2	EM	JS	0.66	15.916	0.000	253.331	0.000	0.43
3	EC	EM JS	0.24 0.04	3.358 -0.619	0.001 0.536	7.891	0.000	0.04

Note: JS = Job Satisfaction; EC = Exchange-based Commitment; EM = Employee

Morale. Sobel Test Statistic =3.26, Prob. = 0.001

## Discussion and recommendations for further research

The purpose of the present exploratory investigation was twofold:

(i) to extend commitment research via contrasting the traditional *three*-component model (Allen and Meyer, 1990) with an alternative *two*-dimensional model, characterized by a *moral duty* mindset and an *indebted obligation* mindset (Meyer et al, 2006; Meyer and Parfyonova, 2010 ), in the Greek context; and,

(ii) to explore interrelationships among job satisfaction, morale and organizational commitment from a positive psychology perspective.

To the best of the researcher’s knowledge, this study was one of the first to test the propositions of Meyer and Associates (Meyer et al, 2006; Meyer and Parfyonova, 2010) concerning the operationalization of organizational commitment as a bi-dimensional construct, consisting of value-based commitment (comprising affective commitment and the moral obligation aspect of normative commitment); and exchange-based commitment

(comprising continuance commitment and the social obligation aspect of normative commitment). Findings appear to support these propositions, highlighting the dual nature of normative commitment in the sample studied. Moreover results seem to provide support to Markovits et al's suggestion that "the meaning of organizational commitment differs depending on the organizational context and environment in which it is assessed" (p. 178), highlighting potential industry and societal effects. Certainly, further research is needed to examine the "external validity of these results and relate them to specific organizational outcomes, such as job performance results and employment practices" (Markovits et al, 2010, p. 192).

Results also provide insight into the role of morale in understanding the job-satisfaction – organizational commitment relationship from a positive psychology perspective. Indeed, "Positive psychology has much to contribute to the understanding of morale. Research guided by positive psychology would need to focus on the positive outcomes attributed to good morale (Peterson, 2000). We hypothesize that morale and its components are healthy for groups and for individuals. After all, good relations with other people are a necessary condition for individual happiness (Diener and Seligman, 2002), and the psychological good life entails being a contributing member of a social community (Peterson, 2006). Other people matter, and it is through group life that people are most fulfilled" (Peterson et al, 2008, p. 29).

Assuming the findings reported in this study are replicated and supported by future inquiry, they suggest two practical possibilities: organizations could undertake various strategies to better manage their employees to produce greater happiness; or they could select employees who are genetically happy (Cropanzano and Wright, 2001). Indeed, "According to Seligman (2004), since only about 50% of happiness is genetic, people can be taught to be happy" (Friedman and Friedman, 2008, p. 4). If this is true, it has implications for HR practice as indicated by Atkinson and Hall (2011); Guest (2002); and Peccei (2004): "While an emergent body of research considers employee happiness in the psychology literature, there is little recognition of it as an important employee attitude within HR research where wellbeing tends to be allied with health issues (see, for example, CIPD, 2007). While our findings are clearly exploratory and preliminary in nature, we suggest that they surface a potentially important and under-researched attitude and that happiness merits further research" (Atkinson and Hall, 2011, p. 101).

## **Limitations**

There are several limitations of this study. One limitation of the present study is that happiness is measured indirectly (via satisfaction, commitment and morale). Second, participant selection was based on convenience sampling. Hence, results cannot be safely generalized beyond the specific sample that was used. Still, however, findings may be useful for hypothesis generation. A third limitation results from the study's cross-sectional design. Fourth, results are based on self-report data, creating the potential for common-method

variance (Evans, 1985; McClelland and Judd, 1993). Another limitation might be the Greek translation of commitment items – which were “initially constructed in English for an English-speaking audience” (Markovits et al, 2010, p. 191). Following Markovits et al (2010), this research “decided to take the direct translation and back-translation approach, assuming the items and concepts to be “etic” (suggesting the concepts are universally applicable). Other researchers prefer more “emic” approaches and seek to develop measures that are culture-specific (Vandenberghe, 2003), which would be informative but renders comparisons of studies across different cultural contexts more difficult” (p. 191). A final limitation of the study is that the sample was drawn from one industry only – e.g. retail banking.

## Contribution

Concluding, it is hoped that the current study: (a) advanced the fairly limited available evidence on the dimensionality of organizational commitment in the Greek context; (b) contributed to an enhanced understanding of the relationship between job satisfaction and organizational commitment, as mediated by morale; and (c) was a first attempt towards happiness research in Greece.

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## ASPECTS OF GOVERNANCE AT FOOD MANUFACTURING ESTABLISHMENTS IN THE GAZA STRIP: FIELD STUDY

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### Abstract

The purpose of this research is to study the aspects of governance at main food manufacturing establishments in the Gaza Strip. The study was considered seven dimensions which include, 1) board membership, 2) management of board affairs, 3) policies and procedures, 4) performance measurement, 5) aspects of board meetings, 6) financial management and control and 7) relationship with the general director. The study population was incorporated all Gaza's main food manufacturing establishments which employ 20 persons or more. The number of these companies was 20 establishments. The research was used a stratified random sample. The sample size was 100 persons. The sample was selected from board members, owners\investors and general directors. A questionnaire was used as a main tool for data collection.

The main conclusion of the study is that the governance aspect of the main food manufacturing establishments in the Gaza Strip is poor. However, the aspects of financial management and control and the relationship with the general directors are acceptable but it needs further improvement.

Large establishments tend to have relative better aspects of governance. They incline to be formal and with better human and financial capabilities.

Food manufacturing establishments need to give extra attention to their governance. The attention should be given to the overall dimensions of the governance including the development of policies and procedures, developing and balancing the relationship among business main stakeholders and financial management and control.

### Introduction

Corporate governance has come to the forefront of academic, regulatory, and investor debate. Key in this debate is the role that corporate governance plays in the generation of economic returns to its owners and stakeholders (Soobaroyen and Sheik-Ellahi, 2008). Part of generating economic returns includes the ability to adapt to and confront periods of financial distress. Corporate governance may be referred to the relationship among the board of directors, top management, and the investors\owners of establishments in determining the direction and performance of organization (Wheelen and Hunger, 2006). Corporate governance is the process whereby organizations make important decisions; determine whom they involve and whom they cause to be accountable. In addition, taking decisions and

rendering of accountant- typically relies on the governance system, policies or framework. Corporations' bylaws should clearly state the roles and responsibilities of governance bodies (Petra, Steven et. Al, 2008). The corporate governance with its different parties (board of directors, top management and investors) should play a complementary role in identifying the establishment's direction, mission, objectives, strategies and policies (Wheelen and Hunger, 2006).

According to the Palestinian Central Bureau of Statistics (PCBS) (2010), Palestinian food industrial sector was considered one of the most important manufacturing sectors in the Palestinian industry. The total number of operating food manufacturing establishments in the West Bank and the Gaza Strip was accounted for (2179) establishments in year 2009, which represented (14.2%) of the total operating Palestinian manufacturing establishments (15340 establishments). The sector was employed (10803) workers in 2009, which represented (16.1%) of total Palestinian workforce (67055 persons) who were employed in the Palestinian manufacturing sector. The total operating manufacturing establishments in the Gaza Strip was accounted for (520) firms in 2009. This number reflects the significance to study and tackle this sector from various dimensions including governance dimension.

This study examines the aspects of corporate governance in terms of its, structure and role in the management and development of Gaza's large food manufacturing establishments from the viewpoints of selected stakeholders. The research question will be as follows:

What are the characteristics and roles of the governance in the Gaza's large food manufacturing establishments?

### **Study objectives**

- Evaluate the characteristics of the governance in Gaza's large food manufacturing establishments.
- Study the effect of the organizational characteristics on aspects of the corporate governance.
- Propose some recommendations that may help manufacturing establishments to promote their managerial practices and performance.

### **Hypothesis**

H1. There is a relative significant difference at level ( $\alpha = 0.05$ ) in the impact of the components of governance on management performance of food manufacturing establishments in the Gaza Strip.

H.2 There is a significant statistical difference at level ( $\alpha = 0.05$ ) in the Aspects of the governance at large food manufacturing establishments attributed to the experience of interviewees and size of establishments.



## Methodology

This research employs descriptive and analytical methods involving both qualitative and quantitative approaches. The fieldwork was based on distributing a questionnaire. Both primary and secondary data sources were used. The data collection was done in the following manner:

1) Questionnaire specifically designed for this research. The close-ended questionnaire was used because, it is easy to answer, compare and analyze.

2) Academic work on the subject such as books, articles, reports and other library-housed materials were collected through library research and through the internet. Overall, this study relied on a variety of sources and used a selective method in gathering the relevant information from each source in order to benefit fully from all available sources.

## Population and Sample

The study population includes all Gaza's large food manufacturing establishments which employ 20 persons or more. The overall food manufacturing establishments accounted for 520 firms in 2009 (see Table (1) below). Table (1) revealed that 72.3% of food manufacturing establishments employ 4 persons or less. While 18.6% employ 5-9 persons. Only 3.7% employ 20 persons or more. These characteristics revealed that Gaza's food manufacturing establishments were dominated by small establishments. The very small establishments were not considered because; size of establishment usually influences the management characteristics and performance. Small size establishments lean to personal relations, informal structure and informal planning and control.

A stratified random sample was used. The sample was selected from board members, owners\investors and general directors. It was difficult to reach a significant number of investors because they are unanimous. All large food manufacturing companies were private limited. The founders of the business are managers and owners. They rely on their personal relations in attracting investors. Those attracted investors are usually sleeping partners and unknown. The researcher noticed that none of the establishments recruit general directors from outside owners structure or their close relatives. The sample size was 100 persons. The questionnaire was distributed and collected in May 2011. The researcher considered all owners\general directors to answer the questionnaire. This was done because they have comprehensive information about the company (see Table 2). The researcher received 100 questionnaires. All of the questionnaires were entered the process of analysis. The response rate was 100%, because personal field visits were used to distribute and collect the questionnaire.

Table (1) Classification of food manufacturing establishments in the Gaza Strip by number of employees at year 2009.

District	Classification of establishments by employment size						TOTAL
	0-4	5-9	10-19	20-49	50-99	100+	
North Gaza Governorate	58	15	4	2	0	0	79
Gaza Governorate	172	45	17	9	1	0	244
Dier Al-Balah Governorate	47	21	5	4	0	1	78
Khanyounis Governorate	72	15	1	2	0	0	90
Rafah Governorate	27	1	0	1	0	0	29
Total	376	97	27	18	1	1	520
%	72.3	18.6	5.2	3.5	0.2	0.2	100%

Source: - Palestinian Central Bureau of Statistics (2010) - General Census Of Establishments, 2009 - Economic Core Results, Ram Allah, Palestine.

Table (2) Manufacturing distribution by population and sample size

Population and sample	Number of board members	Number of owners\investors	Number of owners\general directors	Number of general directors	Total
Population	100	140	20	-	160
Sample	50	30	20	-	100

Source: The population size were estimated based on data available in Table (1) and phone calls conducted with most of food manufacturing establishments with size of employment 20 persons or more.

## Characteristics of food manufacturing establishments in the Gaza Strip

### Age of establishments

Table (3) shows that most of manufacturing establishments their ages were more than 7 years. Large establishments have more experience and better chance to survive compared to small businesses.

Table (3) Research Sample by Age

Age of Food manufacturing establishments	Frequency	Percent
Less than 3 years	0	0
3 -7years	0	0
Greater than 7 years	100	100
Total	100	100

### Size of Establishments

Table (4) shows that the great majority (90%) of research sample employ 20 to 49 persons. Only 10% employ 50 persons or more. These results were expected since all companies which

employ less than 20 persons were excluded. Table (1) shows the different sizes of food manufacturing establishments in the Gaza Strip.

*Table (4) Size of Establishments*

<i>Firm's size</i>	<i>Frequency</i>	<i>Percent</i>
<i>20-49 employees</i>	18	90
<i>50 employees or more</i>	2	10
<i>Total</i>	20	100

### **Legal form of the Establishments**

Table (5) indicated that research sample consists of private limited corporations and none of them was public corporation. This result was logic since the sample was only included large size companies which employ 20 persons or more. However, most of Gaza's establishments were small in nature. Probably because they rely on personal resources which were limited compared with public limited corporations which can raise more fund by issuing new stocks or borrowing from banks (El-Farra, 2006).

*Table (5) Legal form of the Firm*

<i>Legal form of the Firm</i>	<i>Frequency</i>	<i>Percent</i>
<i>Sole Proprietorship</i>	0	0
<i>Partnership</i>	0	0
<i>Private Limited establishment</i>	100	100
<i>Total</i>	100	100

### **Content Validity Reliability of the Questionnaire**

Content validity examines the extent to which the method of measurement includes all the major elements relevant to the construct being measured. Two methods were used to achieve this type of validity: The Experts Validation and Pilot Study.

The questionnaire was evaluated by six experts in the field. As a result; six questions were modified but no questions were added or deleted.

Pilot study was conducted to assess reliability of the questionnaire. Thirty persons were chosen randomly from the study population and were asked to fill the questionnaire. Those questionnaires were not included in the research sample. These questionnaires were used for assessing the validity and reliability of the questionnaire.

Spearman correlation technique was used to confirm questionnaire's validity. The *r* value was 0.880 and sig. was 0.00.

Two methods were used for reliability assessment which employed the Split-Half Coefficient and the Cronbach's Alpha Methods. Split-Half Coefficient was 0.891 and Cronbach's Alpha was 0.911.

The questionnaire was developed in the final format and distributed to collect data from the field.

## **Research Importance**

To the researcher knowledge governance of manufacturing establishments in Palestine has never been examined, partly because of lack of information and partly because of lack of fund and interested researchers in the field of governance. This is the first detailed study devoted specifically to the corporate governance in the Gaza Strip with particular application to food manufacturing sector. The study would contribute to the development of the corporate governance's performance in the private sector in the Gaza Strip. Further this research will help in filling the "literature gap" in the corporate governance research, particularly those within the field of manufacturing sector. The study will also help in providing better understanding of the managerial practices of the manufacturing establishments in the Gaza Strip.

## **Theoretical Framework**

### **The industrial sector in Palestine**

The evolution of the Palestinian manufacturing sector was obvious from the growing rate of its contribution to the Palestinian Gross Domestic Product (GDP). The manufacturing sector contribution to the GDP increased from (8%) during the Israeli occupation (1967-1994) to (16%) prior to the outbreak of the *Al-Aqsa Intifada* in September 2000 (Nofal, 2003). However, this rate was fallen to (14.6%) in 2003. This was attributed to Israeli measures including closures and the Israeli military siege on the Palestinian areas. In addition, Palestinian manufacturing sector suffers from high dependency on the Israeli economy. (Palestinian Central Bureau of Statistics, 2010).

Moreover, food and beverages industry contributed about (23%) of the total production volume in the manufacturing industries in Palestine. This rate reflects the importance of the food sector in Palestine in job creation and filling a large proportion of the Palestinian consumer needs. Also, the increasing importance of food manufacturing industries was linked very much with other economic activities, especially the agricultural sector. Food industries contributed to stimulation of agriculture. Food manufacturing sector increased the value-added of agriculture and diversification of agricultural crops. The growth of food industries through manufacturing food plays a role in raising the income of farmers and the development of rural areas (Naser, 2005)

### Previous studies

Sahmiyah (2005) examined the development of sustainability criteria for Palestinian local NGOs. The study considered many criteria including, vision, mission, objectives, human resources and governance. The study concluded that governance was the second highest rank within the eight sustainability criteria of the Gaza's establishments with a relative weight of 82.7%. The first highest rank was Vision, mission and objectives with 85%. Abdul Latif (2002) argued that forming a board of directors or trustees at Palestinian establishments with clear authorities and responsibilities such as reviewing the general policies of the organization, its programs, its budget and its connections with the outside world is a key element of good governance on the organizational level and the internal and external relations. Gill, Flynn, and Reissing (2005) concluded that board members of Canadian establishments were highly satisfied with board culture, community representation, and financial stewardship. Friedman and Phillips (2004) examined three specific issues of governance: size of councils, their composition in relation to electoral process, and the development of inner councils or executive boards, within councils. Vinten (2002) in his study on the failure of Enron corporation proposed that board members should be properly inducted, trained and developed. In addition, the pros and cons of different types of corporate governance need to be explored and best practice disseminated. Parker, Peters and Turetsky (2002) concluded that corporate survival largely depends on discipline placed on managers. Discipline can come from the marketplace or it can come from inside the firm through corporate governance structures. The study said relative to distressed firms that corporate governance aspects influence the likelihood of firm survival. Soobaroyen and Sheik-Ellahi (2008) explored the influence of corporate governance on non-board business unit managers in relation to its perceived effects on managerial/organizational outcomes. The study concluded that managers who perceived the corporate governance adoption will have a positive impact on their performance via its effect on enhancing the credibility of the unit and the organization. Peters (2004) investigated in a UK survey, how the corporate governance "message" is cascaded through the rank and file. The study found that the respondents were critical of the managerial behaviors they observed in the organization, involving attempts at avoiding accountability for unsatisfactory performance and the absence of transparency within the organization. Shipley and Kovacs (2008) investigated the development of a set of good governance principles applicable to the oversight and operation of cultural heritage institutions. The study came up with a set of good governance criteria and principles including legitimacy and voice, direction, performance, accountability, and fairness. Petra, Steven et. al (2008) found that the presence of CEO duality reduces the likelihood of lower levels of performance-based incentives offered to CEOs. Additionally, the authors found that CEOs are more likely to receive lower levels of performance-based incentives when the majority of the compensation committee members serve on less than three other boards, and when the size of the board is less than or equal to nine members.

## Hypotheses Testing

H.1 There is a relative significant difference at level ( $\alpha=0.05$ ) in the impact of the components of the corporate governance on the management performance of food manufacturing establishments in the Gaza Strip.

### Board of directors membership

Table (6) illustrated weak aspects of the board of directors' membership at large food manufacturing establishments in the Gaza Strip. The total mean value of the field was 4.36, the proportional weight mean was 43.6% and sig. value was 0.00. Table (6) revealed that, the board of directors did not determine the required skills needed for its members, the board members were not diversified in their skills, they were not elected on a regular basis and their was no limit on terms that board members may stay in their positions. Establishments in the Gaza Strip were dominated by family businesses. Members of the board of directors are usually from family members or owners. Therefore, it was not necessary to be elected from qualified and skilled members (El-Farra, 2005). These aspects were very similar to the situation in the Arab world. Abed Elmajeed (2002) mentioned similarity in management characteristics among businesses in the Arab world. However, Table (6) revealed that the establishments had written documents which specify the number of the board of directors, where mean value was 8.1 sig. values was 0.00. This is because the Palestinian companies' law imposes on companies to identify the number of their boards in the establishment documents. Petra, Steven et. al (2008) *found that the presence of CEO duality reduces the likelihood of lower levels of performance-based incentives offered to CEOs*. Experts in corporate governance advice businesses to add more outsiders (people are not affiliated with the corporation) to the board of directors. This would improve the transparency of businesses, increase level of creativity and advance relationships with other businesses (Wheelen and Hunger, 2008).

Table (6) Aspects of Board of Directors Membership by using sign test

Number	Item	Mean	Proportional weight mean	P-value
1	The board determine the required skills for its members	3.0	30	0.00
2	The required skills are written and documented	3.2	32	0.00
3	The existing board has the required skills	6.9	69	0.00
4	The existing board is characterized by the variety of skills and specialization among its members	4.3	43	0.00
5	The establishment has a written document that specifies the number of the board members	8.1	81	0.00
6	The board is elected periodically as indicated in the internal bi-lows of the establishment	3.0	30	0.00
7	The board membership has a term limit of two turns then the board member become a general assembly member	2.0	20	0.00
	Total	4.36	43.6	0.00

### Management of Board Affairs

Table (7) showed poor management of the board affair. The total mean score was 3.4, proportional weight mean was 34% and sig. value was 0.00. It was obvious from Table (7) that most establishments did not have manual that determine the roles and responsibilities of the board members, no clear plan for board meeting and job description was not there. In fact most of board members were inactive in setting business strategies and direction. Most companies in the Gaza Strip rely on few actors of the board members. In addition, the founders of businesses were acted as godfathers for business members. This is a typical management culture in the Arab world. The traditional family structure and social relations in Arab societies, contributed towards shaping the managerial behavior in Arab organizations. Sharabi (1988) in his book argued that the 'neopatriarchy' structure prevails in Arab society and reflects a traditional type of social structure. According to Sharabi (1988) Arab individuals belong to family, clan and religious sect. While the family, which represents a model of this social structure, is characterized by the dominance of the father, the subordination of younger to older, and females to males. Authority, domination and dependency are the basic internal relations of the patriarch structure of the family. The tradition type of Arab social structure may contribute among others in explaining the Arab managerial practices.

Table (7) Aspects of Management of Board Affairs by using sign test

Number	item	Mean	Proportional weight mean	P-value
	<i>The establishment has a board manual that determine the roles and responsibility of the board members, the general policies of the establishment, the internal bi-lows, etc.</i>	4.1	41	0.00
	<i>Each board member has a copy of this manual</i>	2.0	20	0.00
	<i>The board members understand their legal responsibilities</i>	5.0	50	0.00
	<i>The establishment has a written system for the appointment and removal of the chairperson</i>	4.3	43	0.00
	<i>The establishment has a written and clear job description</i>	5.4	54	0.00
	<i>The board meetings are held based on a clear plan</i>	3.4	34	0.00
	<i>There is a clear and written procedure for dealing with board members who consistently fail to attend meetings without good and convincing causes</i>	2.1	21	0.00
	<i>The board keeps and documents formal minutes of meeting that states the decisions that had been taken</i>	3.4	34	0.00
	<i>Total</i>	3.7	37	0.00

### Policies and Procedures

Table (8) reflected weak policies and procedures at Gaza's large food manufacturing establishments. The total mean was 4, proportional weight mean was 40% and sig. value was 0.00. The great majority of businesses did not have a written mission or clear objectives. They did not have written policies, procedures, written code of conduct and code of ethics. The board members were not active in strategic planning for business development. El-Farra (2003) study manifested that managerial practices at Gaza's plastic manufacturing establishments were dominated with tactical practices and no concern was given to strategic dimensions. Palestinian establishments in Gaza are dominated with Entrepreneurship management style. Board of directors was uninvolved in strategic design and general directors were dominating management process. The board is willing to be used as a rubber stamp for top management's decisions. In addition, general director operates alone or some times with a team (Wheelen and Hunger, 2008; El-Farra, 2003).



Table (8) Aspects of Policies and procedures by using sign test

<i>number</i>	<i>item</i>	<i>mean</i>	<i>proportional weight mean</i>	<i>p-value</i>
	<i>The establishment has a written mission statement</i>	5.4	54	0.00
	<i>The board plays an active role in the strategic planning process for the establishment</i>	4.5	45	0.00
	<i>The establishment has a code of ethic and code of conduct</i>	3.0	30	0.00
	<i>The establishment has a conflict of interest policy</i>	3.4	34	0.00
	<i>The policies and the procedures of the establishments are written</i>	3.2	32	0.00
	<i>The organizational policies and procedures are available to staff and others with an interest in the organization</i>	4.3	43	0.00
	<i>The board has clear procedure for ensuring that the policies and the procedures of the establishment are being implemented</i>	4.0	40	0.00
	<i>Total</i>	4.0	40	0.00

### Performance measurement

Table (9) disclosed that the board of directors did not practice its rule in measuring the performance of establishments in order to evaluate and control them. This is a very important rule that the board should play to enhance transparency at establishments. The total mean value was 4.3, proportional weight mean was 43% and sig. value was 0.00. It was clear from Table (9) that the board did not participate or reviews the annual plan of business. They did not measure the performance of business based on goals achievement. This result reflected poor rule the board of directors' play in the life of establishments in the Gaza Strip. In order to have a comprehensive monitoring and controlling system, organizations should have written objectives, structure, job descriptions, indicators for performance, qualified controlling team and suitable diversified controlling tools. Almost these requirements were not available at organizations in the Gaza Strip. This limitation was not only at private sector, public sector but also at a significant number of Palestinian NGOs (Kulab, 2004; Shaheen, 2007).

*Table (9) Aspects of performance measurement by using sign test*

number	item	mean	proportional weight mean	p-value
	The board ensure that the establishment measures its performance based on the determined objectives	5.3	53	0.00
	The board and establishment director review the determined objectives annually	5.5	55	0.00
	The establishment director discusses the results of the performance measurement with the staff	5.2	52	0.00
	The board discuss with the staff the establishment performance periodically	4.3	43	0.00
	The board measure its performance annually	3.2	32	0.00
	The board put an annual plan for its development	3.5	35	0.00
	The plan is implemented	3.0	30	0.00
	Total	4.3	43	0.00

### Aspects of board meetings

Table (10) showed low regular meeting by the board. In addition, the board do not have prepared annual plan for meetings. Further more, the board meetings were not effective. Overall, the total mean value was 4.84, proportional weight mean was 48.4% and sig. value was 0.00. It is necessary to energize the board rule in the management of the establishments in the Gaza Strip. This would enhance the institutionalization among businesses in Gaza, which would reduce the high death rate among businesses and increase the life span of businesses (Ashour and El-Farra, 2002).

Table (10) Aspects of board meetings by using sign test

<i>number</i>	<i>item</i>	<i>mean</i>	<i>proportional weight mean</i>	<i>p-value</i>
	<i>The board meets periodically</i>	3.2	32	0.00
	<i>The number of meetings is suitable to the establishment needs</i>	6.7	67	0.00
	<i>The board agrees on annual plan for meetings</i>	4.3	43	0.00
	<i>The board meetings are organized and effective</i>	5.5	55	0.00
	<i>The decisions are taken through discussion and consensus</i>	4.5	45	0.00
	<i>Total</i>	4.84	48.4	0.00

### Financial management and control

Table (11) revealed an acceptable financial management and control practiced by the board of directors in the Gaza Strip but it needs further development. The board was continuously received quarterly or semi-annual financial reports. It was ensured that the balance sheet and profit and loss account are prepared by the end of every financial year. In addition, the establishments were used external financial auditors. Further, the chairperson was met with the external auditor at least once a year. Moreover, the board was discussed the external auditor report. The overall mean score was 6.48, proportional weight mean was 64.8% and sig. value was 0.00. However, board members had low skills and experience to analyze and interpret financial reports, budgets and accounts. In addition, the board did not bother to ensure written procurement procedures. Overall the aspects of the financial management and control were much better than the other dimensions of the corporate governance. This because finance was the most crucial issue from investors viewpoints, where board members in Gaza are usually owners. In addition, their management skills to follow monitor and participate in setting business strategies were poor (see Table 8 and 9).

Table (11) Aspects of financial management and control by using sign test

<i>number</i>	<i>item</i>	<i>mean</i>	<i>proportional weight mean</i>	<i>p-value</i>
	<i>The board members have skills and experience to be able to analyze and interpret financial reports, budget and accounts</i>	3.9	39	0.00
	<i>The board ensures that the financial system that is used by the establishment is effective</i>	5.5	55	0.00
	<i>The board continuously receive quarterly or semi-annually financial reports</i>	7.7	77	0.00
	<i>The board makes regular comparisons between budgeted income / expenditure and actual income / expenditure</i>	3.2	32	0.00
	<i>The board receives regular written reports highlighting any exceptional items in the financial statements</i>	3.5	35	0.00
	<i>Balance sheet and profit and loss account and are prepared by the end of the financial year</i>	9.9	99	0.00
	<i>The board ensures that there are written and documented procurement procedures for the establishment</i>	5.3	53	0.00
	<i>The board ensures that procurement are carried out based on the procurement procedure of the establishment</i>	5.0	50	0.00
	<i>The establishment has external financial auditor</i>	8.8	88	0.00
	<i>The chairperson meets with the external auditor at least once a year</i>	9.5	95	0.00
	<i>The board discusses the external auditor report</i>	9.0	90	0.00
	<i>Total</i>	6.48	64.8	0.00

### Relationship with the general director

The relationship between the board of directors and general directors were acceptable but it needs further development. Table (12) indicated that the board did not intervene in the daily management of the establishment. The general director participates in the board meetings. The relationship between the board of directors and the general director was characterized by understanding and cooperation. The overall mean value was 6.2, proportional weight mean was 62% and sig. value was 0.00. However, Gaza's establishments did not have written job descriptions for their general directors. In addition, general directors did not provide regular reports to the board. Moreover, the board did not follow or monitor the performance of the general director.

Table (12) Aspects of Relationship with the general director by using sign test

<i>numbers</i>	<i>item</i>	<i>mean</i>	<i>proportional weight mean</i>	<i>p-value</i>
	<i>There is a clear written job description for the general manager</i>	5.3	53	0.00
	<i>The board does not intervene in the daily management of the establishment</i>	7.0	70	0.00
	<i>The general director participates in the board meetings</i>	9.0	90	0.00
	<i>The general director submits periodic reports for the board</i>	4.5	45	0.00
	<i>The relationship between the board the general director is characterized by understanding and cooperation</i>	7.0	70	0.00
	<i>The board follows and monitors the performance of the general directors</i>	4.5	45	0.00
	<i>Total</i>	6.2	62	0.00

### Overall aspects of corporate governance

Table (13) discloses that the aspects of the governance at Gaza's large food manufacturing establishments were poor. The total mean value was 4.48, the proportional weight mean was 44.8% and sig. value was 0.00. The lowest performance were in the management of board affairs, policies and procedures, performance measurement, board of directors membership and the aspects of board meetings respectively. The study did not agree with Sahmiyah (2005). Sahmiyah examined the development of Sustainability criteria for Palestinian local NGOs. He considered many criteria including, vision, mission and objectives, human resources and governance. Sahmiyah concluded that governance was the second highest rank within the eight sustainability criteria of the Gaza's establishments with a relative weight of 82.7%. Abdul Latif (2002) argued that forming a board of directors or trustees at Palestinian establishments with clear authorities and responsibilities such as reviewing the general policies of the organization, its programs, its budget and its connection with the outside world is a key element of good governance on the organizational level and the internal and external relations. Gill, Flynn, and Reissing (2005) concluded that board members of Canadian establishments were highly satisfied with board culture, community representation, and financial stewardship. Vinten (2002) in his study on the failure of Enron Corporation proposed that board members should be properly chosen, trained and developed. In addition, he stated that the pros and cons of different types of corporate governance need to be explored and best practice disseminated. Parker, Peters and Turetsky (2002) concluded that corporate survival largely depends on discipline placed on managers.

Table (13) overall aspects of the governance at large food manufacturing establishments in the Gaza Strip

Number	item	Mean	Proportional weight mean	P-value
1	Board of Directors Membership	4.36	43.6	0.00
2	Management of board affairs	3.7	37	0.00
3	Policies and Procedures	4.0	40	0.00
4	Performance Measurement	4.3	43	0.00
5	Aspects of board Meetings	4.84	48.4	0.00
6	Financial Management and Control	6.48	64.8	0.00
7	Relationship with the General Director	6.2	62	0.00
	Total	4.84	48.4	0.00

H.2 There is a significant statistical difference at level ( $\alpha = 0.05$ ) in the Aspects of the governance at large food manufacturing establishments attributed to the experience of interviewees and size of establishments.

#### Experience of interviewees:

Table (14) shows that the sig. value of Mann-Whitney (0.154) revealed that no significant difference in the aspects of corporate governance attributed to experience of interviewees. This probably was attributed to the similarity in the experience of the establishments. Table (3) revealed that all selected establishments were with experience more than three years.

#### Size of establishments:

Table (15) revealed a significant difference in the aspects of governance among establishments in the Gaza Strip attributed to the size of establishments. Establishments with number of employees 50 persons or more tend to have better aspects of corporate governance compared with establishments which employ between 20 to 49 persons. The sig. value of the total score was 0.038. This difference is logic. Large establishments tend to be more efficient. In addition, their financial, human and managerial aspects lean to be more effective. On the other hand, small establishments tend to be informal in many aspects including in planning, organizing and control. Most of small businesses are managed and controlled by one person. Organizational structure and job description were not written. They rarely have board of directors (Ebert and Griffin, 2003).

Table (14) shows the differences in the aspects of corporate governance attributed to the experience of interviewees by using Mann-Whitney U test

<i>Dependent Variable</i>	<i>Experience</i>	<i>Mean</i>	<i>Sig.</i>
<i>Board of Directors Membership</i>	<i>5 years of less</i>	4.30	0.12
	<i>6 years or more</i>	4.40	
	<i>Total</i>	4.36	
<i>Board Management</i>	<i>5 years of less</i>	3.65	0.32
	<i>6 years or more</i>	3.75	
	<i>Total</i>	3.70	
<i>Policies and Procedures</i>	<i>5 years of less</i>	3.95	0.13
	<i>6 years or more</i>	4.10	
	<i>Total</i>	4.0	
<i>Performance Measurement</i>	<i>5 years of less</i>	4.30	0.32
	<i>6 years or more</i>	4.30	
	<i>Total</i>	4.30	
<i>Meetings and Committees</i>	<i>5 years of less</i>	4.80	0.21
	<i>6 years or more</i>	4.85	
	<i>Total</i>	4.84	
<i>Financial Management and Control</i>	<i>5 years of less</i>	6.45	0.11
	<i>6 years or more</i>	6.50	
	<i>Total</i>	6.48	
<i>Relationship with the General Director</i>	<i>5 years of less</i>	6.2	0.34
	<i>6 years or more</i>	6.2	
	<i>Total</i>	6.2	
<i>Total</i>	<i>5 years of less</i>	4.80	0.154
	<i>6 years or more</i>	4.86	
	<i>Total</i>	4.84	

Table (15) shows the differences in the aspects of corporate governance attributed to the size of establishments by using Mann-Whitney U test

<i>Dependent Variable</i>	<i>Number of employees</i>	<i>Mean</i>	<i>Sig.</i>
<i>Board of Directors Membership</i>	<i>20-49 employees</i>	3.50	0.02
	<i>50 or more</i>	4.60	
	<i>Total</i>	4.36	
<i>Board Management</i>	<i>20-49 employees</i>	3.25	0.03
	<i>50 employees or more</i>	3.85	
	<i>Total</i>	3.70	
<i>Policies and Procedures</i>	<i>20-49 employees</i>	3.55	0.01
	<i>50 or more</i>	4.20	
	<i>Total</i>	4.0	
<i>Performance Measurement</i>	<i>20-49 employees</i>	3.90	0.04
	<i>50 or more</i>	4.40	
	<i>Total</i>	4.30	
<i>Meetings and Committees</i>	<i>20-49 employees</i>	4.40	0.045
	<i>50 or more</i>	4.95	
	<i>Total</i>	4.84	
<i>Financial Management and Control</i>	<i>20-49 employees</i>	5.45	0.034
	<i>50 or more</i>	6.50	
	<i>Total</i>	6.48	
<i>Relationship with the General Director</i>	<i>20-49 employees</i>	5.2	0.032
	<i>50 or more</i>	6.2	
	<i>Total</i>	6.2	
<i>Total</i>	<i>20-49 employees</i>	3.80	0.038
	<i>50 or more</i>	4.96	
	<i>Total</i>	4.84	

## Conclusions and Recommendations

### First: Conclusions

The study concluded that the aspects of governance at Gaza's large food manufacturing establishments were poor; the proportional weight mean was 44.8%. However, large establishments tend to have relative better aspects of governance. They lean to be formal and with better human and financial capabilities.

The main characteristics of Gaza's governance were as follows:

- a. Poor aspects of the board of directors' membership. It was revealed that, the board of directors did not determine the required skills needed for its members, the board members were not diversified in their skills.
- b. Poor management of the board affair. Most Gaza's establishments did not have manual that determine the roles and responsibilities of the board members. They did not have a clear



plan for board meeting and job description was not there. Most of board members were inactive in setting business strategies and direction.

c. Weak policies and procedures were noticed at Gaza's large food manufacturing establishments. The great majority of businesses did not have a written mission or clear objectives. They did not have written policies, procedures, written code of conduct and code of ethics. The board members were not active in strategic planning for business development.

d. The board of directors did not practice its rule in measuring the performance of establishments. The board did not participate or reviews the annual plan of business. They did not measure the performance of business bases on goals achievement.

e. Lack of regular meeting by the board of directors. The board did not have prepared annual plan for meetings.

f. There was an acceptable financial management and control practiced by the board of directors but it needs further development. The board was continuously received quarterly or semi-annual financial reports. It was ensured that the balance sheet and profit and loss account are prepared by the end of every financial year. The establishments use external financial auditors.

g. A satisfactory relationship between the board of directors and general directors were found but it needs further development. The board did not intervene in the daily management of the establishment. The general director was participated in the board meetings. The relationship between the board of directors and the general director was characterized by understanding and cooperation.

## **Second: Recommendations**

The study recommends the following:

- Food manufacturing establishments need to give extra attention to their governance. Good governance is a key for the success of any business. The attention should be given to the overall dimensions of the governance including, policies, procedures, developing and balancing the relationship among business main stakeholders and financial management and control.

- Add more members to the boards from people who are not affiliated with the establishments. This would reduce level of bias and enrich business ideas for development.

- Separate the positions of general directors and members of board of directors so that general director cannot unduly influence the board's meetings and agenda. This should improve the board's ability to properly evaluate top management.

- Use a committee composed of outsiders to nominate potential new directors. This will help to ensure that potential members are not friends of top management

- Nominate people to the board who have knowledge and skills valuable to the board and who have expertise of value to business.

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## COULD A NEW THEORETICAL FRAMEWORK ON INTERCULTURAL COMPETENCE LEAD TO EFFECTIVE TRAINING METHODS?

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### Abstract

The purpose of this paper is to develop an initial theoretical framework based on a thorough literature review in an attempt to capture a spherical meaning of what is it really needed in order to become Intercultural Competent.

Through synthesizing the literature, Intercultural Competence has been interrelated with other dimensions which are regarded important to be considered in order to be able to suggest a training method that will lead to the desired outcome of achieving a high level of Intercultural Competence.

### Introduction

Facing the demands of the 21<sup>st</sup> century, it is evident that companies continually embrace the global market and as a result a highly competitive environment for multinational companies does exist.

The new era of globalization is the long-term importance of creating intercultural training opportunities for business people and students. Failure or success of the twenty-first century international managers and their teams depend on their changed decision-making, taking into account that they are no longer surrounded by their own nationals and their decisions cannot be only based on their common sense and best precedents (Yoshida, 2002). A large percentage of corporate success depends on being in position to provide employees with intercultural competence, helping them to develop effective and appropriate behavior with foreign culture members (Graf and Mertesacker, 2009).

### Developing interest in researching Intercultural Competence

In the past twenty years research on intercultural competence has flourished in a variety of contexts such as international students, expatriates and doctors in sensitivity programs etc.

There are three types of assessment tools being utilized. The first type has been developed before 1996 where many researchers have been developing their own scales for survey research and this is the direct type. The other two types are the indirect and the combined assessment design which are not so common as the direct type and this is perhaps due to their nature being time-consuming in collecting and analyzing direct assessment data (Sinicrope, Norris and Watanabe, 2007).

A major short-coming when using indirect assessment tools can be the fact that often participants have little experience in intercultural situations and are asked for self-reports of

specific behavioral choices in hypothetical situations. Despite though this drawback and other methodological disadvantages, indirect assessment tools still remain the most widely used form of assessment due to their nature and availability. This continuous persistence in use could in fact help in further improvement for each individual assessment tool.

On the other hand the direct type has its own drawbacks since many times authentic scenarios can be difficult to be elicited and portfolios can be subjectively represented. The most important drawback for the combine type it is the fact that they take much longer to be done than the indirect type.

It is obvious that for the combined type one has to weight the advantage of gaining in-depth knowledge and understanding contrasting with the addition of the disadvantages of the indirect and direct type altogether.

### **Need for the right selection of training procedures**

In addition to the right selection of assessment tools, it is also crucial to be able to develop the right training e.g. for international students and potentially future international managers, in order to facilitate and achieve high standards for people's competencies. Being able to provide international students with knowledge on general dimensions on which most cultures differ and possible impacts that these differences can have, then students will be able to communicate more effectively and hopefully guided in paying more attention in their similarities as well. Being aware of expected norms and behaviors of different cultures may lower anxiety and encourage more appropriate behaviors according to the situation (Caligiuri and Tarique, 2005).

### **Need for a finalized global framework**

A major problem arises though, since researchers have not concluded in one global framework which can capture the spherical meaning of Intercultural Competence and its related constructs. This is one of the major reasons why the body of knowledge in intercultural training has not been able yet to impact this field and this is due to the fact that researchers have not agreed yet on the implementation of their findings.

For example an overgeneralization of cultural differences within a proposed framework can indeed lead to a gap between the skills being learned and the application of these skills in organizational practices.

It has to be noticed here that an investigation of the various trainings available should take place relative to the short-term and long-term benefits offered to individuals. Long term benefits can be a direct result of a short-term intervention. The problem arises in cases where a long-term intervention may only have short-term benefits. This can be seen in cases where an individual has learned to be competent within a particular cultural setting but in fact he/she is not capable of shifting that knowledge and uses it appropriately in other cultural settings (Caligiuri and Tarique, 2005).

## **Research aim**

The aim of this research is to develop a theoretical framework which in effect will be able to capture the whole meaning of Intercultural Competence and as such be able to propose the need for tailored training programs which can have a long-lasting effect.

## **Research Objectives**

- Through literature review, learn what it has been already researched in the area of Intercultural Competence.
- Investigate whether there are important factors affecting both negative and positive with their presence the development of Intercultural Competence.
- Identify the gap in existing knowledge.
- To create a new theoretical framework based on existing knowledge and take it a step further.
- Propose a new training procedure based on the study's findings.

## **What is Intercultural Competence?**

As it is described by Hammer (2009, p.3), "intercultural competence is the capability to accurately understand and adapt behavior to cultural difference and commonality. It reflects the degree to which cultural differences and commonalities in values, expectations, beliefs and practices are effectively bridged, an effective environment is achieved, and specific differences that exist in any organization are "addressed" from a mutual adaptation perspective".

It has been suggested by Friedman (2008, as cited in Ashdown, 2010) that "posing questions about one's own cultural underpinnings does not come naturally because culture is taken for granted. Cultural competence is in essence the ability to generate appropriate strategies of action unconsciously, but intercultural competence is the ability to consciously explore one's way of thinking and acting so as to actively construct an appropriate strategy" (Ashdown, 2010).

Motivation for developing this intercultural competence is being triggered by unsuccessful intercultural interactions that are filled with clashes of worldviews. The reality of being part of a global community suggests that managers should be in position to identify and exploit cultural differences in order to act according to each situation in the most appropriate way. Prior knowledge and ways of acts could then become integrated in new other-world understandings in order to create a dynamic multicultural perspective (Ashdown, 2010).

## **The development of the need of being Intercultural Competent**

It has been reviewed by Collard (2007) that mono-cultural assumptions of colonial and national leadership cultures that have been stated in the past are now frequently

inappropriate for diverse populations. The global era now is witnessing the emergence for creating a cross cultural theory and also research paradigms which could combat cultural blindness and develop cultural sensitivities.

It is now accepted that within post-colonial, multi-cultural groups there the potential for interactive effects between their values and societal norms.

Recent perspective views culture as dynamic, ever-changing, multi-layered and complex. This perspective acknowledges that all cultures are constantly subject to change. The key point to bear in mind is that cultures are in constant change and adaptation. Any generalization which can possibly ignore this complexity will inevitably lead researchers in the wrong direction and most probably to unhelpful training methods (Collard, 2007).

In recent years many attempts have been made in order to investigate leadership scholars' approaches which are more attuned to intercultural dynamics (Collard, 2002; Merchant, 2004; Collard and Wang, 2005 as cited in Collard, 2007). Based on this notion, a study held by Wang (2004, as cited in Collard, 2007) investigated the reactions of Chinese leaders on their changing conceptions of learning and leadership. The statements of participants clearly indicated that these Chinese leaders are not frozen in a static inherited culture as older theories assumed. It has to be noted that some of the participants were extremely critical about their cultural inheritance. At the end of the study participants views have been realigned and accommodated understandings that knowledge can be indefinite and contestable and that a learner can be an active constructor of knowledge. It is obvious that once more the subjectivity of our understandings indicate a level of change that may be obscured by cross-cultural frameworks. This evidence indicates that a change which has been stimulated by direct experience, such as new course, may be more effective than a change at a conceptual level such as a theory. The conclusion of this study is that if the above findings are true then it is an important learning for any educational program in any nation which seeks the promotion of cultural adaptability (Collard, 2007).

As such leaders have to value diverse epistemologies and acknowledge that there are multiple culturally based learning procedures (Collard, 2007).

Cultural interactions are seen as being composed by what each individual brings to their social, educational, organizational, ethnic, national and also international encounters. As such this perspective is now attuned to the post-modern conceptions of learning and knowledge, where individuals are seen as active constructors of their own explicit values and knowledge. Besides this perspective, intercultural competence is also redefined, referring to the individual's capacity to recognize different cultural values and be in position to incorporate alternative frames of reference into knowledge construction (Paige, 2004, as cited in Collard, 2007).

Researchers place also importance in adding into the inter-cultural perspectives the cognitive ability that enables them to transform prior frameworks into new perceptions of “inter-culture” (Davis and Cho, 2005, as cited in Collard, 2007).

A question have been made by Chapman (1998, as cited in Collard, 2007) in relation to our understanding of leadership in intercultural contexts and this is whether leaders are passive transmitters of dominant leadership cultures and practices or are they constantly changing and reconstructing their knowledge?. If that is the case courses which teach intercultural competence will equip them to operate with sensitivity when in “alien terrains”. And also when viewing leaders as learners then there is in effect, the potential for innovation and change (Collard, 2007).

### **Expatriates Success**

Expats have also attracted the attention of researchers since they do not only need to be intercultural competent but they also need support on how to adjust in living in another country. A study held by Mansour and Wood (2010) did test the training that was provided to US and European expatriates in Morocco. The design of the study dealt with subdividing the skills needed in order to be successful in a foreign country into three categories of skills: maintenance of self, interpersonal skills and cognitive skills. The success of multinational organizations often depends of the success of these expatriates and although there is an increasing number in the researches devoted in this area, still there is reluctance in translating research findings into practice. The question that remains is to whether existing intercultural training programs do adequately prepare expatriates to operate successfully. The need to develop even more “sensitive” training programs in order to provide the best skills possible to expatriates, is when the gap between cultures is big enough in order to cause maladjustment (Mansour and Wood, 2010).

There are consistent evidences that show the failure rate of expatriates when not being able to adjust adaptively and also there is consistent evidence on a positive relationship between expatriates adjustment and job performance (Bennett et al. 2000; Harzing 1995; Cavusgil et al. 1992; Kraimer et al. 2001; Takeucki et al. 2005, as cited in Mansour and Wood, 2010).

An important issue which has been raised is that the difficulty in expatriates training is the fact that the theory behind is yet to be fully developed. And this inconsistency is created by not having a conclusive theory to base a training method further creates complications on how to implement an effective training method (Mansour and Wood 2010).

In line with the framework of the **Intercultural Developmental Inventory** which deals with moving from ethnocentrism towards ethno-relativism it has been stated that perceived ethnocentrism of the host country nationals’ has a significant negative correlation with the expatriates adjustment.(Mansour and Wood 2010).



The results of this study have shown that locals and expatriates co-workers played a key role for the expats adjustment. This is consistent with the results of previous studies (Black and Gregersen, 1991; Black 1988 as cited in Mansour and Wood, 2010). This evidence shows that expatriates should be trained also on how to create a network in the host culture in order to be able to create social engagements with the host nationals (Mansour and Wood 2010).

Although culture shock could be the source of many stress-induced reactions the results of this study have shown that culture shock did not seem to have an impact on the study's respondents. One explanation could be the fact that respondents had previous contact with the host nationals or another explanation could be the fact that these expats receive help by the locals (Mansour and Wood 2010).

### **Culture Shock**

Culture shock can be caused when people face a new cultural pattern which is different from their own. For example the differences between high and low context cultures can cause misunderstandings and maladaptive behaviors due to the fact that people cannot understand their differences (Xia, 2009). When people face unfamiliarity and change their own psychological adjustment is influenced and can cause symptoms of depression, anxiety and feelings of helplessness (Xia, 2009).

### **Need for Practical Experience**

In another study held by Ashdown (2010) the focus is placed on the fact that management training should include theory that involves practical experience in order that managers will be guided to compare similarities between their own contexts and cross-cultural settings and as a result gradually design conceptual bridges between different contexts (Ashdown, 2010).

Negotiating reality can enable managers to deal with cross-cultural interactions among diverse groups of people. And also they will be able to recognize and use cultural differences as a resource for learning and designing effective actions according to each context (Ashdown, 2010).

While many programs have been excellent in introducing students to cultural concepts, becoming aware of cultural differences and adapting to new situations, they do not systematically identify, or prepare students to develop and use cultural learning strategies (Cohen, Paige, Shively, Emert, Hoff, 2005).

As such the fundamental purpose of the research program held by Cohen et al. (2005, as cited in Cohen, Paige, Shively, Emert, Hoff, 2005) was to test the efficacy of the "Maximizing study abroad guide" on whether it actually provides students with the required knowledge in order to enhance language learning and promote intercultural skills. An experimental research design had been delivered that examined the strategy being used, language

acquisition and intercultural development at two different points in time and also compare students who used the guide to those who did not (Cohen, Paige, Shively, Emert, Hoff, 2005).

With respect to cultural learning the work of Kolb (1984, as cited in Cohen, Paige, Shively, Emert, Hoff, 2005) had been very influential on the design of the learning strategy. That is, effective learning involves experience, reflection, conceptualization and experimentation. Students were encouraged to approach culture by utilizing a learning cycle which involved participation in the culture by active experience, making sense of what they are experiencing through reflective observation and abstract conceptualization. Interaction plays an important role in this learning cycle because through active involvement acquiring knowledge becomes inevitable (Cohen, Paige, Shively, Emert, Hoff, 2005).

The overall results of this study had shown a discrepancy between the quantitative data and the qualitative ones. It has to be noticed though that there was a number of individual items that had shown that there was a positive effect on the group who had used the study guide both language-wise and culture-wise. One possible explanation given, is that time constrained the number of strategies that the students could have used. Many students did indeed report that they were pressed for time during study abroad. Several students also commented that if they had more time they would have used the strategies to a greater extent in order to further improve their learning. A suggestion given for future research is an ethnographic study to take place, since it would likely provide rich insights into how and why students use specific strategies and be able to effectively triangulate data collection methods (Cohen, Paige, Shively, Emert, Hoff, 2005).

In another paper held by Graf (2004) it has been mentioned that most of the training conducted is not theoretically substantiated and one reason for this is the lack of articulated theory of intercultural competence underlying the various designs and techniques in use (Graf, 2004).

The purpose of this study was to assess different intercultural training designs based on two dimensions: didactic and experiential learning, gather evidence for the benefit of the presented training designs and be able to draw conclusions for how to design intercultural trainings. On one hand didactic approach allows for a cognitive understanding of what is being taught and on the other hand the experiential approach to training is based on the assumption that people learn best through their experiences (Graf, 2004).

Although the findings suggest that culture general training tend to be more favorable this could be due to the fact that Germans and Americans who were participating in the research do not essentially need different competencies when working with individuals of another culture. It has been concluded that a “one-size-fits-all” approach might not be effective, as various aspects of the training need to be tailored in order to fit the culture and the organization (Graf, 2004).

Also, the experimental design is the one that is being recommended because through experience individuals are getting feedback on doing the role-plays and this allows the enhancement of the knowledge about other cultures, experiencing also emotions and getting along with prejudices and learn to re-act appropriately in various educational settings. Didactical sessions can come as a supplement and they are appropriate for improving knowledge about other cultures because they are insufficient on their own to develop the emotional and the behavioral dimension of intercultural competence (Graf, 2004).

One potential problem in the design of an intercultural training is the increasing demand for short-term trainings. Although these short-term trainings can be effective in increasing awareness it has to be considered that acquiring intercultural competence is a much more complex and long-term process. In general the cognitive component of intercultural competence can be developed within a short period of time, but the ability to manage biases and stereotypes and become able to develop the appropriate behaviors have to be trained gradually in order to have a long-term effect as well (Graf, 2004).

### **IDI Intercultural Development Inventory**

A validated assessment tool belonging in the indirect type of assessing Intercultural Competence is the IDI which has been developed by Dr. Mitch Hammer and it is based on the Developmental Model of Intercultural Sensitivity (DMIS) originally proposed by Dr. Milton Bennett. The IDI is a cross-culturally valid and reliable assessment tool (Hammer, 2009).

There are several assumptions which are underlying the DMIS and these are related as to how the DMIS can be measured by the IDI. Most importantly, it is suggested that, the intercultural sensitivity model captures the individual's experience of cultural difference, not objective behavior. It is also suggested that, intercultural sensitivity is being viewed in developmental terms and it is conceptualized as a continuum ranging from a more ethnocentric to a more ethno-relative worldview. Having this structure it is implied that, progression along the continuum can be facilitated through training and education (Hammer, Bennett, 1998, 2001).

In a study held by Hammer et al. (2003) different analyses took place in order to test the reliability and validity of the IDI. Overall, the results of the confirmatory factor analysis which was carried out as part of the development of a revised IDI tool, indicated that a five-factor solution provides a good fit to the data. In addition, in a direct comparison of the five-factor solution with both the original model of intercultural sensitivity proposed by Bennett (1993b) and a two-dimensional, more global model, the five-factor was found to be superior (Hammer et. al., 2003).

In an attempt to further provide analyses of the IDI, an effort was undertaken – after establishing the validity and reliability of the 50-item IDI – to develop a total IDI score grounded in the DMIS theory such that lower scores reflect more ethnocentric orientations and higher scores reflect more ethno-relative world views (Hammer et. al., 2003).

Teaching sensitivity on cultural difference was the purpose of a teacher action research held by O' Durocher (2007). The purpose was to deliver teaching of subjective culture in the foreign language classroom. Bennett's model was compared and contrasted with other approaches to teaching culture, its strengths and weaknesses were discussed and suggestions for implementing the model were presented. In this study it is pointed out that Bennett's model provides a good blueprint for intercultural communication training. It has also been said that there is a gap in Bennett's model, that is, the fact that it does not address, at least not explicitly, the relationship between language and culture (O' Durocher, 2007).

## **Other interrelated constructs**

### **High vs. Low Context Cultures**

The cultural framework proposed by Edward Hall states that all cultures can be situated in relation to one another through the styles in which they communicate. High and low context communication assumes great significance when people from different categories interact and therefore contributes to trust building or the lack of it. As stated in *Understanding Cultural Differences* (Hall and Reed, 1983, p.85) "A high-context communication or message is one in which most of the information is already in the person, while very little is in the coded, explicit, transmitted part of the message. A low-context communication is just the opposite; that is, the mass of the information is vested in the explicit code". For example, low-context people such as Germans and Nordics will require explicitness about how they are to proceed. On the contrary, high-context people such as French, Indians and Japanese will leave a lot unsaid, paying their colleagues the compliment of assuming they know the situation. It is important to note here that, high-context people speak more but they say less and low-context people speak less but every word counts (Lewis, 2006).

Related with the cultural framework proposed by Edward Hall, a study was held by Donghoon, Yihang & Heung Soo (1998) which compared Chinese, Korean and American cultures. Based on the findings of this research study, it was reported that Hall's description of the characteristics of high- and low-context cultures can indeed be empirically confirmed. Overall, the results have shown that the three cultures differ in a way that is consistent with Hall's cultural framework. More specifically, the American subjects have shown to exhibit tendencies that are consistent with low-context cultures. On the other hand the Chinese and Korean subjects have shown to exhibit tendencies that are consistent with high-context cultures (Donghoon, Yihang & Heung Soo, 1998).

### **Emotional Intelligence**

The other construct that is taken into consideration is Emotional Intelligence. Emotional Intelligence has been defined as the ability to recognize and regulate emotions in ourselves and others (Goleman, 2001). A lot of interest has been placed in measuring Emotional Intelligence because scientists became aware of its crucial importance in many areas such as

job success and leadership, life satisfaction, healthy psychological adaptation, positive interactions etc (Stys and Brown, 2004).

Based on Stone's (2006) proposed model of Intercultural Effectiveness (Stone uses the term Effectiveness instead of Competence) - which includes: knowledge, skills, emotional intelligence, motivation, openness, resilience, reflectiveness and sensitivity – it would be interesting to test whether students who score high on measures of Emotional Intelligence would also score high on Intercultural Competence.

In the study held by Tang, Yin and Nelson (2010, p.12) the results were consistent with a conceptual framework differentiating one culture from another. As it was expected, regarding emotional intelligence, the Taiwanese sample of academic leaders tended to use a less assertive communication style as well as an indirect communication style in order to maintain group harmony.

A strong significant relationship was found for the Taiwanese sample between challenging the process and their Emotional Intelligence's skill of assertion, and this finding seems to be in accordance with previous studies on influence tactics. Different cultures might possibly impose assertion in different ways. The use of Assertiveness varies according to the different types of strategies being employed by each culture (Tang, Yin and Nelson 2010).

Overall, from the comparisons among the two cultures, the strong correlation between EI and leadership practices implies that emotional intelligence was perceived as an underlying competency for effective academic leadership in both cultures. It has been also stated that in order to be able to lead effectively, high emotional intelligence is a required skill in order to have a sense of self-awareness, being able to manage their own emotions and also those of others and lastly to be able to lead in accordance with the cultural expectations of their organizations (Tang, Yin and Nelson 2010).

### **Personal Character Traits**

It has been found that successful and well-adjusted international assignees tend to share certain personality traits. These characteristics enable individuals to be open and receptive in learning the norms of other cultures and be able to adjust themselves according to new environments. Individuals who are assertive and exhibit the characteristic of openness tend to establish interpersonal relationships with people from different cultural backgrounds much more easily than non-assertive individuals (Caligiuri and Tarique, 2005).

In the study held by Bird, Mendenhall, Stevens and Oddou (2010, p.1) progress in describing the relationship of intercultural competence and global leadership's effectiveness and performance, is still impeded due to the various domains of intercultural competence not being clearly stated and as such not being validated.

Perhaps the absence of a comprehensive formulation of intercultural competence can be due to the fact that attempts have been made across a wide range of disciplines such as

psychology, international management and education. Another reason of this complexity might be the fact that intercultural competence it is often described as involving affective, cognitive and behavioral competent and further distinguished between stable and dynamic components. Working without a global framework can lead to a-theoretical, survey-oriented, conceptual mapping studies that they often reproduce similar findings which are described with different terminologies. Such attempts are not entirely unproductive but special attention should be placed in order for more refined empirical and theoretical research to continue. Within the contents of this study, the broad definition has been retained and the relevant content domain has been defined in terms of the stable competencies – which can also be defined in terms of personality traits or predispositions (Bird, Mendenhall, Stevens and Oddou, 2010).

After careful consideration and gaining insight on what is actually needed in order to become intercultural competent it has been decided that both quantitative and qualitative data should be used in order to achieve the desired outcome of the proposed framework. Data will be taken before and after the application of a training method in order to compare the results and possible effects of the training method.

The new framework that is being proposed by the current study should be tested in order to see its effect and whether it could indeed offer a long-term solution to the current problem of being able to master intercultural competence.

The research questions (RQ) and hypotheses (H) that have been developed are the following:

RQ1: How do individuals realize the need of becoming Intercultural Competent?

RQ2: Do individuals identify any practical implications in relation to a training method?

RQ3: How do individuals behave when faced with the idea of changing existing practices and also changing existing behavioral choices?

H1: It is expected that high-context individuals will score high on Intercultural Competence questions.

H2: It is expected that low-context individuals will score low on Intercultural Competence questions.

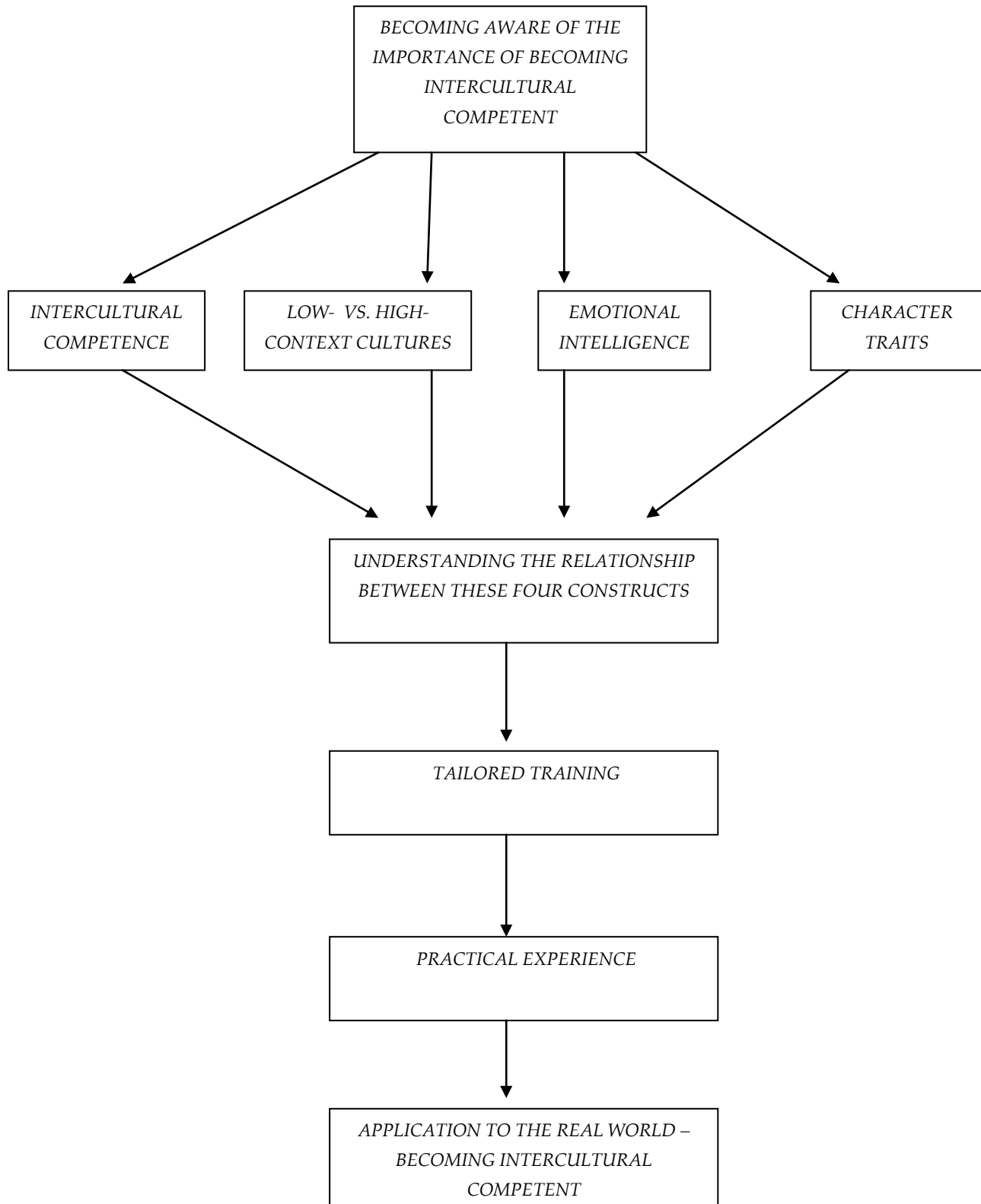
H3: It is expected that individuals scoring high on Emotional Intelligence will score high on Intercultural Competence questions.

H4: It is expected that individuals scoring low on Emotional Intelligence will score low on Intercultural Competence questions.

H5: It is expected that individuals scoring high on Specific Character Traits will score high on Intercultural Competence questions.

H6: It is expected that individuals scoring low on Specific Character Traits will score low on Intercultural Competence questions.

The new proposed framework:



## Conclusion

Taking into serious consideration the previous research work which has been analyzed in section 4, it is evident that the gap in knowledge appears due to the fact that the different attempts to identify Intercultural Competence were made from a variety of different schools of thought which were based on one point of view each time. This fact limits the horizon of identifying what is actually needed in order to become intercultural competent.

The problem that arises is that a finalized and spherical framework on Intercultural Competence has not yet been defined.

An attempt has been made with this study to have a wider view on what skills are actually needed in order to become intercultural competent taking into consideration different aspects that could affect a person's personality and behavior.

It is also a must, that long-term effects are the final goal of delivering this framework and not just a short-term intervention which could be applied only for a specific incidence.

The most important part that is being proposed with this new framework is the addition of the construct of emotional intelligence, the difference between low and high context cultures and character traits. Differences between these will lead to a different and tailored training according to the person's needs.

The first part of the framework focus on becoming aware of what is intercultural competence and why it is important in today's globalized century. Understanding the relationship between intercultural competence and the other 3 constructs and also considering possible interrelationships between them.

Learning should then come through practical experience and lastly applying what it has been learned in the real world.

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## INTER-CULTURAL COMPETENCE AS A KEY SUCCESS FACTOR FOR SALES PERFORMANCE OF FRONT LINE EMPLOYEES: THE CASE OF THE BANKING INDUSTRY IN CYPRUS

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### Abstract

In the current highly competitive market, with events such as the recent global recession, banking institutions have to enrol with the changes of the environment and utilize to the fullest extent possible all of their key components. As such, among the most precious elements a bank possesses is the front line workforce that interacts on a daily basis with the end customer. However, in the banking industry of Cyprus, appraisals undertaken by a banking institution in order to evaluate the sales performance of its front line employees showed a considerable weakness. Based on an extensive and systematic review of the literature, this article introduces three new factors regarding the sales performance of front line employees, inter-cultural competence, Problem Solving Approach (PSA) and negotiation skills. Lastly, front line employees should learn to sell through communicating rather than persuading, which calls for a searching need in the field of relationship developmental skills. Hereupon, through its synthesis and the introduction of those new elements into a new synthesized conceptual model, that is what this paper aims to fulfil.

**Keywords:** Sales performance, Bank, Front line employees, Inter-cultural competence, Cyprus, Emotional Intelligence

### Introduction

Today's financial environment is frequently characterized as competitive and unstable. Financial providers must be flexible because everything is changing so rapidly. Due to the financial crisis, which started the first quarter of 2007 (Goddard, Molyneux and Wilson, 2009) consumers changed the way they behave.

This global (Akinbami, 2010) phenomenon has tremendous impact also on Cyprus. Cyprus has an important - strategic geographical position and has always been the reason for many wars, as many empires tried to dominate Cyprus (Dinkov and Stoyanov, 2005). Accordingly, existing theories on sales performance and sales process may not apply in the reality of Cyprus. New approaches should be explored in order to have theories applicable to the idiosyncratic conditions of Cyprus. As it is shown from a bank's annual results there is a need of developing new approaches for the front employees

helping them being more efficient. practice. Existing approaches seems to be insufficient and is rather urgent because, as cited by Cook and Hababou (1998), Deloitte and Touche stated that “In the future, the banking branches that do succeed will likely function more as sales centres than service outlets”.

There are a lot of articles on sales performance but only a few focuses on the front line employees working in a Bank (Singh, 2000). The current paper seeks to identify those factors, which when integrated can achieve success in sales. This “gap” will be investigated through a series of steps. The remainder of the study consists of the following sections: Firstly, the author will try to give some basic Definitions of the concepts involved and then proceed to the Search Strategy, including the sources and focalization. The articles which will result from the election criteria will be eventually “synthesized” at the end, trying to identify what has been written and tested on this topic (Tranfield, Denyer and Smart, 2003).

## **Background**

Systematic review of past research is an important part of this doctoral journey towards the creation of a conceptual framework, linking inter-cultural competence with front line employees’ sales performance in the banking sector in Cyprus.

### **Research aim and Objectives**

The Research aim is as follows:

The aim of this research is to develop a conceptual framework relevant to the link of front – line employees’ sales performance with inter-cultural competence in the Banking Sector in Cyprus. Specifically, this paper aims to develop a conceptual framework in order to promote better sales performance for the front line employees in the banking sector in Cyprus. Trying to serve academic and practitioner communities, the explored hypothesized explanatory variables will, at a later stage, be validated by empirical research in the banking sector in Cyprus.

The Research objectives are as follows:

- a. To systematically review the literature on the synthesis of concepts relating to front line employees’ sales performance in the banking sector in Cyprus.
- b. To investigate if correlations exist between relevant concepts.
- c. To develop a conceptual framework as a result of synthesizing pre - existing knowledge
- d. To test the developed conceptual framework in the banking industry in Cyprus.
- e. To adjust the framework in the banking industry in Cyprus, and to produce new knowledge contributing in this way to both theory and practice.

The objectives a to c, examine the ground basis of theory and thus, confirm existing knowledge. Furthermore, objectives d to e, contribute to theory and professional practice at a doctoral level.

## **Literature Aim and Objectives**

### **Aim**

The aim is to provide «collective insights through theoretical synthesis» (Tranfield, Denyer and Smart, 2003, p. 220) into the field of the banking sector in Cyprus, linking front - line employees' sales performance with inter-cultural competence.

### **Objectives**

- To systematically review the existing researches on sales performance of front line employees and the importance of inter-Cultural competence
- Synthesize performance of front line employees on sales along with inter-cultural competence.
- Try to explain sales success by multivariate analysis

## **Defining Front line employees**

Front line employees have to anticipate customer's wishes with high quality service and at the same time be efficient and productive, satisfying the organization (Singh, 2000). They are the link between the bank and customer (Stephenson and Kiely, 1991; Font, 1993).

## **Defining Employee Performance and Sales Performance**

“Performance can be described as an umbrella term for all concepts that considers the success of a company and its activities” (Tangen, 2004, p. 40). In the case of front line employees' performance, productivity and quality are two different elements, influenced by different factors. Quality connects with customer interaction, which requires emotional and laborious efforts; and productivity, is the “backroom” work and the transactions with the customers (Singh, 2000).

Personal selling is communicating information trying to persuade a prospective customer to proceed to a buy of something – a good, service, idea, or something else (Futrell, 1992). One of the oldest paradigms in the profession of selling is the “seven steps of selling” proposed by Dubinsky (1980) which the following are included: the “prospecting”, “pre-approach”, “approach”, “presentation”, “overcoming objections”, “close” and “follow up”. Later on, these techniques evolved to methods more close to a relationship approach (Moncrief and Marshall, 2004)

## **Defining Emotional Intelligence**

During the last years, emotional intelligence has puzzled a lot of researchers, who have tried to define, explain and measure it. Goleman (2001) claims that most researchers agree on the core dimension of emotional intelligence, which is about the ability to “recognise and regulate emotions in ourselves and others” (Cherniss & Goleman, 2001, p.14) In this definition we can also find also the four major emotional intelligence domains: Self-Awareness, Self-Management, Social Awareness, and Relationship Management. In this paper, emotional intelligence will be studied within the parameters of the sale's

performance of front-line employees in the banking sector in Cyprus. A specific skill, the inter-cultural competence skill, will be under the Emotional Intelligence's domain as it has to do with the social competence in the "Social Awareness", and the communication under the domain of "Relationship Management".

### **Defining the concept of Motivation.**

Motivation is one of the main factors contributing to increased performance, thus a provided definition is essential for the later study. According to Barrick and Ryan (2003), Motivation is the decisive effect which determines the project someone puts effort in, the level of effort, stamina and persistence he or she will show to achieve his goals (Barrick & Ryan, 2003). The same authors claimed that Motivation is the link between aspects of sales Representatives' job performance and conscientiousness. Moreover, Salovey and Mayer (cited in Goleman, 1998) added that motivation is one of the five basic emotional and social competences.

### **Task**

According to Motowidlo, as cited by Barrick and Ryan (2003), there is differentiation between task knowledge and task skill. The first one refers to the knowledge of principles and procedures related to the operational functions, whereas task skill is the skill required for accomplishing a particular task.

### **Defining the Local Culture**

According to Hofstede (1980) Culture is the mental programming a group of people share and which differs from the mental programming another group of people have in common. The "national norm", which comprises the common beliefs, is not easy to change as it is in every function of a society (Hofstede, 1980).

The current study associates itself with the third Dimension of Hofstede theory, the "Individualism – Collectivism" as it explores the way people comprehend and react to specific situations in specific geographical location regarding the way they are nurtured by society. According to Hofstede, in countries with high individualism, there is greater independence among individuals, whereas in countries with high collectivism, there are stronger bonds between people. European countries differ from one another; even though they are presumed to be collectivistic (Segalla et al., 2006).

According to the research upon the influence of regional culture on sales force recruitment is an "Under-researched" area and there are a lot of elements, which need to be examined (Rouzie's et al., 2003). There is a need for the production of new approaches and theories, as "theories reflect the cultural environment in which they were written" (Hofstede, 1980, p. 50).

The current study will focus on the culture of Cyprus. Cyprus belongs to the same culture group as Greece. The reason is the geographical proximity, common traditions, language, national origin and religion (Dimitratos et al., 2011). Nevertheless, it is a challenging endeavour when it comes to

anthropological observations and behaviours. There might be a need for a differentiated approach, as far as Cypriot culture is concerned.

### **Defining intercultural competence**

Intercultural competence includes cultural awareness, cultural sensitivity and cultural adroitness. Cultural awareness is about knowing what effects a person's behaviour will have on others. Also, it includes the understanding of characteristics of other cultures and accordingly adopting the behaviour. Cultural sensitivity is when someone is open-minded and does not judge, because he or she tries to understand and respect values of other cultures. Cultural adroitness is to know what to do in order to communicate effectively avoiding offending anyone (Chairsakeo and Speece, 2004). People not sharing the same culture, have different and sometimes "incompatible values, norms, relationships and communication styles" (Chen-ya and Mattila 2010, p. 330). This, of course, increases the chances of misunderstanding, according to Furnham and Bochner (1986) and Hall (1959), as cited by Chen-ya and Mattila.

## **Methods**

### **Search Strategy**

#### **Search Strategy adopted – elaboration**

The author of this study chose to proceed with a combined search strategy, applying both manual and automated search. Manual search in the library targeted on definitions. For the examination of topics relevant to the current study's topic, automated search was conducted 3.1.2.

#### *Specification of the search terms*

During the creation of the present literature review, the author used the following English search terms:

- Emotional Intelligence AND sales\* OR selling
- Success AND sales\* OR sell\*
- Intercultural AND service OR sell\* OR sales\*
- Performance AND salesperson
- Personal AND selling

\*The asterisk was used in order to increase the amount of articles, allowing the following variables:

Sales\* = sales, salespeople, salesperson

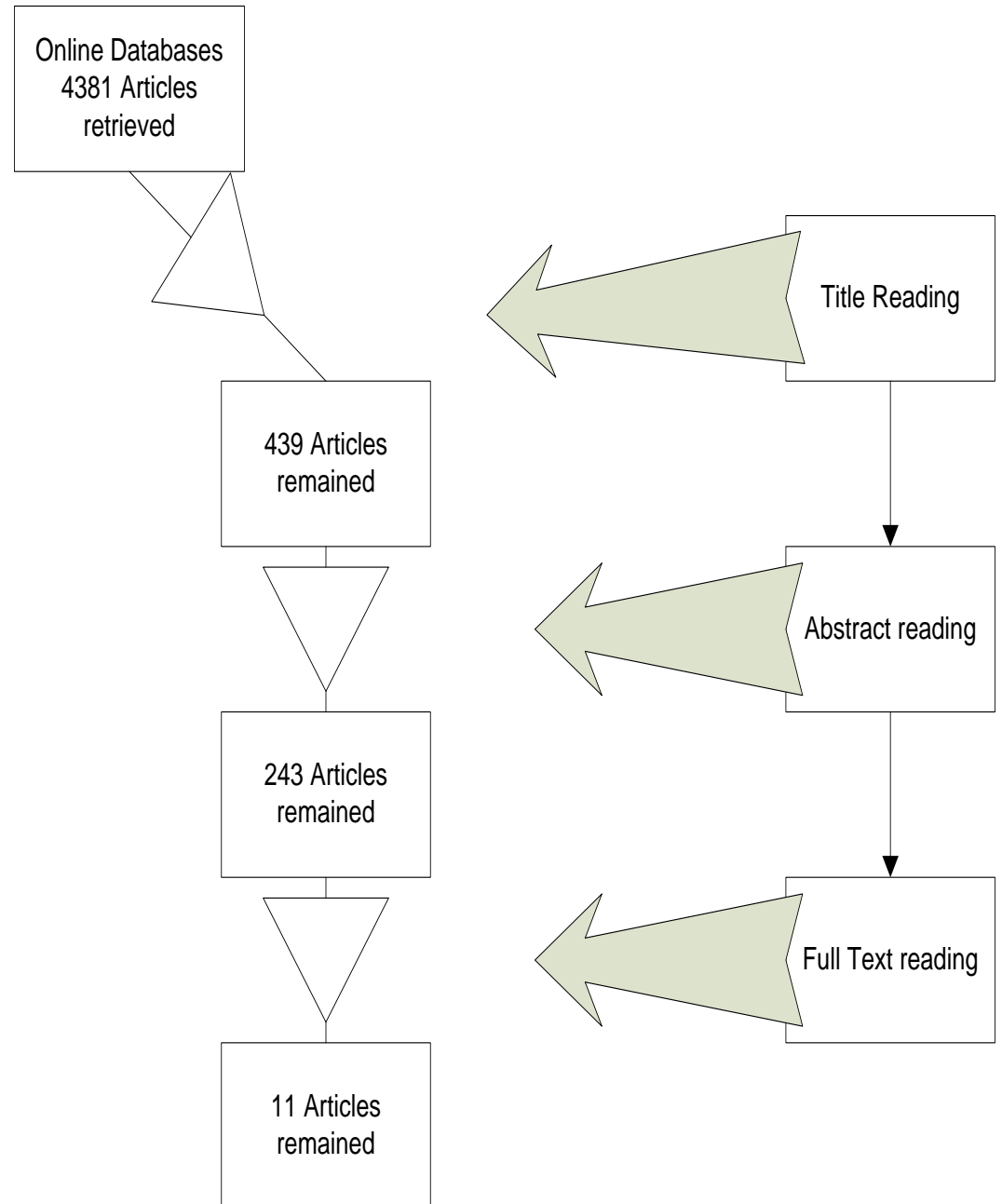
Sell\* = selling, seller

**Resources used for automated search**

The present study based its search on online electronic databases and internet search engines. Same search terms were used in all electronic databases, in order to ensure that every available relevant article was going to be examined. In this way the author increases the possibility of an intensive and thorough search.

- EBSCO Host: <http://web.ebscohost.com>
- Emerald Insight: <http://www.emeraldinsight.com>
- Science Direct: <http://www.sciencedirect.com>
- Google Scholar: <http://scholar.google.com>
- Reuters <http://www.reuters.com>

The sum of the results retrieved from the literature search are shown in Figure 1 below:

**Figure 1**

#### Specification of time frame the search was limited to

Sales models have been in the body of literature for ages. The author decided to set the time frame from 1985-present. The reason is because in 1985 Churchill et al. (1985), regarded as pioneers in their field,



conducted a meta-analysis using 116 articles, trying to find the determinants of sales performance detected until then. In addition, this article was published in the Journal of Marketing Research, ranked as top in the Harzing list.

### **Ancillary search procedures**

Besides the automated search, the author tried to find relevant sources through the references of articles retrieved. That enables the researcher to read into the topic and ensures that the author will be informed about influential writers in the field and important definitions and models developed by them.

### **Selection Criteria**

Authors should include in the review, only studies which meet all the inclusion criteria. Those criteria were clarified in the review protocol (Tranfield and Smart, 2003).

**Time :** As the table illustrates, time frame includes studies from 1985 onwards, for the reason mentioned above.

**Language :** Studies written in other language except English were excluded, as the author could only comprehend literature written in English.

**Focus :** Selling Process is a complex topic affecting the performer, the receiver and the person who evaluate the selling process. The current study deals with employee's perspective, so studies not referring to employers, were excluded. The focus needs to be specifically on how employees deal with and perceive the selling process.

**Methodology adopted:** The author included research papers conducted with both qualitative and quantitative research approaches. The topic of the current study is dealing with social skills, cultural and inter-cultural competences, which can be well examined through the qualitative approach, as it allows in depth investigation giving the chance to people express and justify their selves. On the other hand, since it also investigates those factors, which help the selling process, a quantitative approach allows the examination of correlations and analysis

### **Quality Assessment**

A Quality Checklist was generated in order to measure the quality of the selected studies, and it comprises the following elements: Validity, Credibility, Integrity and Reliability.

#### **Validity**

Validity measures the success of the study to cover its research topic. Specifically, it focuses on the study's success to measure what it intends to measure.

#### **Credibility**

Credibility measures the degree to which the research of the article is believable and how credible the author's qualifications are to undertake the research topic. In addition, credibility is also measured by the writing style of the article, if it is academic and scientific.

**Integrity**

Integrity focuses on how robust the research study is and if the chosen research process is strictly adopted. It can be measured by evaluating if the methodology approach adopted in the study is identified and has a rationale of the choice made (Caldwell et al., 2010; Coughlan, et al., 2007).

**Reliability**

Reliability focuses on the consistency and the degree to which the study can be replicated and how generalizable the results are. However, reliability cannot be measured, it can only be hypothetically assumed (Collis & Hussey, 2003; Caldwell et al., 2010).

**Figure 2**

**Data Extraction**

After the process of selecting the studies to be included in the review and after passing them through the quality assessment process, the following data were extracted from the selected studies:

- Publication details: Title of the paper, Author's name, year of publication.
- Features of the study: methodology adopted, population characteristics, sample size.
- Key findings.

This process was implemented and documented through a data extraction form that minimizes as much as possible the human error (White and Schmidt, 2005; Tranfield et al., 2003). Table 2 illustrates the data extraction form along with the data extracted from each of the selected studies.

Table 2. Data extraction form –Summarized data from the selected studies

Nr	Title	Author/s	Publication details	Year of publication	Methodology adopted	(Population) Characteristics	Sample size	Key results
1	A grounded theory model of service providers' stress, emotion, and coping during intercultural service encounters	Chen-ya Wang and Anna S. Mattila	Managing Service Quality, Vol. 20, No 4, 2010, p.p. 328-342	2010	Semi-structured qualitative interviews	Female and Male Caucasians, Asians, Asian-American. Ages: 20-45 Service encounters	9 Female 4 Male	Intercultural interacting can be frustrating for service encounters. Luck of intercultural sensitivity may lead to avoidance of the customer
2	Success in Selling – The Current Challenge in Banking	Bill Stephenson and Julia Kiely	International Journal of Bank Marketing Vol. 9, No 2, pp. 30-38	1991	Semi-structured qualitative interviews	Senior managers from NatWest, Barclays, Lloyds, Midland and Abbey National	10	Sales Culture: Driving force for future success the movement to individual ability
3	The Determinants of Salesperson Performance: A Meta-Analysis	Gilbert A. Churchill, Neil M. Ford, Steven W. Hartley,	Journal of Marketing Research Vol. 22, No 2, pp. 103-118	1985	Meta-analysis : systematic synthesis of quantitative empirical evidence of	Published and unpublished literature: Journals, dissertations, industry selected	116 Articles	According to the average size of association with sales performance: role, skill, motivation, personal

		Orville C. Walker			research studies	material		factors, aptitude, organizational /environmental factors
4	Hiring for success at the buyer – seller interface	Gerg W. Marshall, Daniel J. Goebel, William C. Moncrief	Journal of Business Reseach , Vol. 56, pp. 247-255	2003	Triangulation Focus groups and Questionnaires	Focus groups: sales managers and sales executives from mix industries(consumer and business markets) Questionnaires: US members of a multi-industry association of sales managers Average age: 44	6 Focus groups Group size: 8-12 Questionnaires: 147 Male 62 Female	Created a list of sales managers' importance ratings of success factors for salespeople, with the highest "Listening skills" as sales fall into the category of relational era.
5	Critical success factors in the personal selling process An empirical investigation of Ecuadorian salespeople in the banking industry	Fernando Jaramillo, Greg W. Marshall	The International Journal of Bank Marketing, Vol. 22, No 1, pp. 9-25	2004	Quantitative - Questionnaires	Sales force of the two large Ecuadorian banks (self-reported and supervisors' ratings)	246	Critical success factors: The five stages of selling procedure.

6	A meta – analysis of the relationship between organizational commitment and salesperson job performance: 25 years of research	Fernando Jaramillo, Jay Prakash Mulki, Greg W. Marshall	Journal of Business Research, Vol. 58, pp. 705-714	2005	Meta-analysis : systematic synthesis of quantitative empirical evidence of research studies	Studies in English from 30/6/74-31/8/2002	51 manuscripts Sample orig. from 14 countries	Confirm the positive relationship between organizational commitment and job performance
7	Exploring the role of self- and customer-provoked embarrassment in personal selling	Willem Verbeke and Richard P. Bagozzi	International Journal of Research in Marketing, Vol. 20, 233-258	2003	Qualitative Focus groups (Two Experiments)	Sales Professionals Majority : Male Ages: 30-40 Experience: Average years of experience 5.8 (1 <sup>st</sup> Exp.) and 6.7 (2 <sup>nd</sup> Exp.)	Total for both Experiments 133	Managing embarrassment and showing sensitivity can positively affect sales. Otherwise negatively impacts sales performers.
8	Retail Banking in Spain: Recent changes and their effect on the content and culture of Front-desk Jobs	Francisco Bosh Font	International Journal of Bank Marketing, Vol. 11, No 1, pp 11-17	1993	Systematic Literature Review	Information carried out by FRS Iberica	Spanish consumers	The recent changes on technology and customers' increased financial sophistication, front line employees become advisors and through communication promote products
9	Culture, intercultural communication	Chaisrakeo Sunanta and Speece	<i>Journal of Business &amp; Industial</i>	2004	Qualitative Approach – In depth	Sales reprs of multiple nationalities	From high-context cultures: 4 Male	Negotiation skills depend on cultural context and have an

	competence, and sales negotiation: a qualitative research approach	Mark	<i>Marketing</i> , Vol. 19, No 4, pp.267-282.		interviews	operating in Thailand in various companies (i.e. insurance, retailing) Age: 25-50 Experience in international sales negotiation	6 Female From low-context cultures: 11 Men	impact on salesperson's Problem Solving Approach.
10	Exploring the need for emotional intelligence and awareness among sales representatives	Dean R. Manna and Alan D. Smith	Marketing Intelligence & Planning, Vol. 22, No. 1, pp. 66-83.	2004	Qualitative Approach – Interviews	Professional sales representatives	515	Communication skills, negotiation skills, emotional intelligence and presentation skills are very crucial to salespeople.
11	Discriminating emotional intelligence-based competencies of IT employees and salespeople	Yildirim Osman	Journal of European Industrial Training, Vol. 31 No. 4, pp. 274-282.	2007	Quantitative-Emotional Intelligence Inventory	Employees from banking, insurance etc sectors. (12 Firms) Average age from sales: 35 and ITs: 30.	From sales people: 30 Male 31 Female From salespeople in IT sector: 26 Male 24 Female	Certain competencies like social skills, differ between sales people and IT employees.



## Synthesis

### Synthesis development

#### The changing role of front line employees

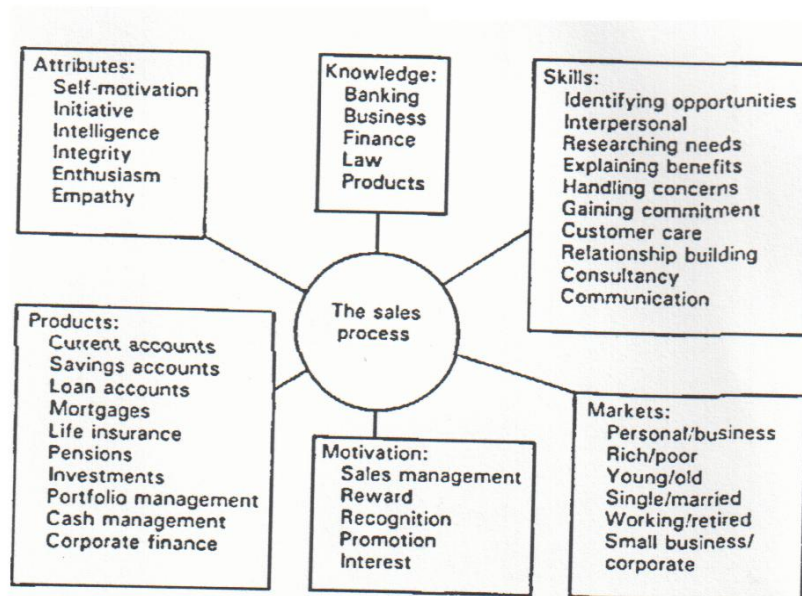
Banks have already realized that to succeed in today's demanding and competitive arena, they need to be flexible and change their focus from the "institutional image" to individuals' abilities, taking advantage of the people working face-to-face with customers (Stephenson and Kiely, 1991).

The advancement of the technology and customers' increased financial sophistication has inevitably changed the way bank's branches are organized. Since the "back office"- transactional- activities have been automated, staff can focus on the interaction with the customer. Today, branch office is the "delivery and selling point" and front line employees become advisors and through advising proceed to cross selling. That's exactly what clients look for. Front line employees should satisfy clients and at the same time make sure that they will make profit for the bank. This requires communications skills, as they will absorb and transfer information and then accordingly suggest and advice.

#### **Stephenson's & Kiely's Model: "Factors Influencing Selling Process in the banking sector"; Missing skill?**

Most of the skills have already been discussed and are incorporated in various selling models. Stephenson and Kiely (1991) created a model illustrating the "Factors Influencing Selling Process in the banking sector". As shown in Figure 3, sales process is surrounded by the factors influencing it. The factors are categorized in six groups. First category is "Attributes", second category is "Knowledge", third category is the one concerning the "Skills", fourth group is the group of "Motivation", fifth category is "Products" and sixth relates to "Markets". The last three categories concern the organization, whereas the first three concern the service encounters (Stephenson and Kiely, 1991). This is a rather complete model, but as they stated, "motivating and managing a branch staff in selling brings with it a totally different set of challenges from that of dealing with direct sales forces" (Stephenson and Kiely, 1991, p. 38). Thus, the existing model of sales and other models of sales need to be adjusted when it comes to branches. Employees having constant contact with foreign customers, something very frequent in Cyprus' reality, presume an important factor missing from the model, the skill of inter-cultural sensitivity. Chen and Starosta (1996), as cited by Chairsakeo and Speece, stated that inter-cultural competence is a sine qua non for the efficiency, due to the globalization and the need for intercultural selling (Chairsakeo and Speece, 2004).

Figure 3: Stephenson's &amp; Kiely's Model



### The importance of Inter-cultural competence

The above skill is highlighted in the research Wang and Mattila (2010), even though it does not focus on sales but in service provider's perspective, especially when having to deal with customers coming from different cultures. According to the article, there are two ways of coping. On the one hand, dealing with the problem; on the other hand avoiding the problem. According to the interviews, employees interacting with customers from different cultures need to be good in understanding the body language and be patient. Otherwise, it can get very frustrating for the customer and provoke again avoidance (Wang and Mattila, 2010). Inter-cultural sensitivity is a skill that strengthens performance when dealing with international customers or prospect customers. Authors encourage further research in various service industries on this subject (ibid.).

### Examples of other Social emotions-importance of inter-cultural understanding

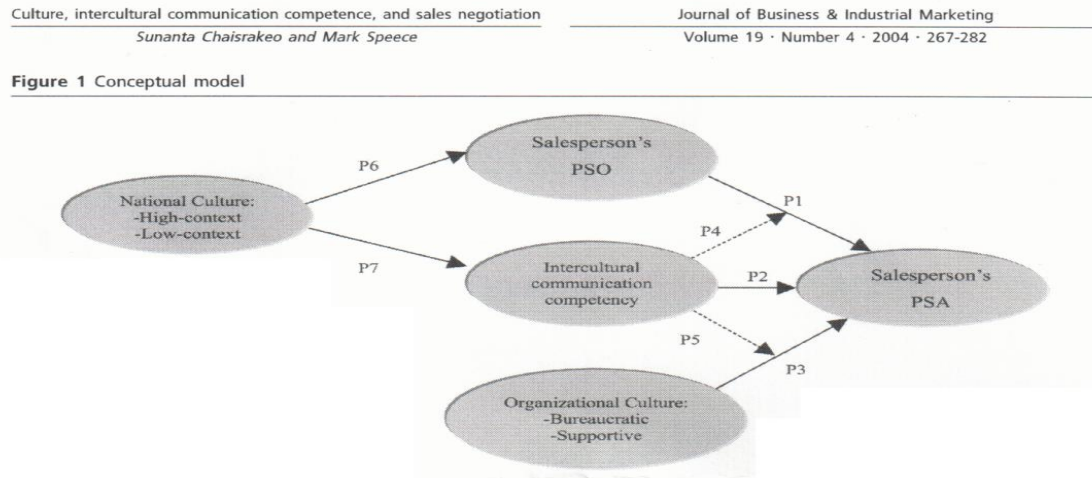
Almost a decade before, Willem Verbeke and Richard P. (2003) discussed indirectly the previously mentioned skill of inter-cultural awareness but actually focused on personal selling. Social emotions affect personal selling. When salespeople are not aware of other cultural norms, they might easily offend and provoke negative results to their sales performance when it comes to foreign customers. According to the authors, social emotions have not been examined in detail within the selling literature, compared to other emotions. The authors encourage further research on other social emotions because a lot of them have not been studied in the sales literature, such as pride. Social emotions are correlated to intercultural skills, since the authors stress that the results of people's behaviour depends on the culture wherein the

study is undertaken (Verbeke and Bagozzi, 2003, p. 256). So, what happens on the case where different cultures need to be synchronized?

### **Correlation between inter-cultural and negotiation skills**

As mentioned previously, studies suggest that when selling something to people coming from different cultures can be tricky. Chairsrakeo and Speece (2004), after doing in depth interviews with sales representatives having international experience, reached a conclusion, that during a selling process with foreign customers or not, employees need good negotiation skills. This factor is likely to fall into the category of the factor missing from Stephenson's and Kiely's model, inter-cultural competence. Negotiation is divided into two styles: the first is the problem – solving approach and the second the competitive approach (Chairsrakeo and Speece, 2004). According to Vida's (1999) competitive approach, employees tend to persuade client using inappropriate tactics. Front line employees working in a Bank should sell through communicating rather than persuading, which is obvious in other selling industries. This communicative procedure includes a passive approach, like giving information (Font, 1993). The first style ensures a long-term relationship and employees are actuated by cultural aspects as it has to do with in depth communication (Chairsrakeo and Speece, 2004, p. 267). In this style, employees tend to adapt their behaviour trying to focus on the customer's needs gathering as much information as they can. This leads to the observation, that inter-cultural communication competency actually affects sales performance, because a failure to communicate right with international clients, may lead to loss of possible sales (Chairsrakeo and Speece, 2004). Negotiation depends also on the cultural context. In high-context cultures, similar to collectivist cultures, people express a lot in non verbal manner, whereas in low-context cultures, like in individualistic cultures, people expect formal communication with the verbal expression (Chairsrakeo and Speece, 2004). Cross-cultural negotiations include being open and sensitive to others. Inter-cultural competence includes cultural awareness, cultural sensitivity and cultural adroitness, characteristics, which according to Zakaria (2000) are at one point inherent and on another point learnt. People who have these attributes are likely to be more successful in cross-cultural sales negotiations as with inter-cultural competence they are able to approach and solve problems.

Figure 4: Chaisrakeo &amp; Speece Conceptual Model on Problem Solving Approach



### Both cultural and relationship development skills needed

Another research emphasizing on the need of new approaches in the selling functions is the one conducted by Marshall et al. (2003). This research confirms what was mentioned at the beginning of this synthesis, where Font (1993) stated that employees should absorb information and promote products accordingly. This is happening among others, within the framework of “relational and consultative sales approaches” (Marshall et al. 2003, p. 246). The traditional sales process model needs to be updated as most of the research took part in the “era dominated by transactional selling models” (Marshall et al. 2003, p. 254). Now there are some skills and knowledge required which differs from the traditional success factors. In the article the authors refer to previous success factors stated by Lamont and Lundstrom (1977), for instance personality and personal characteristics, such as capability and adaptability. They also referred to Weitz et al. (1986), who concluded that knowledge structures and acquisition skills amplify success in sales. Nowadays, what is relatively new is what Macintosh et al. (2003) stated, that there is a need of relationship developmental skills (Marshall et al. 2003) After the survey was conducted, the results showed that skill – based factors were at high importance, with first and foremost the listening skills, something already proven by Castleberry and Shepherd (1993) and Ramsey and Sohi (1997) (Marshall et al. 2003). The second factor refers to the “follow up” skills, but with the extra effort in the relational approach. The third factor refers to the adaptive performance, already known by Weitz et al. (1986). The fourth factor refers to the “Tenacity-sticking with a task”, the fifth refers to the skill of being well – organized and the sixth factor refers to the verbal communication skills; lastly, the proficiency level of interacting with people, already acknowledged in the relational and consultative models of selling of Rackham and DeVincetis (1999). The survey affirmed that a good salesperson must have traditional capabilities.

**Cultural factors – closely related to sales performance**

Cultural factors related to sales performance are once more proved by Jaramillo and Marshall (2003), who conducted a research and published an article in 2003 on sales performance in the banking sector. This study aimed to identify the success factors in sales of banking products and services in Ecuador. At the beginning, the authors suggest that researchers in the past have found correlation between culture and sales performance, due to the existence of different perspectives and perceptions. And that was of course connected with the previous mentioned theory of Hofstede, individualism and collectivism. The authors mentioned a cross – cultural study in Australia and Hong Kong that found differences in perceptions of personal selling. Furthermore, the same authors have referenced to DeCarlo et al. (1999) statement, that culture also effects the salesperson perception and thus the intrinsic/extrinsic motivation, something relevant to the present study (Jaramillo and Marshall, 2004). The gap covered in the mentioned study, was the exploration of selling techniques in the Hispanic salespeople and is highly relevant to the recent study, as Cyprus culture is also high context culture. The sample was from two large privately-owned Ecuadorian banks and the selling techniques used in this study were based on the one of Dwyer et al. (2000). The results showed that the best predictors of performance are five out of the seven stages of selling procedure: “Prospecting”, “Approach”, “Sales presentation”, “Closing” and “Follow-up service” (Jaramillo and Marshall, 2004, p.20). Regarding the limitations and suggestions for further research, the authors pointed out that other variables may affect the sales performance in the banking sector, for instance personality or motivation. Importantly, things may vary among units. They suggest the consideration of these limitations in future research in other countries for further comparison (Jaramillo and Marshall, 2004, p. 23).

A couple of years later, another rather interesting study conducted by Jaramillo et al. (2005) was investigating the relationship between organizational commitment and job performance, and how this is affecting sales employees, bearing in mind also the cultural influence. The results of this meta-analysis stated that organizational commitment explains only the 6% of salespeople’s job performance (Jaramillo et al. 2005). They included an important statement of Churchill et al.’s (1985), that “none of the predictors by themselves account for a greater variance in performance – less than 10% on average”. Another factor mentioned in the study, was the self-motivation which was connected to job commitment. A self-motivated person will show the “in” and “extra” role performance maintaining a positive attitude (Jaramillo et al. 2005). Another important finding is that this positive relationship is stronger in collectivistic cultures, as job performance is influenced by individuals’ values (ibid.). These findings confirm that culture has an effect on performance and that a lot of predictors must be taken into consideration in order to examine performance.

*Figure 6 : Marchall et al. table of success factors for professional salespeople*

Table 2

Sales managers' importance ratings of success factors for professional salespeople

Success factors	Mean	S.D.
<i>Highest level of importance</i>		
Listening skills	6.502	0.683
Follow-up skills	6.358	0.772
Ability to adapt sales style from situation to situation	6.321	0.687
Tenacity-sticking with a task	6.107	0.924
Well-organized	6.084	0.889
Verbal communication skills	6.047	0.808
Proficiency in interacting with people at all levels of a customer's organization	6.000	0.991
<i>Second level of importance</i>		
Demonstrated ability to overcome objections	5.981	1.085
Closing skills	5.944	1.109
Personal planning and time management skills	5.944	0.946
Proficiency in interacting with people at all levels of your organization	5.912	0.994
Negotiation skills	5.827	0.975
Dresses in appropriate attire	5.791	1.063
Empathy with the customer	5.723	1.074
Planning skills	5.685	0.966
Prospecting skills	5.673	1.209
Creativity	5.670	0.936
Ability to empathize with others	5.549	1.105
Skills in preparing for a sales call	5.526	1.219
Decision making ability	5.502	1.023
<i>Third level of importance</i>		
Evidence of working through unexpected problems	5.467	0.991
Ability to interpret customers' body language	5.447	1.233
Previous customer contact experience	5.432	1.225
Displays appropriate body language	5.419	1.193
Written communication skills	5.405	1.093
Effective use of data in presentations	5.359	1.198
Patience	5.186	1.273
Good sense of humor	5.158	1.052
Leadership skills	5.149	1.198
Ability to communicate technical product information	5.146	1.322
History of past sales successes	5.038	1.387
<i>Fourth level of importance</i>		
Aptitude for learning technical product specifications	4.887	1.383
Previous sales experience	4.841	1.290
Excellent references	4.827	1.493
History of past business successes	4.780	1.375
Skills in calculating prices and/or profitability	4.673	1.376
History of speaking before groups	4.598	1.331
Potential for moving into sales management	4.581	1.441

Table 2 (continued)

Success factors	Mean	S.D.
<i>Fifth level of importance</i>		
Specific industry knowledge	4.484	1.600
Ability to conduct research on industry competitors and trends	4.439	1.365
History of preparing and presenting formal business proposals	4.379	1.293
Attractive physical appearance	4.322	1.301
Previous formalized sales training	4.186	1.344
Past experience in team selling	4.150	1.403
Good driving record	4.112	1.609
Word processing skills	4.074	1.375
Four-year college degree	4.065	1.725
<i>Sixth level of importance (these items are below the scale midpoint)</i>		
Ability to coordinate schedules of support personnel	3.962	1.466
Database management skills	3.888	1.270
Grade point average	3.772	1.238
History of leadership positions in college organizations	3.721	1.622
Spreadsheet skills	3.679	1.369
Took a personal selling class in college	3.659	1.692
Clean credit report	3.651	1.747
Mechanical skills for setting up displays and demonstrations	3.474	1.456
Proficiency in using the Internet	3.249	1.440
Computer graphics skills	3.160	1.326
History of membership in college organizations	3.116	1.437
Played sports in college	2.629	1.532
Plays golf	2.233	1.293

All items were scaled as follows: 1 = of no importance at all in hiring decisions, 7 = of the utmost importance in hiring decisions.

### Low percentage of each predictor of sales performance

Churchill et al. (1985) showed that each predictor has on its own on average 4% association with the salesperson's performance. Thus, models of the factors determining salesperson's performance should

include multiple variables. The Personal Variables include the intra-individual characteristics, like age, height, sex, weight, race, appearance, education, marital status, club memberships (Churchill et al., 1985). Moderator variables, product and customer type effect the strength of the relationship between salespeople's performance and the major determinants, which are according to the research: aptitude, skills, motivation, role, personal factors and organizational/environmental factors (ibid.). The findings indicate that in terms of the average size of their association with sales performance, role variables come first, second skills, then motivation, fourth personal factors, aptitude and lastly organizational/environmental factors. The authors stated that, since the type of product is so influential, researchers should be careful with the differentiation of sales jobs (ibid.). That's why investigating an adjusted model in the banking sector and in specific in the front line service, is better than reaching to conclusions based on generalization of the existing variables. Churchill et al. suggest that "theoretical models which hypothesize multiple determinants – and categories of determinants – of sales performance are probably on the right track" (Churchill et al., 1985, p.117). The variables included in this model are also included in the model Stephenson and Kiely (1991) suggested. The last model further adds the "Role" and "Organizational/Environmental factors".

### **Emotional Intelligence**

Going through the existing body of literature on sales representative another important component emerges, emotional intelligence, which is also missing from the two previously mentioned models of Churchill et al. (1985) and Stephenson and Kiely (1991). Individuals working as sales representatives need the qualities of emotional intelligence, such as self-worth and self-acceptance (Manna and Smith, 2004). Treasure (2002) as cited by Manna and Smith (2004), pointed out three factors, which create high-quality commercial relationships. The first one is cultural awareness; the second one is value exchange and the third one communications. The research showed that communication skills, negotiation skills, emotional intelligence and presentation skills and the differentiation of personality types are very crucial for salespeople (Manna and Smith, 2004). This affirms the previous mentioned skills and adds another one, that of emotional intelligence.

Yildirim (2007) refers to McClelland (1998), who said that success depends on the combination of competencies. The author suggests that the main clusters of competencies should be determined (Yildirim, 2007). The model of Emotional Intelligence provides insight of the competencies included in each cluster. His research studied both salespeople and IT employees. Results comparing the difference between salespeople and IT employees showed that social skills are clearly higher in salespeople (Yildirim, 2007), confirming again the importance of this factor.



Figure 5: Yildirim's Structure for Emotional Intelligence

JEIT 31,4	Competencies	Structure matrix	Standardized function coefficients	Wilks' Lambda	F	Sig.
280	<i>Self-awareness</i>					
	Accurate self-assessment	− 0.02	− 0.26	0.99	0.10	0.75
	Emotional self-awareness	0.04	− 0.15	0.99	0.41	0.52
	Self-confidence	0.29	0.28	0.81	24.05	0.00**
	<i>Self-management</i>					
	Achievement orientation	0.12	− 0.33	0.96	4.29	0.04*
	Adaptability	− 0.10	− 0.11	0.97	2.94	0.09
	Emotional self-control	0.07	− 0.05	0.98	1.47	0.22
	Initiative	0.03	− 0.54	0.99	0.20	0.65
	Optimism	0.21	0.53	0.89	12.96	0.00**
	Trustworthiness	− 0.16	− 0.74	0.93	7.60	0.00**
	<i>Social awareness</i>					
	Empathy	0.05	0.03	0.99	0.90	0.34
	Organizational awareness	0.28	0.34	0.82	22.85	0.00**
	Service orientation	0.31	1.07	0.79	28.18	0.00**
	<i>Social skills</i>					
	Change catalyst	0.17	0.09	0.92	8.55	0.00**
	Conflict management	0.32	0.00	0.79	28.42	0.00**
	Developing others	0.24	0.12	0.86	16.66	0.00**
	Influence	0.22	0.09	0.88	14.35	0.00**
	Inspirational leadership	0.33	0.80	0.77	32.00	0.00**
	Teamwork and collaboration	0.05	− 0.92	0.99	0.73	0.39

**Table III.**  
Structure matrix for  
emotional competencies

**Notes:** \* $p < 0.05$ ; \*\* $p < 0.01$ ; Box's  $M = 407.1$ ;  $F = 1.96$ ;  $p = 0.00 < 0.01$ ; Canonical Correlation = 0.85; Wilks' Lambda = 0.27;  $p = 0.00 < 0.01$ ; Percentage of cases correctly classified: 93.7 percent; Functions at Group Centroids: for Salespeople 1.45; for IT − 1.77

## Conceptual Framework

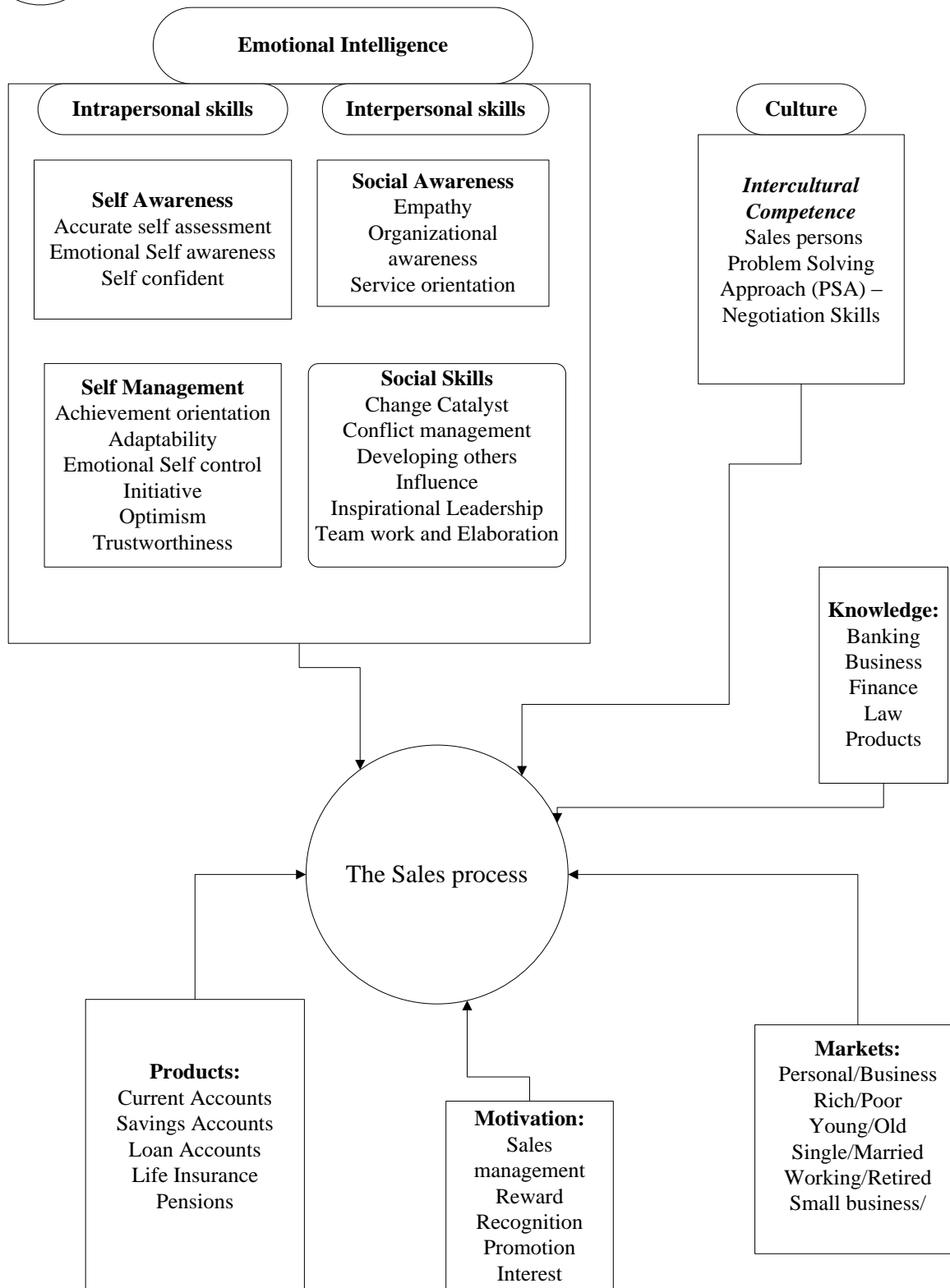
In conclusion, the existing models discussed before could be synthesized and expanded according to the changes and new demands (Figure3). Emotional Intelligence incorporates self-awareness, self-management, and social-awareness social-skills. All these clusters could replace Attributes, which refer to Emotional Intelligence, and Skills from Stephenson's and Kiely's model (1991). Furthermore, the skill of inter-cultural competence, negotiation skills along with Problem Solving Approach, could be added to Yildirim's (2007) table (according to Goleman's framework of competencies) under the "social-skills". On the other hand, a couple of factors should be excluded from Stephenson's and Kiely's model (1991), such as Mortgages, Investments, portfolio management and Corporate business, as those do not apply to front line employees' job specifications.

The new model is more likely to apply to Cyprus' environment and to front line employees in the banking sector. Cyprus' location is very strategic, as it is a "cross-road" between three continents: Asia, Africa and Europe and is the third largest island in the Mediterranean Sea located just 40 miles south of Turkey. Furthermore, Cyprus' low taxation attract a lot of foreigners to visit and settle as financiers and investors. This whole situation results in the existence of a big number of wealthy multicultural individuals, or even better, prospect customers.



Figure 3

## Factors Influencing selling process in Banking – Front line employees



## Limitations

The present study focuses on one specific country and the conceptual framework has been adjusted according to Cyprus' characteristics. For Cyprus, the inter-cultural competence is very important due to reason explicated previously. Thus, this conceptual framework should be validated again when trying to find those factors influencing the performance of front line employees in another country. Furthermore, the study concentrates on a specific unit of the banking sector and thus the constructed model should be differentiated when measuring another department's selling process. Moreover, due to the limitation of words, important theories and aspects are not investigated in depth. Further investigation is needed to cover the topic area.

## Conclusion

In the current study, the researcher tried to approach the topic of the selling process of front line employees in the banking sector in Cyprus through a systematic literature review. Firstly, the topic was introduced and the reason for initiating this study was justified. Consecutively, there was a thorough explanation of research aim and objectives, as well as of the literature aim and objectives, followed by the definitions of the most important elements concerning front employees selling process. Through the Search strategy, Selection criteria and Quality Assessment, the author tried to make sure that this study could be repeated step by step and possible error or omission could easily be traced and corrected.

Finally, going through the selected articles, a model has been synthesized, adopting various elements from other models and abstracting other elements not suitable to the selling process of the front line bank's employees in Cyprus. Elements like intercultural competence, Problem Solving Approach and Negotiation skills have been added to a basic selling process model concerning the banking sector. The development of this model will be tested in banking sector in Cyprus, contributing in this way to theory and practice.

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## SOCIAL ENTREPRENEURSHIP: SOLUTIONS FOR MARKET FAILURES

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### Abstract

New models and management approaches are being searched in today's economic world where the borders are removed and people are trying to live with economic crises. Neither governments nor private sectors are being able to control the markets. Economic and social problems are growing rapidly and the countries are going bankrupt like businesses. Under these circumstances third sector foundations are giving opportunity to market failures and looking for solutions by social entrepreneurship. In this paper reasons for the market failures have been discussed and third sector and social entrepreneurship are offered as a solution for today's economic problems.

**Keywords:** Market Failures, Third Sector, Social Entrepreneurship

### Introduction

Regulating the markets is implementation of the classic economic view's internal dynamics. However, to gain functionality, the neoclassic market system has been changed with the view of defending governmental needs and trying to explain reasons of market failures and at this point criticizing the classical view. By reviving the economy's market failures, the classic view has paved the way in terms of interferences of limited governmental market economies functionality. In terms of expressing welfare economics, it is necessary to discuss the activity of markets and government. A fundamental goal of this study is looking at the role of well-functioning markets within a nation-state with an active economy and robust corporate involvement, instead of a more historic and accepted economic model, which places emphasis on the government as the centre of the economy.

This study is focused on whether or not it is possible to correct market failure by using social entrepreneurship as a form of social transformation.

Social entrepreneurship is becoming more important every day as problems are gradually increasing. The practice and perceptions taking place at the market level should be used to solve social problems. To fill the gaps, the transformation of a reactive organization structure to a social entrepreneurial organization of third sector is necessary.

## Market Failures

One of the most widely accepted definition of market failure belongs to Charles Wolf. Wolf (1989) defines market failure as markets' failures in generating economically optimum and socially desirable outputs.

Economists also define market failure as the opposite of theoretically and ideally operating economy (Crampton, 2007). At the same time; market mechanism's incapability of providing pareto efficient distribution in itself or maximizing social utility and its failure in ensuring efficiency are defined as market failure (Unsal, 2010).

Pareto optimal realization; requires efficiency achievement in production, alternation and general. Lack of efficiency in these three cases; expresses that pareto optimum and sources are not used effectively in economy, resource allocation is not optimal and the maximum level of welfare can not be provided. Accordingly; cases in which marginal social costs can not be equalized with marginal social benefits show that market failures have come out. In such cases in which markets fail to provide economic efficiency, maximization of public welfare can also not be achieved. Market failures can be discussed in two ways. First one is market failures arising in static economies and the second is market failures that come out in dynamic markets. Market failures in a static economy are evaluated for the cases where there is no economic growth or progress and these are failures created by economic externalities, the emerging imperfect competitive markets, public goods, asymmetric information existence (<http://www.tisk.org.tr/yayinlar.asp?sbj=ic&id=71>) or undesired income distribution (Zerbe and McCurdy, 1999). Besides, monopoly owners show tendency to cause loss of social welfare retrenching the output and increasing the price. The comparison of external cost production in consequence of an economic activity and economic activity in pareto optimal reveals the fact that market output is subject to excessive externality (spill-over). Because the related information ranges asymmetrically among economic operators, markets fail in performing an efficient production. As to public properties, they provide positive externality and also have the characteristics of non-rivalness and non-excludability in their consumption. Once the product is brought into public use, we cannot prevent people using the benefits offered and also the realized profit obtained by one of the users does not lessen another's profit. For example; once highways have been constructed, the beneficiaries of them cannot be restricted. For the reason that production cost of a product cannot be compensated because of nonseparable feature of the product economists emphasize that no one will desire to produce that product. Furthermore, by reason of the fact that the product is unrivalled, cost of its consumption by an additional user will be zero. And the price that is adopted in order to prevent its usage by another person will cause deactivation (Crampton, 2007). Besides; dynamic market failures are considered as the failures caused by both macro imbalances and factor markets which cannot be fully operated and also non-existing financial markets (<http://www.tisk.org.tr/yayinlar.asp?sbj=ic&id=71>).

On the purpose of rectifying market failures, the governments in developed and developing countries, interfere in markets by applying some sets of rules to regulate the markets. In this regard; the concept of market failure has been firstly begun to be used in order to explain the need for increased government expenditures (Zerbe and McCurdy, 1999).

In the cases where markets cannot be disciplined, intervention of the state may be regarded as necessary. That does not mean that a constructive intervention of the state in operation of the economy will always bring to a successful conclusion. And states do not give guarantee in respect of acting more ideally than the prospective behaviors of enterprises (Baumol and Blinder, 2000). In addition, transaction costs that are created by market regulations carried out by intervention of the state should provide further added value than the profit obtained in consequence of market regulations. States are not always excellent. When intervention of the state provides important benefits in the areas such as inflation, environmental deterioration or public property supply, sometimes it can be difficult or impossible to determine the optimal level of state intervention. In such circumstances, no intervention may be more beneficial due to the danger of excessive intervention. (Baumol and Blinder, 2000). When viewed from this aspect; regulations are considered as doubtful cases. Market failures, that are named as cases in which markets fail in resource allocation, constitutes an economic reason for intervention of the state in the economy. Interventions made by the state in order to clear market failures may cause public failures. Increasing interventions of the state or concentrated interventions of the public sector in markets with the aim of overcoming market failures caused the emergence of “state’s failure” or “public failure” literatures weakening functionality of the market mechanism. Public failures imply that the states whose tasks and functions have overgrown fail in performing the required functions. Public failures emerge due to the fact that there is no connection between cost and revenue and as institutions having no aim or their non-economic aims and as differential externality (Tosun, 2007). Many arguments brought up for overcoming market failure legitimize intervention of the state, yet on the other hand; results of the state intervention may not raise the expected effect.

These arguments made either in the academic field or in practice lead the third sector to participate more actively in markets and expand its sphere of influence. In addition to activities carried out by the government in areas where they remain incapable, the third sector with its support given to these two sectors has become an important social dynamic.

### **Increasing Role of the Third Sector in Markets**

The third sector is an area that participates actively in the process of finding efficient and long-term solutions for social problems and works in various fields for directing political agents to develop new policies for carrying these solutions into effect on this basis, in which organizations, founded voluntarily without state supervision carry on business (TUSEV, 2006).

Nowadays we are undergoing a change from a welfare mixture with superiority of the state towards a sense of welfare where the state and even voluntary sector are at the center. Voluntary agencies have come out with the reason that the state remains incapable of satisfying social needs of the public in terms of efficiency and productivity. In this sense, non-governmental non-profit organizations, established at national and international levels by the citizens for voluntarily assisting the state in the areas where the government fails in providing efficiency and remains ineffectual, have appeared as the third sector. Yet, the third sector should be considered as an alternative to neither the state nor the private sector but as a complement of them. The third sector is a sector that voluntarily orients property ownership, dynamism, efficiency and creativeness of the citizens to civil services and offers social services without any profit making purpose. Organizations, changing their center of attention from charity purposes into performance and responsibility, are increasing in number within the third sector. Voluntary agencies in the third sector maintain their existence and developments by means of reliability, credibility and image supports (Gökbunar and Erdal, 1997).

In recent years it has been accepted that in addition to the state, families, voluntary agencies and public sector organizations are also supposed to play an active role in providing social welfare. Besides, the fact that voluntary agencies are able to offer more efficient and affordable service than many public institutions in reaching the poor is asserted. In this regard, areas of social responsibility go beyond the responsibility of the state and people anymore may relive their suffering by the agency of miscellaneous voluntary associations (Arpacı and Karakılçık, 2009).

Distribution of an important part of public wealth by means of the third sector considering need priorities to the community may contribute to creating a social market economy model by decreasing conflicts among social classes seen in the systems depending upon the private sector. In this context, third sector organizations, may lead a totalitarian social development by effectively transferring part of the income belonging to high income groups to low income groups (Arslan, 2008).

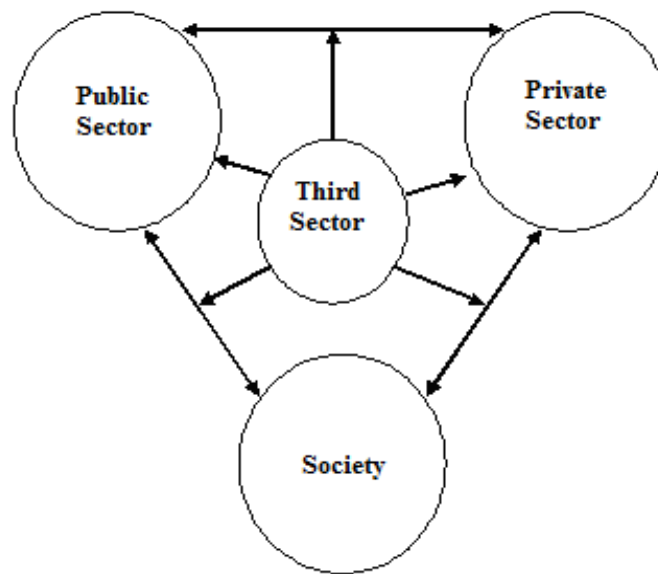
For creating a sustainable social economy, the third sector should be engaged in activities corresponding to social needs and try to find solutions in order to maintain these activities. And this steers third sector organizations into innovation and also encourage them to present creative and innovative implementations.

Increasing social problems and their ability to affect people from all corners of the world by creating a butterfly effect cause an increase in third sector organizations. At the same time, domains of the said problems and sustainable solution seeking necessitate these organizations to be managed with an entrepreneurial approach (Stull, 2009). It is seen that third sector organizations acting with this awareness invigorates the social economy further providing important social benefits.

Market failures play an important role in expanding activity and influence areas of the third sector. These failures may be seen not only in offering product and service in adequate quality having social and



environmental effects but also in employing disadvantaged groups in labor market and the organization type oriented to this (Haugh and Kitson, 2007).



*Figure 1. Influence Area of the Third Sector*

As seen in Figure 1: the third sector has an important effect on both public and private sectors and also the society as it also affects the relation between them. In one sense, the third sector accelerating blood circulation and dynamizing the market among the actors in the market, causes increase in the said interaction volume with its increased area of influence.

One of the most important impacts created in the market by third sector organizations is moving market functioning to a fair ground and contributing to sustainability of the institutions having social sensitivity by means of advertising. Third sector organizations of high standing in the eyes of society, owing to “social income” they have, press upon the market for being accountable, out of unfair competition, environmentally respectful and answerable to their stakeholders. This regulation provided by third sector organizations, gives opportunity to generate efficient solutions determining institutional failures within a short time and minimize unpredictable problems as far as possible.

It is seen that there have occurred important developments in the third sector in Turkey especially within the last decade. Besides; the government encourages cooperation between the private sector and the third sector by means of tax policies. Many corporations anymore name third sector organizations as ‘strategic partners’ and once this relationship is established, increases social acceptance of the corporations. In consequence of the studies done (Oruc and Sarıkaya, 2010; Sarıkaya and Oruc, 2010) it is seen that the biggest and most popular corporations in Turkey regard the third sector as a competitive advantage and they make long-term cooperation with third sector organizations in the subjects such as

education, health, culture, art, sport and social welfare. These establishments also gradually become more professional and have a further voice in social subjects with the solutions they offer.

As a conclusion, third sector organizations carrying business on behalf of society, both provide a social added value and make contribution to the markets for being operated sustainably and effectively distributing the social benefit received in accordance with their mission. Especially with social entrepreneurship activities that have come to the forefront in recent years, this efficiency increases further (Sarıkaya, 2010).

### **Market Failures and Social Enterprise**

Keynesian economy, argues that the private sector may cause ineffective macroeconomic output at times and for this reason the public sector should intervene with an active policy in such cases. Keynes believed in mixed economy that involves the state and public sectors having great shares and a dominating private sector. In today's world, governments fail in bringing social welfare at the level provided within the frame of the Keynesian model. Governments have less income to distribute for the reason that they have basic importance in terms of countries' infrastructure and in addition they sell the assets also providing revenue stream under government ownership. Under many circumstances, even the income received from income tax has been reduced. Newly increased tax may raise incomes, yet probably this will not find favor politically. Technological developments in health services have raised the rate of expectations regarding human life in a way aggravating the problem further and created a demand to be satisfied at high-prices. All of these social problems have contributed to reveal a set of social tendency, organizational structuring and personal initiatives gathered under the same roof by name of "social entrepreneurship" (Roper and Cheney, 2005).

There is no definition that has reached consensus upon social entrepreneurship grounding on the fact that entrepreneurship may mostly aim at gaining social benefit rather than maximizing personal benefit. Various approaches about concept are available (Tan et al., 2005). One dimension of these approaches is at the point of implementation area. In addition to the approaches that identify social entrepreneurship with third sector organizations, some approaches arguing that the public sector may also undergone a social entrepreneurship also come into question. Yet; when regarded in the sense of social economy, it will be more pertinent to discuss social entrepreneur within the scope of the third sector.

With its general meaning; it is possible to define social entrepreneur as "forming social economic structures, relations, institutions, organizations and applications that generate and maintain social benefits" (Alan, 2000).

The expectations and needs of society continuously increase and undergo a change. Markets may remain incapable of fulfilling these needs or generating specific goods or services. Furthermore; states do not take the necessary step at this point. So third sector organizations as social entrepreneurs undertake a

significant role for satisfying these social expectations and make a great contribution on behalf of sustainable development (Sud et al., 2009).

Social entrepreneurship aims at using entrepreneurial methods in solving social problems and fight against the said problems. In this sense, there take place many social entrepreneurs playing a role in community and economic development (Parkinson and Howorth, 2008).

One of the most significant factors in emergence of social entrepreneurs is market failures. For example failures of commercial enterprises in satisfying social needs such as public properties also create a need for social enterprise. This failure of commercial entrepreneurs in the market turns out to be an opportunity for social entrepreneurs and generates an area of activity (Austin et al., 2006). In one sense; a market solely built on the basis of commercial enterprises, fails in responding the needs as required and this results in market failures of both the public and private sectors.

Some market failures of the public and private sectors in today's market are as follows (Uluyol and Danacı, 2009):

- Failure of the private sector insufficiently producing the goods and services that will cause social and environmental effects,
- Not providing employment to people disadvantageous in the matter of finding a job in traditional markets,
- The fact that public sector remains incapable of solving social problems,
- Failure in reaching people from all strata equally in terms of service distribution.

With social entrepreneurship; activity areas assumed by the government such as poverty, health care, education, environment, economic development have begun to be mentioned with third sector organizations. Criticisms of the Neoliberals herein claim that it originates from state failures (Arpacı and Karakılıç, 2009). In one sense, areas which were regarded as the fundamental duty of government in the past, are converting into activities in which third sector organizations have become more active because of the fact that the responsibility areas of government have narrowed and because of gaps in the market.

Social entrepreneurs are persons or organizations attempting with the aim of determining and dealing with the social problems they regard as significant. Social entrepreneurs develop programs in regard to solving the determined social problem; supply them determining the source and labor required for these programs and they also coordinate and manage these programs by use of modern management techniques (Korosec and Berman, 2006). On the other hand, they try to increase the awareness of society intended for the existing problem and call the attention of social actors in this regard.

Social entrepreneurs in our day emerges both as an organization created by the social economy and a type of activity in social area. The basis of social entrepreneurship is to provide social benefits

innovatively and creatively by providing financial sustainability (Birch and Whittam, 2008). In this sense, social entrepreneurship is extremely important in terms of economic revival and social dynamism.

Social entrepreneurship is neither a fully charitable institution nor a fully commercial organization. Fully charitable organizations continue their existence and carry out their activities by use of donations and charities and benefits from volunteers. And social enterprises may receive bequest, earn income in the market conditions and take loans. Besides; they can also employ wage-personnel in addition to volunteers (Herman and Rendina, 2001). Therefore, social enterprises are organizational forms having the features of both organizations and aiming a sustainable social added value.

Social enterprises, especially in a period where markets suffer from lack of resource and are deprived of satisfying the fundamental needs of society create resources and distribute them to the society within the frame of social needs. So they have a significant function on the point of facilitating market movement and removing inconveniences occurring in the market.

In this sense, third sector organizations having a strong leadership and social entrepreneurship, play a more effective role on the point of filling in the areas left unattended by the organizations of private sector and expand the influence area of the said institutions (Crampton et al., 2001).

Although social entrepreneurship in Turkey is a new one both academically and in practice; it has made significant progress especially through the effect of international cooperation. For example, the British Council has begun to implement a regional project to establish partnership between England and Turkey in the area of social entrepreneurship since 2009-2010. The Project aims at providing a platform in order to make third sector organizations having a social mission create difference in its vicinity, and contribute to a positive social upheaval by means of enterprise, innovativeness and creativeness. Social Entrepreneurship Project developed by the British Council and executed by the partnership of TUSEV (Third Sector Foundation of Turkey), has been established with the intention of working on common problems together with social entrepreneurs and social enterprises aiming at creating permanent solutions for social problems, sharing experiences and developing solutions. This Project that also offers opportunity for information exchange with other implementing countries, intends to take firm steps for developing social entrepreneurship in Turkey (<http://www.tusev.org.tr/content/default.aspx?c=77&s=157>).

## **Conclusion**

Sustainability is one of the most frequently used concepts in today's markets. Sudden fluctuations in the market sweep away many corporations, regardless of how big or small they are and this generated negative atmosphere has global impact. This interaction, increases concerns in economic and social terms, either states or private sector organizations search new solutions.

Solutions that are searched in social subjects ignoring the human element will not be long termed. Third sector organizations maintaining human efficiency is the most important treasury of our World and highlight significant projects either in the national or international arena. These organizations going beyond 'clearing the garbage' created by market failures, both contributes to sustainable development of societies and assist with efficiency and sustainability of private sector organizations by means of the social enterprises they have executed.

As a consequence, third sector organizations serving as important glues in the markets and converting the increasing interaction into social added value, through social entrepreneurship activities, have become significant actors of social dynamism with more effective, innovative and creative solutions on the points where states and markets remain incapable. Societies making good use of this dynamism, will overcome fluctuations in the market with less damage, recover in a short time and turn the existing dynamism into sustainable development.

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## HORIZONTAL MERGERS AND THEIR EFFECT ON SHAREHOLDERS VALUES: THE CASE OF AIRLINE INDUSTRY

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### **Abstract**

The current paper makes use of event study methodology to scan whether horizontal mergers alter the value of the acquiring firm. Two models have been estimated in order to examine the biased of the findings with the use of different models. However, both AAR and CAAR obtained from both models were on average the same indicating that results are unbiased to model choice. In general the results indicated that in most markets are efficient since no significant effect on the return was found. The results are more in line with the European studies where they also found insignificant returns for the bidder firms. In terms of event window the study utilised several different windows so as to examine also the biased of the results on the the span of the event period. Again the study found no evidence of cumulative and abnormal return in any event window, apart for only one merger. In this specific merger the study found evidence of cumulative and abnormal returns only when event window was quite small. At a longer window the abnormal returns seems to disappear. The latter provided evidence of market inefficiency in the short run for the given market, which in turns suggest that investors can gain abnormal returns with the use of publicly available information.

**Keywords:** Mergers, Event Study, Market Efficiency, Airline Industry

### **Introduction**

The wave of M&A in the world over the recent years emerged due to numerous different factors, all of which have brought about an increased competition amongst all organisations that covers every kind of industry. Nowadays the pressure that it is put on businesses is tremendous as they are faced with a more rapid pace of product introductions as well as a quite noticeable change in the market in general.

One of the industries that have been consolidated though mergers is the airline industry. The deregulation initially, and latter the process of privatization have promoted significant changes in the structure of the airline industry, initially in the US and a decade later the European market. New types of carries have enter the industry offering lower fares rising the levels of competition, higher fuel prices increased the cost of services produced. All this had as a result a boom in Mergers and Acquisition in the airline markets. Literature tried to evaluate those mergers from different perceptive. A bulk of literature suggests that firms merged in order to increase cost efficiency where other support the hypothesis of market

power and scale economies. Irrespective of the motives behind the M&A's in the airline market studies aimed to evaluate their effect on the shareholders values. Most of the prior literature showed evidence of abnormal returns for the shareholders of both the bidding and the target firms around the merger announcement.

Based on the aforementioned the current study aims to determine the reaction on stock prices to announcements of airline mergers in both Europe and US with the use of event study methodology.

### **An overview of the Airline Industry**

Nowadays the airline industry through changes in national deregulation and international agreement has become gradually more global. However that was not the case three decades ago. Deregulation emerged firstly in the US market. Anderson et al. (2005) indicated four major changes in the US airline industry. The first one is the instruction of low cost carriers that led to increase competition. This piloted to the second one, the decline of airfares. However, even though the fares had decrease the study indicated a variability of fares across the market. The last change was the introduction of the hub-and-spoke system. Given the deregulation process that emerged in 1978 the airline industry has faced numerous financial problems that lead to bankruptcies of numerous companies as well as large merger wave (see figure 1). In regards to bankruptcies, in the earlier years those affected smaller carries, whereas in the last decade four of the largest airlines firms declare bankruptcies, namely Delta, Northwest, United, and US Airways (GAO, 2008). Those four companies have engaged into the majority of mergers. The sustainability of the industry came forth from the growth of existing companies as well as from the entry of new airline companies within the market.

With a ten year delay deregulation emerged in the European airline market, where full deregulation came forth in 1997. The important changes that emerged from the deregulation process were that airlines could work between two member states through their home state and they can also operate domestic flights in any other member state. Additionally all restriction in regards to routes, prices and frequencies have been abolished. Last but not least the merger wave in Europe came forth from the removal of cross-border mergers with the EU (Cento, 2009). Following the delay of deregulation in Europe the merger picked up in the last decade. Lufthansa and KLM have engaged into the bulk of European mergers, whereas the later has become the biggest European carries after the merger with the Air France.

One of the most noticeable events that further promote the globalisation of the airline industry was the Open Skies agreement between the US and the EU. The agreement was finalised on the 30th March of 2008 and has removed previous government. In accordance with Cento (2009) this agreement is an important positive factor for the future of the airline industry on a global level. The author concentrates on the three elements which he considered to be the most important factors emerged out of this treaty.



- All EU airlines are classified as “community air carriers”
- Companies can flight from and US and EU at any airport at any destination
- EU airlines can use US airports as a stopover point for flights to third countries

## Literature Review

The primary assumption of the relevant literature is that improved stock performance (ex ante studies) or improved profitability and cost efficiency (ex post studies), are the best indicators of true performance increase, that is, creation of economic wealth. Based on the proposed measure of wealth creation the performance effect of mergers in the relevant literature is primarily evaluated with the use of two different approaches.

The first approach attempts to evaluate the effect of the merger of performance indirectly by analysing the reactions of the stock market to merger announcements. The methodology utilised under this approach is called event study. The second approach tries to follow a direct assessment by analysing the effects of mergers in as far as this can be estimated from internally generated accounting data through the use of accounting ratios or more complex methodology such as production and profit functions, so called ex post studies. Ex post studies usually compare profitability and cost data for merging firms with a control group of less acquisitive or non-merging firms and/or with the history of the merging firms themselves.

Many studies prefer the first approach on the notion that accounting figures can be manipulated to show a company in the best possible manner, and even when there is a minimum of manipulation, historical accounting data can still give a misleading picture for the company's performance. For example earning per share does not show whether a company is making a return above its cost of capital, which is one of the targets of any corporation.

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Ex ante studies, define the announcement of a merger as an event in the stock price history of the merging firms. The effect of this event is estimated by assuming that changes in the share prices of the merging firms, after controlling for movements in the market in general and the systematic risk of the firms under consideration represent the value of the event (Kothari and Warner, 2007).

This methodology it is based on the principal assumption that markets are efficient. A market is said to be efficient when stock prices fully reflect all available information and thus stock prices are correctly priced at all times (Fama, 1970). He argues that in an active market that includes many well-informed investors; stock prices will reflect all the information available. As a result, no analysis - be fundamental or technical - can be expected to result in better long-term stock-picking performance. Thus, buying and selling securities in an attempt to outperform the market will effectively be a game of chance (random walk) rather than skills.

Based on this assumption, prior to an event there exist a normal relationship between a given firm's stock returns and the market returns (Khotari and Warner, 2007). If this relationship is altered around the time of the event this is characterized as an abnormal movement that is considered to be unique to the given event (Pautler, 2001). If markets are efficient, then an announcement of a merger or acquisition will be immediately incorporated in the share price. A positive reaction to the announcement will be reflected with an increase in stock prices whereas a negative one will be mirrored by a decrease in the stock price.

The present study concentrates on even study methodology. Thus it is important to examine the evidence of the prior literature so as to compare those results with the current paper. Apart from the empirical evidence examine past studies can be helpful in developing the methodology of present study. Several studies have utilised the event study methodology to evaluate the effect of a merger announcement on the stock price in the airline industry. Eckbo (1983) and Stillman (1983) found evidence of positive statistically significant abnormal returns during the event period. Knapp (1990) examined 9 US airline mergers in the year 1986. His result indicated significant abnormal returns for both the target and the acquired company's shareholders for 20 days prior and 10 days following the merger announcement.

Their results are supported by Signal (1996). Signal used US data for the period 1985-88 and examined 27 airline merger incurred at that given period with available; out of the 27 only 14 had available market data. The results showed the significant positive cumulative and abnormal returns and the result were found to be unbiased to the span of the event period. In line with the aforementioned studies are the results of Zhang and Aldridge (1997). Utilizing Canadian data for mergers that took place between 1992 and 1993 they found evidence of significant abnormal returns for the shareholders of both the bidding and the target firms.

Flouris and Swidler (2004) evaluated the effect on the stock price after the announcement of American Airline to take over the Trans World Airlines. They applied the Capital Asset Pricing Model to evaluate expected returns and with an event window of sixty days their result indicated that the market had preserved negatively the takeover announcement since the equity value of the acquirer has declined by 32%.

The literature regarding the European Airline industry is limited. Friesen (2005) examined the effect of the merger between the Air France and the KLM on the shareholders value. The study employed the market model and the results indicated insignificant abnormal returns for shareholders of the bidder firm and significant abnormal returns for the shareholders of KLM. In the same line were the results of Mukim (2010). Mukim also examined the merger between Air France and KLM with the use of a four day window and as well as for the whole data period, he found insignificant negative abnormal returns for the shareholders of Air France and significantly positive returns for the shareholders of KLM.

## Methodology

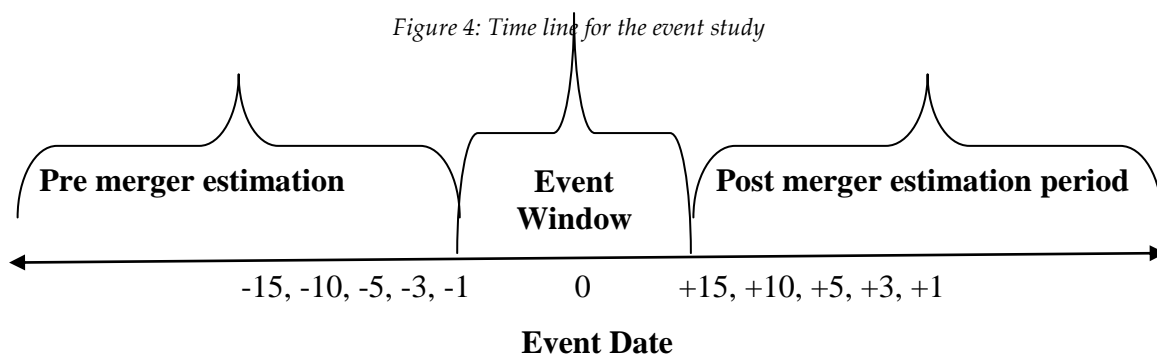
According to Pilloff and Santomero (1998) the methodology of “events study” is, among those considered in the literature, the one that better allowed analysing the problem of value creation or destruction. This methodology is the only that allowed to measure, in a direct way, the impact of mergers and acquisitions in value creation or destruction for the stockholders. In essence, the researches of events studies measure the abnormal returns (based on price changes) of the acquiring firm (bidders) or of the acquired firm (targets) or both, by comparing with the portfolio of stocks representing the market (Rhoades, 1994).

Essentially, the event study analyzes the stock return of acquiring firm or target firms, or both, relative to a portfolio of stocks representing the market. Differences in returns of the acquiring firm or target firm relative to market returns are usually calculated over a period ranging from one day to many days or weeks leading up to and following the “event” of the merger announcement. In making the calculation, the researcher aims to determine whether the announcement of the merger causes the stock return of the acquiring or target company to perform differently than the general market return for stocks (see Rhoades, 1994). In event studies, differences in the stock returns between acquiring firms or target firms and the market are used as estimates of “abnormal” or “excess” returns. To examine the validity of those abnormal returns, statistical tests are performed.

Weston et al (2001) states the methods to calculate the Abnormal Returns, which is through a “clean” period and the average daily return for the organisation is estimated for this period. These are the mean adjusted method which assumes a constant ex-ante stock price, the market model a one-factor model which is based upon the CAPM (Sharpe, 1963), and the adjusted market model method. Nevertheless, over the short-horizon window the sensitivity of the results to the methodology used is low, i.e. for most cases the results are similar independently of the methodology used.

Following Gong (2009) the first step in the event study is to define the event of interest and of up most importance is to define the event date. The event of interest is the merger between two airlines companies whereas the event date is considered to be the announcement date.

The next step is to identify the event window as well as the estimation window. Seiler (2004) labelled the Event Window as being “the number of trading periods examined preceding and following the event date” (pg. 424). Additionally, in regards to the estimation window Seiler stated is “defined as being the period of time over which no event has occurred. It is used to establish how the returns on the stock should behave in the absence of the event” (pg. 424). Following the literature the current study uses different event windows, -15 to +15, -10 to +10, -5 to +5, -3 to +3, and -1 to 1 days before the event date (0). The reasoning for using different event windows is because the literature is not consistent. Some studies argue that the effects of events do not rapidly incorporate into stock prices (McWilliams and Siegel 1997). On the other hand Fama suggested that ‘Short-horizon tests represent the “cleanest evidence we have on efficiency” (Fama, 1991, p.1602).



Before estimating the expected returns, the next step is to calculate the daily returns, the percentage change in daily prices. Since stock returns are known to follow a log normal distribution (Seiler 2004), following Hays (1998) the returns of security  $i$  at time  $t$  can be calculated:

$$R_{it} = \frac{P_{i,t} - P_{i,t-1}}{P_{i,t-1}}$$

Equation 1

where

$R_{i,t}$  = return of security  $i$  for day  $t$

$P_{i,t}$  = Daily Stock Price for security  $i$  for day  $t$

To eliminate estimation biased on the model used the current study utilised two different models to calculate expected returns, the Capital Asset Pricing Model (CAPM) and the market model. The first is an ex ante model based on the work of Sharp (1963) and Linter and it is based on a one-period, mean variance theory of equilibrium returns whereas the second is an ex post model which is based upon a proposal by Markowitz (1959)

In accordance to Hays (1998) CAPM is the most robust and most frequently used method in event studies. This procedure consists of estimating an Ordinary Least Square (OLS) regression of the organisation's return time-series against the market index. The calculations

must involve a period not included in the event period to prevent the event from influencing the normal performance model parameter. This is known as the estimation window. In accordance with the CAPM and the Market Model the expected return  $R_{it}$  for firm  $i$  in time  $t$  is given by [Hays (1998), Friesen (2005), Piskula(2011)]:

$$\text{Model 1: CAPM} \quad R_{it} - R_f = \alpha_i + \beta_i (R_{mt} - R_f) + \varepsilon_t \quad \text{Equation 2}$$

$$\text{Model 2: Market Model} \quad R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_t \quad \text{Equation 3}$$

where,

$R_{it}$ = actual returns to bank stock  $i$  at time  $t$

$R_f$ =risk free rate of return

$\alpha_i$ = ordinary least squares (OLS) estimated of the intercept of the estimate model.

$\beta_i$ = OLS estimate of the market model slope coefficient reflecting change in the market return relative to the return on the company  $i$ .

$R_{mt}$ = actual return of the market at time  $t$

$\varepsilon_t$ = Statistical error.

The next step is to identify the abnormal returns. In order to calculate the abnormal return it is important to calculate the alpha and beta of equation 2. Abnormal return is the difference between the realised return and expected return [Hays (1998), Friesen (2005), Gong (2009), Piskula(2011)]. That is:

$$AR_{it} = R_{it} - (\alpha_i + \beta_i R_{mt}) \quad \text{Equation 4}$$

where,

$AR_{it}$ = abnormal return to stock  $i$  at time  $t$

$R_{it}$ ,  $\alpha_i$ ,  $\beta_i$  and  $R_{mt}$  are as defined above in equation 2.

Under the CAPM  $\alpha_i$  &  $\beta_i$  are estimated by running a regression of  $R_{it}$  &  $R_{mt}$  over an appropriate estimation period. These estimated parameters are then substitute equation 2 to calculate expected returns  $E(R_{it})$  for each organisation where

$$E(R_{it}) = \alpha_i + \beta_i R_{mt} \quad \text{Equation 5}$$

where,

$E(R_{it})$ = expected return on stock  $i$  for time  $t$

Thus we can re-write equation 3 as follows (Flouris and Swidler, 2004):

$$AR_{it} = R_{it} - E(R_{it}) \quad \text{Equation 6}$$

If the merger event is concentrated to create additional value for the shareholders then AR must be positive. It will be zero if the effect of the merger is neutral (Sudarsaman, 2003). In the case where the precise event date not being known due to leakage of information, or when the event is spread over a time interval the abnormal returns are accumulated. After computing the abnormal returns for all securities in the sample, the average of abnormal returns ( $AAR_t$ ) should be calculated during the test period. The average abnormal return and its variance are given by (Wu and Ray, 2005):

$$AAR_t = \frac{1}{N} \left[ \sum_{i=1}^N AR_{it} \right]$$

Equation 7

$$V(AAR_t) = \frac{1}{N^2} \left[ \sum_{i=1}^N \hat{\sigma}_i^2 \right]$$

Equation 8

where,

$AAR_t$  = average of abnormal return for day t

N = number of securities in the sample

$\hat{\sigma}_i^2$  = estimated variance for firm i

Finally, in accordance with Gong (2007) following the assumption of time-series independence, the average cumulative abnormal return from event time the AR's are added over the time period being studied, from initial  $t = 1$  through to the final  $t = T$  as seen below in order to determine cumulative abnormal return.

$$CAAR_{iT} = \sum_{t=T1}^T AAR_{it}$$

Equation 9

$CAAR_{it}$  and  $AAR_{it}$  need to be tested for their statistical significance using the t-test. The t-test is for  $AAR_{it}$  is:

$$AAR_{it}, t-stat = \frac{AAR_{it}}{\sigma_{it}}$$

Equation 10

For the merger to have an effect on the shareholder value the average abnormal return must be found statistically significant (Gong, 2007).

The t-test is for  $CAAR_{it}$  is:

$$CAAR_{it}, t-stat = \frac{CAAR_{it}}{\sigma_{it}}$$

Equation 11

For the merger to have an effect on the shareholder value the average abnormal and the cumulative abnormal returns must be found statistically significant (Gong, 2007).

## Data

The data employed in this paper are the daily stocks of the acquirer company together with the stock market index of the airline under question. In terms of the risk free rate for calculating the CAPM the 3 months Treasury Bills rate is used.

The table below presents a list of the mergers under examination

*Table1: M&A Details*

<i>Date</i>	<i>Acquirer</i>	<i>Target</i>	<i>Country of Acquirer</i>	<i>Country of Target</i>	<i>Transaction Value at Announcement</i>
10-Feb-05	Deutsche Lufthansa	AG Amadeus Global Travel Distribution SA	Germany	Spain	5182053300
15-Aug-05	Skywest Inc	Atlantic Southeast Airlines Inc	US	US	425000000
21-Jun-07	Air France – KLM	Martinair-Holland Mv	France	Netherlands	Stocks
14-Apr-08	Delta Airlines Inc	Northwest Airlines Corp	US	US	3100000000
03-May-10	United Airlines	Continental Airlines	US	US	3200000000

## Empirical Results

In this paper we apply event study to determine whether M&A activity generates a significantly positive value for the acquiring firm. Since the target firms' data are not available after M&As, this paper only focuses on the change of shareholder's return of the acquirer firm. The study is based on 5 M&As in European and North American airline industry between 2005 and 2010.

Firstly the firm's specific coefficients were estimated with the use of equation2 and 3. Then with the used of the estimated coefficients of both equations two sets of abnormal returns and cumulative abnormal returns were calculated for the individual M&A event. As stated above the idea of the event study methodology is that markets are efficient and thus investors are rational. This in turn suggests that the effect of any announcement should be incorporate in the stock price rather quickly. Since stock prices are considered to be rational indicators of expected returns, investors' response through prices signifies their perception in regards to

the merger. If shareholders believe that the merger would increase the value of the firm then there would be positive abnormal returns. On the opposite side if shareholders consider that the merger would be unprofitable and thus decrease the value of the firm then there would be negative abnormal returns (Diepold et al 2006).

Tables 2 and 3 represent the results. As already mentioned, two models have been estimated so as to examine the bias of the findings with the use of different models. At a glance it is evident that both AAR and CAAR obtained from both the market model and the CAPM are practically the same. This suggests in turn suggests that choice of the model does not produce any bias in the results.

In general the study's findings indicated mixed results, since some mergers were conceived as having a positive effect on the value of the shareholders and thus produced positive AAR and CAAR and some negative effect on the value of the shareholders and thus produced negative AAR and CAAR. Nevertheless, opposing to most US literature, in all cases in all event windows, apart from one case, none of the results were found to be statistically significant. The results are more in line with the European studies where they also found insignificant returns for the bidder firms [Friesen (2005) and Mukim (2010)]. Some probable explanation for the insignificant abnormal returns as Mei and Sun (2008) pointed out the bidder firm might have prior ownership into the acquired firm. For that reason the benefits of the merger are already incorporated in the share price. Additionally, in some of the mergers there was a huge difference in the firms' size. If this is the case, then the addition of the target to the bidder's value is small compared to the total. Finally, in accordance with Weston, Siu et al. (2001) the insignificant abnormal returns for the bidder firms are consistent with a competitive corporate control market in which companies earn usual returns in their business.

In terms of event window the study utilised several different windows so as to examine not only the effect of the mergers on the shareholders' wealth but also to evaluate the dispute in the literature in regards to the subject market. More specifically Ebnet and Theuvsen, (2007) stated that in cases of M&As the information concerning the evaluation of the target firms usually are made known over a long period. However, current results indicated the opposite. In more detail only one merger was found to provide abnormal returns for the shareholders but only when event window was quite small. At a longer window the abnormal returns seem to disappear. More specifically, the merger between Air France –KLM and Martinair-Holland is found to generate negative cumulative and abnormal returns for the shareholders of the acquirer in both models. These results provide evidence of market inefficiency in the short run for the given market, which in turn suggests that investors can gain abnormal returns with the use of publicly available information.



Table 2: AAR and CAAR from the Market Model

	<i>Air France</i>	<i>Lufthansa</i>	<i>Delta</i>	<i>SkyWest</i>	<i>United</i>
<i>AAR(-15,+15)</i>	-0.0058	0.0027	-0.0045	0.0054	-0.0019
<i>t test</i>	-0.4460	0.2712	-0.0683	0.1621	-0.0486
<i>AAR(-10,+10)</i>	-0.0055	0.0027	-0.0053	0.0076	-0.0064
<i>t test</i>	-0.4541	0.2610	-0.0816	0.2023	-0.2047
<i>AAR(-5,+5)</i>	-0.0068	0.0003	-0.0039	0.0175	-0.0109
<i>t test</i>	-0.5690	0.0451	-0.0573	0.3454	-0.3077
<i>AAR(-3,+3)</i>	-0.0104	0.0014	-0.0088	0.0173	-0.0086
<i>t test</i>	-1.2357	0.1613	-0.1082	0.2756	-0.2131
<i>AAR(-1,+1)</i>	-0.0090	-0.0005	-0.0075	0.0555	-0.0148
<i>t test</i>	-6.7398*	-0.0375	-0.0701	0.6582	-0.2958
<i>AAR(0)</i>	-0.0090	-0.0208	0.0517	0.0078	-0.0079
<i>CAAR(-15,+15)</i>	-0.0098	0.0038	-0.0088	0.0063	0.0004
<i>t test</i>	-0.8016	0.3197	-0.1247	0.1828	0.0060
<i>CAAR(-10,+10)</i>	-0.0093	0.0047	-0.0064	0.0072	-0.0067
<i>t test</i>	-0.7411	0.3652	-0.0918	0.1820	-0.2042
<i>CAAR(-5,+5)</i>	-0.0083	0.0003	-0.0039	0.0175	-0.0109
<i>t test</i>	-0.5710	0.0451	-0.0573	0.3454	-0.3077
<i>CAAR(-3,+3)</i>	-0.0150	0.0014	-0.0088	0.0173	-0.0086
<i>t test</i>	-1.2099	0.1613	-0.0088	0.2756	-0.2131
<i>CAAR(-1,+1)</i>	-0.0194	-0.0005	-0.0075	0.0555	-0.0148
<i>t test</i>	-1.6431**	-0.0375	-0.0701	0.6582	-0.2958

\*significant at 5% level

\*\*significant at 10% level

## Conclusions

The current paper utilized event study methodology to examine whether merger and acquisitions alter the value of the acquiring firm. The study concentrated only on the bidder firms due to data unavailability in regards to the target firms and it was based on 5 M&As in European and North American airline industry between 2005 and 2010.

Two models have been estimated in order to examine the biased of the findings with the use of different models. However, both AAR and CAAR obtained from both models were on average the same indicating that results are unbiased to model choice. In general the results indicated that in most markets are efficient since no significant effect on the return was found. The results are more in line with the European studies where they also found insignificant returns for the bidder firms [Friesen (2005) and Mukim (2010)].

In terms of event window the study utilised several different windows so as to examine not only the effect of the mergers on the shareholders wealth but also to evaluate the dispute in the literature in regards to the subject market. Again the study found no evidence of cumulative and abnormal return in any event window, apart for only one merger. In this specific merger the study found evidence of cumulative and abnormal returns only when

event window was quite small. At a longer window the abnormal returns seems to disappear. The latter provided evidence of market inefficiency in the short run for the given market, which in turns suggest that investors can gain abnormal returns with the use of publicly available information.

Table 3: AAR and CAAR from the CAPM

	<i>Air France</i>	<i>Lufthansa</i>	<i>Delta</i>	<i>SkyWest</i>	<i>United</i>
<i>AAR(-15,+15)</i>	0.0000	0.0021	-0.0045	0.0054	-0.0019
<i>t test</i>	-0.4460	0.2068	-0.0683	0.1621	-0.0486
<i>AAR(-10,+10)</i>	-0.0055	0.0021	-0.0053	0.0076	-0.0064
<i>t test</i>	-0.4541	0.1972	-0.0816	0.2023	-0.2047
<i>AAR(-5,+5)</i>	-0.0068	-0.0001	-0.0039	0.0175	-0.0109
<i>t test</i>	-0.5690	-0.0200	-0.0573	0.3454	-0.3077
<i>AAR(-3,+3)</i>	-0.0104	0.0010	-0.0088	0.0173	-0.0086
<i>t test</i>	-1.2357	0.1080	-0.1082	0.2756	-0.2131
<i>AAR(-1,+1)</i>	-0.0090	-0.0011	-0.0075	0.0555	-0.0148
<i>t test</i>	-6.7398*	-0.0728	-0.0701	0.6582	-0.2958
<i>AAR(0)</i>	-0.0090	-0.0218	0.0517	0.0078	-0.0079
<i>CAAR(-15,+15)</i>	-0.0067	0.0031	-0.0088	0.0063	0.0004
<i>t test</i>	-0.5655	0.2512	-0.1247	0.1828	0.0060
<i>CAAR(-10,+10)</i>	-0.0060	0.0039	-0.0064	0.0072	-0.0067
<i>t test</i>	-0.5119	0.3060	-0.0918	0.1820	-0.2042
<i>CAAR(-5,+5)</i>	-0.0053	-0.0001	-0.0039	0.0175	-0.0109
<i>t test</i>	-0.3882	-0.0200	-0.0573	0.3454	-0.3077
<i>CAAR(-3,+3)</i>	-0.0109	0.0010	-0.0088	0.0173	-0.0086
<i>t test</i>	-0.8841	0.1080	-0.0088	0.2756	-0.2131
<i>CAAR(-1,+1)</i>	-0.0148	-0.0011	-0.0075	0.0555	-0.0148
<i>t test</i>	-1.6401**	-0.0728	-0.0701	0.6582	-0.2958

\*significant at 5% level

\*\*significant at 10% level

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## EVALUATING THE SATISFACTION OF INTERRAILERS WITH REGARDS THE SERVICES AND ACTIVITIES RENDERED IN ITALY, GREECE AND CROATIA

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### **Abstract**

Tourists are often confronted with a large quantity and variety of services and activities aimed at satisfying their every quest and dream of getting to know new places and people of different backgrounds. Tourist Organizations know all too well that just satisfying the basic necessities of the client, it's fundamental that the client feels completely involved in order to gain his full satisfaction.

Youth Tourism is a segment of tourism that has recently experienced accelerated growth; it is well known market segment in global travel. In Youth Tourism InterRails a well-known form of travel primarily because of the cost vs. quality, this makes this sort of travel very appealing to young travelers.

A present investigation analyses backpacking with the objective of defining and comparing the satisfaction of InterRailers regards the quality of services offered in Italy, Greece and Croatia, four main tourist activities were analyzed namely transportation, accommodation, catering and local tourist entertainment. For the purpose of this investigation two scientific methods of observation were used: direct observation and inductive natural quantitative exploration. This study was based on 70 enquiries and 10 interviews done on InterRailers travelling between the dates of the 4th December 2009 and the 13th March 2010 respectively.

The application of descriptive and multivariate statistics allowed us to extract diverse conclusions to our study, it is important to emphasize that substantial differences in InterRailer satisfaction concerning the transportation service and local tourist entertainment, however the same difference did not occur in relation to accommodation and catering, in all three destinations.

**Keywords:** Tourism, Satisfaction, Service, Quality, Backpacking, InterRail

### **Introduction**

Tourism in the last decades has turned itself into one of the most dynamic industries around, from both an economical and socio-cultural point of view. Consumers are faced with a large quantity of services meant to meet all their needs. However, organizations are aware that meeting consumer needs solely is not enough; consumer satisfaction is met by making a consumer feel drawn into an experience with emphasis on quality.

A client determines the quality of a service depending on the grade of satisfaction drawn from having his expectations met. Therefore, to satisfy a client it is necessary to first have a profound knowledge into his needs, second, possess and pursue the process of effectively and consistently meeting those needs.

Two decades ago, researchers suggested a new term to describe the style of travel exercised by youth, based on the liberty of choice and the use of economical services, the term was *backpacker*. The growth of this segment, with its distinct behavioral patterns, drew some authors to think and research this segment, intrinsic aspects as well as extrinsic aspects were analyzed, InterRail stood out, as an extremely attractive form of transportation.

## Concept of Tourism

Tourism is probably the activity that best characterizes contemporary societies; it is a collective practice a stimulant. At the basis of tourism we find a string of processes that are both diverse and complexes, their manifestation is sub-adjacent and allow each and every individual to become a tourist (Leme & Neves, 2007). Tourism is a phenomenon that refers the following:

“Movement of people in their own country or crossing national borders. Reveals the presence of various elements, interaction and relation of individuals and groups, human comprehension, sentiments, perceptions, motivations, satisfaction, pressures rejections and the notion of pleasure, that lead to great changes in society” (Marujo, 2008, p.14).

In its complexity and multiplicity, according to Ramos (1996, p.83)

“Affects people, the location and culture of a country or region (...) it is a phenomenon with multiple characteristics that has increasingly come to assume significant importance in various levels, in the relations between regions, countries and continents”.

Therefore, tourism is an agent for social change that affects all the factors linked with the culture of societies: norms values ideologies and beliefs. It is considered an activity that enables people to interact by sharing cultural, social and economic diverse experiences (Mazon, 2001).

## Turistic Activities

Based on their importance, some activities are crucial to tourism, without them it would not be possible to structure tourism into an economically viable activity, touristic consumption is fundamental to other activities that rely directly on it for subsistence, the main tourist activities are classified as follows (Cunha, 2009):

- **Transportation:** tourism, by definition, presupposes dislocation and as result, transportation automatically becomes crucial to tourism. For all its attraction, a location or region cannot develop touristically without accessibility to other forms of transportation. The existence of ports, railways, roads and air routes lead to the

development of tourist destinations. For the harmonious development of tourist destinations the actual transportation method is just as important as the infra-structure that makes that form of transportation possible.

- **Accommodation:** the importance of accommodation is derived from the definition of a tourist; the visitor spends at least one night at the location visited. Therefore, it is easy to conclude that although some tourist attractions exist without accommodation, it is not possible to structure a successful tourist destination without some or other form of accommodation. Making accommodation available to tourists is considered touristic, for lucrative purposes or not accommodation is essential for tourist destinations, without accommodation these would simply not exist.
- **Catering:** is of extreme importance as it meets the needs of the tourist, a variety of establishments prepare and provide food and beverages to the tourist, these establishments can be classified as restaurants.
- **Tourist Entertainment:** these attractions are of prime importance to the tourist product, of a region. Without these attractions there wouldn't be a need for any of the other services, and tourist destinations as we know today simply wouldn't exist.

## Youth Tourism

Backpackers have been described in many ways; Hampton (1998) notes that these tourists generally do independent tours survive with little economic resources, use local transport, take all their belongings in backpacks and avoid crowds whilst trying to discover new sites.

The concept of youth was first defined in 1985 by the UN general Assembly, within the framework of the International Year of Youth as the age group between 15 and 24 years. However, the same House added that, in addition to the statistical definition of the term youth referred to above, the sense of the word youth varied in different societies throughout the world and that the definitions of youth had changed continuously in response to the fluctuations of the political circumstances, economic and socio-cultural (Youth at the United Nations, 2009).

In turn, to Giaretta (2003), in his studies he has chosen the age group composed of individuals between eighteen and thirty-five years of age to define tourism of youth. For the author, the tourism of youth and tourism

“Practiced by a homogeneous group of young people, with the marked characteristics by age group, life style and state of mind, which triggers a series of sub-segments divided into several types of tourism” (page 8).

## Backpacking

An alternative form of tourism, usually a youth tourist or backpacker. This term defines the style of travel economic and independent, practiced by young people from throughout the

world who seek to learn about natural attractions and cultural in greater number of destinations, with high degree of interaction between the travellers themselves and the people of local communities, usually in long journeys (Oliveira, 1998, 2000). Swarbrooke e Horner (1999) argued that the backpackers can be considered as a true market segment of international tourism.

### **Origen e Characteristics of Backpacking**

Even prior to appear the words backpacker, Cohen (1972 apud Kotler, Bowen & Makens, 1999) had defined the tourist as a drifter (without tourism) in a rather similar to what we refer to the backpackers:

"Type of international tourists that adventure in locations distant from the traditional routes. Doesn't have a fixed route or agenda planned and without any well-defined purpose of travel (...) usually they stay in youth hostels or campsites in the company of friends (...)" (p.662).

The term *backpacker* was thus introduced to tourist study by an Australian Philip L. Pearce, in 1990, and has often been used to define the segment of travelers who have a style of travel independent, flexible and economical, for long periods and who seek to know several destinations on the same journey.

The segment *backpacker* presents a series of characteristics that make it possible to differentiate it from the other. Cohen (1973 apud Kotler, Bowen & Makens, 1999) was one of the first to characterize the market for independent travelers and young people, at the time known as drifters, dividing them into travelers permanent or temporary. Permanent Travelers, according to the author, follow a style of life which is totally focused on travel, in general, remaining "on the road" for many years, while the temporary only travel for a short period of time and then return to their daily lives. This last definition of travelers seems closer to the current *Backpacker*.

According to Loker-Murphy (1995), the reasons that lead the tourists to choose this type of trip, *backpacking* are the economic point of view, an opportunity to get to know other people and to become better acquainted with the reality of the country, the extension of the time travel, independence, flexibility, convenience and ease, prior experience as *backpacker* and recommendation from other people.

Swarbrooke, Horner (1999) cite as characteristics of travel for backpackers: the independence, instead of the acquisition of travel packages; the desire to keep the expenses to the lowest level possible; the trend of trying to escape from the local traditional tourist and the possibility of extending the duration of the trip in addition to the common period of two weeks of vacation.

The backpackers are different than the other tourists because they are not fans of the package tour trade, by traveling with a limited budget, because of difficulties related to the lack of time related to the extension of the route to be followed and by traveling to see the maximum possible, going beyond the tourist attractions common to experience and learn more about the country being visited; it also mentions that the tourists backpackers require certain social skills, behavior more open and tolerant in front of different cultures.

### **Definition of Backpacking**

The backpackers are often open to experience the local way of life, citing the meeting with the people as a motivation. Its activities, second Loker-Murphy and Pearce (1995) focus mainly on nature, culture or adventure. These characteristics are related to the fact that the backpackers traveling more than other tourists, the demand for attractions unusual or unexpected experiences with the tight budget that many backpackers are needed is in good part related to the long duration of their travel (Loker-Murphy & Pierce, 1995).

Although the backpackers have been described in many ways, Hampton (1998) notes that these tourists are generally seen as independent tourists who survive with little economic means, using local transport, carrying all their belongings in the back, avoiding crowds and discovering new places. In short, Visser (2004) describes the tourists backpackers as a sub-sector of tourism international economic characterized by tourists with characteristics that include communication networks, demand for affordable accommodation and a parallel structure for restaurants and services support (Hampton, 1998).

It presents itself to the characteristics used by Loker-Murphy and Pearce (1995) to define backpackers, usually spend at least one night of travel in hostels and youth hostels, while traveling, express a preference for housing, while traveling, follow an agenda of travel flexible, emphasize the importance of the meeting with other travelers, prefer long periods of holidays and emphasize participative activities and informal.

In spite of the tourist backpacker é have been defined in various ways by academics, according to their main characteristics, it is worth pointing out that a more precise definition of the term backpacker é must, of necessity, have a content less practitioner. This is because, although some of the traits are common to most of these travelers, others represent only characteristics of travelers.

The heterogeneity of the segment and what the brand and, therefore, must be taken into account when the attempt to define (Loker-Murphy, 1995; Mohsin & Ryan, 2003). Thus, a more appropriate definition for backpacker would be:

“Young People of any age, who are carrying out, basically, independent travel and economic - avoid the mass tourism and luxury, they stay in lodgings economic, discuss prices



when possible and use the infrastructure of services (restaurants, communications, transport), which allows them to, often, a closer contact with the population visited and the style of life in the region".

### **Travelling in Europe by Rail**

Currently, the European Union (EU) has a rail network of 210 000 km and offers a large number of international passenger transport services. There are 5 000 km of lines of great speed in various countries, with trains reaching 320 km/h, making rail transport more competitive and, therefore, more attractive, with a view to opening for international passenger transport services (Official Website of the European Union, 2009).

### **What is an Interail Pass?**

By the discoveries that allows for and by unique experience that normally provides, the InterRail is a product for any age and a pivot in the curriculum of a young man; and a pass of international train (personal and non-transferable), available to citizens of any nationality (with six months' residence in a European country) with which young people with less than 26 years old may travel through Europe by train in 2ND class (Trains of Portugal, 2009a, 2009b; Free to explore Europa, 2007; Young, 2009).

This pass allows still travel to special prices or with reductions in certain shipping companies (Trains from Portugal, 2009b; InterRail.net, 2009; Eurail 2009a).

You can travel with the InterRail pass in the countries of Europe: Germany, Austria, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Denmark, Slovakia, Slovenia, Spain, Finland, France, Great Britain, Greece, Hungary, Holland, Italy, Luxembourg, Macedonia, Montenegro, Norway, Poland, Portugal, Czech Republic, the Republic of Ireland, Romania, Serbia, Sweden, Switzerland and Turkey (Trains, Portugal, 2009c).

### **Types of Passes**

Currently, there are two kinds of InterRail pass:

#### **InterRail Global Pass**

THE InterRail Global Pass allows free transit between the 30 countries of the area InterRail: Germany, Austria, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Denmark, Slovakia, Slovenia, Spain, Finland, France, Great Britain, Greece, Hungary, Holland, Italy, Luxembourg, Macedonia, Montenegro, Norway, Poland, Portugal, Czech Republic, the Republic of Ireland, Romania, Serbia, Sweden, Switzerland and Turkey (Trains, Portugal, and 2009c).

#### **InterRail One Country Pass**

THE InterRail One Country Pass allows travel freely in the (s) Company (s) of railways in only one country; it may be acquired for it doesn't matter. The acceding countries with the

exception of the following: Bosnia-Herzegovina and Montenegro, Belgium, the Netherlands and Luxembourg are included in the Benelux Pass that includes the 3 Countries, the Pass to Greece can include the boats Superfast Ferries and Blue Star Ferries of maritime company ATTICA, which makes the connection between Italy and Greece, in which case designated by Greece Plus. THE InterRail One Country Pass considers the travel in the countries and railway companies adhering to them are valid, not being granted reductions in other countries.

### **Client Satisfaction**

One cannot minimize the importance of customer satisfaction. Without client, the service company has no reason to exist. All the service companies need to define and measure proactively to the satisfaction of the customer. Expect that the customers are complaining to identify problems in the system of service provision or measure the progress of the company with regard to the satisfaction of the customer on the basis of the number of complaints received and a naive approach (Gerson, 1998).

The level of satisfaction of a client or homogeneous group of customers depends not only on the extent to which the attributes of a product meet the needs of the customers as also depends on the expectations of customers face to the overall performance of the product (Pires & Santos, 1996).

Although there are a variety of alternative definitions, the definitions most popular are satisfaction or dissatisfaction of client and comparison of the expectations of the customer with regards their perceptions. This comparison is based on what the marketing professionals call model of breakage of expectation (expectancy disconfirmation model). Saying in a simple way, if the perceptions of a client meet their expectations, it is said that the expectations were confirmed and the client is satisfied.

There are two types of breakage of expectation. It is a real perception fell short of what was expected, the result will be a drop of expectation negative, which results in dissatisfaction of the customer and can trigger the negative publicity mouth to mouth and/or the defection of the client. On the other hand, there is a drop of positive expectation, when the perceptions exceed our expectations, result it the satisfaction of the customer (Hoffman & Batenson, 2006).

### **Measuring Client Satisfaction**

Before measuring anything, we must know what we are measuring and why. The first benefit of a measurement program is that it gives a person immediate feedback that is objective and with meaning.

It may also be the basis for a system of rewards that can only succeed if based on given objective and quantifiable. The benefits of measuring quality and customer satisfaction can be summarized in five topics (Gerson, 1998; Hoffman & Batenson, 2006):

- Providing the people with a sense of achievement and fulfillment, translates in good customer service.
- Giving people a performance standard that should try to achieve, will lead them into improving and increasing the customer satisfaction.
- Offering immediate feedback, especially when the client is to measure the action of the supplier.
- Say what must be done to improve the quality and customer satisfaction and how to do it (this information may also come directly from the client).

In qualitative and quantitative methods of collection the process of identification and weighting of the attributes is used as well as the collection and processing of information. The methodologies used are different depending on the size of the work and the types of desired results. Also the techniques and media for the collection of information vary depending on the type of methodology used (Pires & Santos, 1996).

- **Qualitative Research:** the quality of the research takes understanding subjectively the customer experience when buying or using your product or service. There are no rigid measurements in qualitative research. Qualitative Investigation: The quality of the research takes understanding subjectively the customer experience when buying or using your product or service. There are no measurements are rigid in qualitative research.
- **Quantitative Investigation:** quantitative research and objectives are measurable. We obtain the data according to a standard pre-determined. To complete the research, we performed statistical analyzes on the data, for Quantitative Investigation: quantitative research and objectives are measurable data according to a standard pre-determined. To complete the research, we perform statistical analyzes on the data, to determine the degree of satisfaction of the clients and the assessment made by these the quality of the service.

## Quality of Service

The quality of a service, second Teboul (1999) is created at each point of interaction involving the provider of the service, the worker and the client. For this author, in the process of interaction, the quality of the service is a function of 3 elements: (1) the expectations that involve the clarification that should be provided and their control;(2) the delivery of results expected of professional practice, the standards or behaviors seized or acquired and (3) the perception that involves the control of the service given the client's perception of making the necessary adjustments.

Also Kellogg, Youngdahl and Bowen (1997), on the basis of a conceptual model of the chain of values of the service, show the importance of consumer behavior, influencing, positively or

negatively affect the quality of the service in the various stages of the value chain and the relationship that these behaviors have on the perceived value of the service and the level of satisfaction. Highlighting not only how consumers co-guarantee service quality during the process but also the need to determine and specify what the client feels as costs are incurred. That is, although not always economic costs are entailed, they express themselves through various forms of stress that also contribute to the quality of service received.

### **Tools used to Measure Quality**

There are a variety of tools to measure the quality and customer satisfaction and many of them can be used jointly. However, there are seven tools for measuring the quality (Gerson, 1998): evaluation tests, graphs of Pareto, histograms, and diagrams of correlation, and diagrams of cause and effect, control charts and stratification. There are other measurement techniques that can be used, as for example, brainstorming (this is not as well a measuring technique but a way of generating creative ideas to the continued improvement of the quality), graphs, flow charts, to process, analyze SWAT and benchmarking (After measuring levels of customer satisfaction, we must analyze the results so that we can implement the improvements suggested by the polls or carry out the follow-up directly with the customers to expose their views. This analysis and follow-up will also give personal particulars as to the efficiency of its performance, setting references which will make it easier to measure exactly the performance of future services (Gerson, 1998; Mowforth & Munt, 1998).

### **Methodology**

This research, exploratory in nature, examines backpacking to define and compare the InterRailers satisfaction with the quality of services in Italy, Greece and Croatia. For this research we built up, at random, a sample of 70 individuals (36 female and 34 male gender, 51 Portuguese nationals, 19 of other nationalities) who along its route had passed through Italy, Greece and Croatia.

For this research were used two scientific methodologies: direct observation, through the ethnographic work carried out in 11 countries (Italy, Greece, Croatia, Bosnia, Serbia, Bulgaria, Turkey, Romania, Hungary, the Czech Republic and Germany) and 18 cities (Rome, Bari, Ancona, Florence, Igoumenitsa, Corfu, Split, Hvar, Ploce, Sarajevo, Belgrade, Sofia, Istanbul, Bucharest, Timisoara, Budapest, Prague and Munich) and the inductive of a quantitative nature based on 70 surveys obtained between December 14, 2009 and March 13, 2010 through InterRailers of different nationalities that, in their journeys had travelled in the above-mentioned countries.

### **Results**

The word statistics can be attributed to different meanings. In the broadest sense, refers to a discipline whose fundamental objective is the collection, compilation, analysis and interpretation of data. The goal of statistical inference, based on the analysis of a limited set of

data (a sample) aims to characterize the whole from which such data was obtained (Pinto Coelho, Cunha and Legatheaux Martins, 2008).

### **Internal Consistency of the Scales Used**

The index alpha ( $\alpha$ ) estimates how uniformly the items contribute to the sum of the weighted instrument, ranging on a scale of zero to one. This property is known as internal consistency of the scale and the alpha ( $\alpha$ ) may be interpreted to mean coefficient of all the estimates of internal consistency that they would all possible divisions of the scale were made (Cronbach, 1951).

In general, an instrument or test is classified as having reliability appropriately when the  $\alpha \geq 0,70$  (Nunnally, 1978). That is then followed by the consistency of the scale used. The instrument used to assess the satisfaction of InterRailers on the 4 tourist activities and consisting of a scale consists of 14 items for the transport, 17 for accommodation, 18 for the restoration and 20 for the tourist attractions in accordance with the methodology proposed by Likert scale consisting of five).

### **Inferential Statistics**

The statistical inference (statistical or inductive) is composed of a set of analytical techniques used to identify and characterize relationships between variables. It aims to extrapolate the results (obtained with the descriptive statistics) thereby allowing people to uncover characteristics based on known information about one or more samples drawn from this population. Thus, the statistical inference allows us to draw conclusions and make inferences that go beyond mere description of the information (Pinto Coelho, Cunha and Legatheaux Martins, 2008).

Taking into account that dependent variables (tourist activities: transport, accommodation, catering, and tourist attractions) and independent variables (destinations: Italy, Greece and Croatia), we calculated, initially, the average of each sample using the following tests to check if there were significant differences in the averages for the satisfaction of the dependent variables between the 3 destinations:

### **Transportation**

In the descriptive level, the average rating for the satisfaction of InterRailers was 3.4142 for the quality of Italian transportation, 3.0880 for the quality of Greek transportation and 3.1149 for the quality of Croatian transportation (Table 1.1). The highest average value refers went to Italian transportation.

Table 1.1: Descriptive Statistics (transportation).

Descriptive Statistics			
	Mean	Std. Deviation	N
Italian Transports	3,4142	0,62695	70
Greek Transports	3,0880	0,59650	70
Croatian Transports	3,1149	0,53273	70

In this case, it is necessary to verify the assumption of normality before executing the parametric test of ANOVA because when the samples have a size greater than 30, this procedure is needless (Maroco, 2003).

The output presented below (Table 1.2), is related to the sphericity test by Mauchly (Mauchly's Test of Sphericity), plus an assumption that needs to be verified to be able to use parametric test for more than two matched samples (ANOVA for repeated measurements). The Mauchly sphericity test measures the equality of variances of differences between treatment levels.

In this case, once the  $\text{sig}=0.147 > \alpha=0.050$  for the test of sphericity does not reject the  $H_0$ . It is then that there is sphericity as soon as we can apply the test for paired samples (ANOVA for repeated measurements) (Table 1.3).

Table 1.2: Mauchly's Test of Sphericity (transportation).

Mauchly's Test of Sphericity <sup>b</sup>							
Measure: MEASURE_1							
Within Subjects Effect	Mauchly's W	Approx. Chi-Square	df	Sig.	Epsilon <sup>a</sup>		
					Greenhouse-Geisser	Huynh-Feldt	Lower-bound
Factor1	0,994	3,841	2	0,147	0,947	0,974	0,500
Tests the null hypothesis that the error covariance matrix of the orthonormalized transformed dependent variables is proportional to an identity matrix.							
a. May be used to adjust the degrees of freedom for the averaged tests of significance. Corrected tests are displayed in the Tests of Within-Subjects Effects table.							
b. Design: Intercept							
Within Subjects Design: factor1							

Table 1.3: Test of Within-Subjects Effects (transportation).

Test of Within-Subjects Effects						
Measure: MEASURE_1						
Source		Type III Sum of Squares	df	Mean Square	F	Sig.
Factor1	Sphericity Assumed	5,041	2	2,521	9,979	0,000
	Greenhouse-Geisser	5,041	1,894	2,661	9,979	0,000
	Huynh-Feldt	5,041	1,947	2,589	9,979	0,000
	Lower-bound	5,041	1,000	5,041	9,979	0,002
Error (factor1)	Sphericity Assumed	34,353	136	0,253		
	Greenhouse-Geisser	34,353	128,823	0,267		
	Huynh-Feldt	34,353	132,406	0,259		
	Lower-bound	34,353	68,000	0,505		

In this case, once the  $\text{sig}=0.000 < \alpha=0.050$  rejects the  $H_0$ . This means that there are significant differences in the averages for the satisfaction of InterRailers regarding the variable transport between the three destinations.

There are significant differences, it is still necessary to apply a multiple comparison test of averages (Table 1.4) to verify that averages between these differences occur.

Table 1.4: Pairwise Comparisons (transportation).

Pairwise Comparisons						
Measure: MEASURE_1						
(I) Factor1	(J) Factor1	Mean Difference (I-J)	Std. Error	Sig <sup>a</sup>	95% Confidence Interval for Difference <sup>a</sup>	
					Lower Bound	Upper Bound
1	2	0,344*	0,089	0,001	0,126	0,561
	3	0,317*	0,092	0,003	0,091	0,543
2	1	-0,344*	0,089	0,001	-0,561	-0,126
	3	-0,027	0,075	1,000	-0,211	0,157
3	1	-0,317*	0,092	0,003	-0,543	-0,091
	2	0,027	0,075	1,000	-0,157	0,211
Based on estimated marginal means						
*. The mean difference is significant at the 0,05 level.						
a. Adjustment for multiple comparisons: Bonferroni.						

In this case, there are significant differences in the satisfaction of InterRailers between the quality of transport in Italy and Greece ( $\text{sig}=0.001 < 0.050$ ) and the quality of transport between Italy and Croatia ( $\text{sig}=0.003 < 0.050$ ).

## Accommodation

In the descriptive level, the average rating on the satisfaction of InterRailers was 3.6684 for the quality of Italian accommodation, 3.7707 for the quality of Greek accommodation and 3.5874 for the quality of Croatian accommodation (Table 1.5). The highest average value was related to Croatian accommodation.

Table 1.5: Descriptive Statistics (Accommodation).

Descriptive Statistics			
	Mean	Std. Deviation	N
Italian Accommodation	3,6684	0,62440	70
Greek Accommodation	3,7707	0,58980	70
Croatian Accommodation	3,5874	0,63109	70

In this case, it was necessary to verify the assumption of normality before executing the parametric test of ANOVA because when the samples had a size greater than 30, this procedure and needless (Maroco, 2003).

The output presented below (Table 1.6), is related to the sphericity test Mauchly (Mauchly's Test of Sphericity), plus an assumption that needs to be verified to be able to use parametric test for more than two matched samples (ANOVA for repeated measurements). The Mauchly sphericity test measures the equality of variances of differences between treatment levels.

In this case, since the  $\text{sig} = 0.099 > \alpha = 0.050$  for test of sphericity, the  $H_0$  is not rejected. It is said that there is sphericity and then we can apply the test in paired samples (ANOVA for repeated measurements) (Table 1.7).

Table 1.6: Mauchly's Test of Sphericity (accommodation).

Mauchly's Test of Sphericity <sup>b</sup>							
Measure: MEASURE_1							
Within Subjects Effect	Mauchly's W	Approx. Chi-Square	df	Sig.	Epsilon <sup>a</sup>		
					Greenhouse-Geisser	Huynh-Feldt	Lower-bound
Factor1	0,908	6,497	2	0,099	0,915	0,939	0,500
Tests the null hypothesis that the error covariance matrix of the orthonormalized transformed dependent variables is proportional to an identity matrix.							
a. May be used to adjust the degrees of freedom for the averaged tests of significance. Corrected tests are displayed in the Tests of Within-Subjects Effects table.							
b. Design: Intercept							
Within Subjects Design: factor1							



Table 1.7: Test of Within-Subjects Effects (accommodation).

Test of Within-Subjects Effects						
Measure: MEASURE_1						
Source		Type III Sum of Squares	df	Mean Square	F	Sig.
Factor1	Sphericity Assumed	1,164	2	0,582	2,467	0,089
	Greenhouse-Geisser	1,164	1,831	0,636	2,467	0,094
	Huynh-Feldt	1,164	1,879	0,620	2,467	0,092
	Lower-bound	1,164	1,000	1,164	2,467	0,121
Error (factor1)	Sphericity Assumed	32,086	136	0,236		
	Greenhouse-Geisser	32,086	124,495	0,258		
	Huynh-Feldt	32,086	127,766	0,251		
	Lower-bound	32,086	68,000	0,472		

In this case, once the  $\text{sig}=0.089 > \alpha=0.050$  does not reject the  $H_0$ . Does this mean that there are no significant differences in the averages of satisfaction of InterRailers regarding the variable accommodation between the three destinations.

## Catering

In descriptive levels, the average rating of satisfaction of InterRailers was 3.9689 for the quality of the Italian catering, 4.0484 for the quality of Greek catering and 4.0597 for the quality of Croatian catering (Table 1.8). The highest average value of Catering went to the Croatian Catering.

Table 1.8: Descriptive Statics (catering)

Descriptive Statistics			
	Mean	Std. Deviation	N
Italian Catering	3,9689	0,57818	70
Greek Catering	4,0484	0,49393	70
Croatian Catering	4,0597	0,51787	70

In this case, it is not necessary to check the assumption of normality before performing parametric test of ANOVA because when samples are larger than 30, this procedure is pointless (Maroco, 2003).

The output presented below (Table 1.9), is related to the sphericity test Mauchly (Mauchly's Test of Sphericity), plus an assumption that needs to be verified to be able to use parametric test for more than two matched samples (ANOVA for repeated measurements). The Mauchly sphericity test measures the equality of variances of differences between treatment levels.

In this case, once the  $\text{sig}=0.200 > \alpha=0.050$  for the test of sphericity does not reject the  $H_0$ . It is then that there is sphericity as soon as we can apply the test for paired samples (ANOVA for repeated measurements) (Table 1.10).

Table 1.9: Mauchly's Test of Sphericity (catering).

Mauchly's Test of Sphericity <sup>b</sup>							
Measure: MEASURE_1							
Within Subjects Effect	Mauchly's W	Approx. Chi-Square	df	Sig.	Epsilon <sup>a</sup>		
					Greenhouse-Geisser	Huynh-Feldt	Lower-bound
Factor1	0,122	139,057	2	0,200	0,532	0,534	0,500
Tests the null hypothesis that the error covariance matrix of the orthonormalized transformed dependent variables is proportional to an identity matrix.							
a. May be used to adjust the degrees of freedom for the averaged tests of significance. Corrected tests are displayed in the Tests of Within-Subjects Effects table.							
b. Design: Intercept							
Within Subjects Design: factor1							

Table 1.10: Test of Within-Subjects Effects.

Test of Within-Subjects Effects						
Measure: MEASURE_1						
Source		Type III Sum of Squares	df	Mean Square	F	Sig.
Factor1	Sphericity Assumed	0,333	2	0,167	1,842	0,162
	Greenhouse-Geisser	0,333	1,065	0,313	1,842	0,179
	Huynh-Feldt	0,333	1,068	0,312	1,842	0,179
	Lower-bound	0,333	1,000	0,333	1,842	0,179
Error (factor1)	Sphericity Assumed	12,128	134	0,091		
	Greenhouse-Geisser	12,128	71,338	0,170		
	Huynh-Feldt	12,128	71,539	0,170		
	Lower-bound	12,128	67,000	0,181		

In this case, once the  $\text{sig}=0.162 > \alpha=0.050$  does not reject the  $H_0$ . Does that mean that there are no significant differences in the averages for the satisfaction of InterRailers regarding the variable catering between the three destinations.

## Tourist Entertainment

The descriptive level, it appears that the average rating on the satisfaction of InterRailers and 3.9075 for Italian tourist entertainment in Italy, from 3.7910 for Greek tourist entertainment in Greece and 3.4410 for the Croatian tourist entertainment in Croatia (Table 1.11). The highest average value is related to tourist entertainment in Italy.

Table 1.11: Descriptive Statistics (tourist Attractions).

Descriptive Statistics			
	Mean	Std. Deviation	N
Italian Tourist Entertainment	3,9075	0,52838	3,9075
Greek Tourist Entertainment	3,7910	0,42870	3,7910
Croatian Tourist Entertainment	3,4410	0,41000	3,4410

In this case, it is not necessary to check the assumption of normality before performing parametric test of ANOVA because when samples are larger than 30, this procedure is pointless (Maroco, 2003).

The output presented below (Table 1.12), refers to the sphericity test Mauchly (Mauchly's Test of Sphericity), plus an assumption that it needs to be verified to be able to use parametric test for more than two matched samples (ANOVA for repeated measurements). The Mauchly sphericity test measures the equality of variances of differences between treatment levels.

In this case, since the  $\text{sig} = 0.269 > \alpha = 0.050$  for test of sphericity, the  $H_0$  was not rejected. It is said that there is sphericity and then we can apply the test for paired samples (ANOVA for repeated measurements) (Table 1.13).

Table 5.12: Mauchly's Test of Sphericity (Tourist Attractions).

Mauchly's Test of Sphericity <sup>b</sup>							
Measure: MEASURE_1							
Within Subjects Effect	Mauchly's W	Approx. Chi-Square	df	Sig.	Epsilon <sup>a</sup>		
					Greenhouse-Geisser	Huynh-Feldt	Lower-bound
Factor 1	0,960	2,628	2	0,269	0,962	0,990	0,500
Tests the null hypothesis that the error covariance matrix of the orthonormalized transformed dependent variables is proportional to an identity matrix.							
a. May be used to adjust the degrees of freedom for the averaged tests of significance. Corrected tests are displayed in the Tests of Within-Subjects Effects table.							
b. Design: Intercept							
Within Subjects Design: factor1							

Table 1.13: Test of Within-Subjects Effects (Tourist Attractions).

Test of Within-Subjects Effects						
Measure: MEASURE_1						
Source		Type III Sum of Squares	df	Mean Square	F	Sig.
Factor1	Sphericity Assumed	7,897	7,897	3,949	25,619	0,000
	Greenhouse-Geisser	7,897	7,897	4,105	25,619	0,000
	Huynh-Feldt	7,897	7,897	3,988	25,619	0,000
	Lower-bound	7,897	7,897	7,897	25,619	0,000
Error (factor1)	Sphericity Assumed	20,345	20,345	0,154		
	Greenhouse-Geisser	20,345	20,345	0,160		
	Huynh-Feldt	20,345	20,345	0,156		
	Lower-bound	20,345	20,345	0,308		

In this case, since the  $\text{sig} = 0.000 < \alpha = 0.050$  the  $H_0$  was rejected. This means that there are significant differences in the means for the satisfaction of InterRailers and variable transport between the three destinations.

With significant differences, it is still necessary to apply a multiple comparison test of means (Table 1.14) to verify that averages between these differences occur.

Table 1.14: Pairwise Comparisons (Tourist Attractions).

Pairwise Comparisons						
Measure: MEASURE_1						
(I) Factor1	(J) Factor1	Mean Difference (I-J)	Std. Error	Sig <sup>a</sup>	95% Confidence Interval for Difference <sup>a</sup>	
					Lower Bound	Upper Bound
1	2	0,116	0,069	0,292	-0,054	0,286
	3	0,466*	0,073	0,000	0,288	0,645
2	1	-0,116	0,069	0,292	-0,286	0,054
	3	0,350*	0,061	0,000	0,200	0,500
3	1	-0,466*	0,073	0,000	-0,645	-0,288
	2	-0,350*	0,061	0,000	-0,500	-0,200
Based on estimated marginal means						
*. The mean difference is significant at the 0,05 level.						
a. Adjustment for multiple comparisons: Bonferroni.						

In this case, we can see significant differences in the satisfaction of InterRailers between the quality of tourist attractions offered by Croatia and Italy ( $\text{sig} = 0.000 < 0.050$ ) and quality of attractions offered by Croatia and Greece ( $\text{sig} = 0.000 < 0.050$ ).

## Conclusions

The world is trying to understand all the changes that have occurred in recent decades. There is unanimity in asserting that these changes were of crucial importance for today's society that lives in a globalized world where all the communication barriers have been filled by information systems technology. Tourism was one of the sectors that most felt these changes. In this research, it is possible to verify that:

### In relation to transportation

The average value of satisfaction of InterRailers on the quality of the services provided in rail transportation was 3.4142 for the Italian transportation, 3.0880 for Greek transportation and 3.1149 for Croat transportation.

Taking into account the scale used to determine the satisfaction of InterRailers (Likert scale composed of 5 points) it was assumed that all the results that show average values equal to or greater than 3 - " Sufficient " attributed to the InterRailers quality of satisfied.

Assuming the average values presented above, it is possible to verify that they are all above 3 then verifying that InterRailers are sufficiently satisfied with the quality of services in rail use in Italy, Greece and Croatia.

Although satisfied, is to emphasize that there are significant differences in satisfaction InterRailers about the quality of services in rail transport used for all three destinations, InterRailers are more satisfied with the quality of services in rail Italians than with the quality of services in rail Greeks and Croats. Although positive, the lowest mean value is related to the quality of services in rail Greeks.

The indicators that were used to evaluate the satisfaction of InterRailers about the quality of services in rail use in Italy, one can conclude that the indicators that show a greater satisfaction from InterRailers are the existing environment at stations and rail transportation and security at stations and on rail. In turn, indicators showed less satisfaction from InterRailers in hygiene and cleanliness of rail transport, the personalized service and information and explanations given in railway stations.

The indicators that were used to evaluate the satisfaction of InterRailers about the quality of services in rail used in Greece, one can conclude that the indicators that show a greater satisfaction from InterRailers are punctuality of the trains and in stations and existing environment rail transport. In turn, indicators showing less satisfaction from InterRailers are the frequency of schedules, the capacity of rail transport and cleaning and hygiene in railway transport.

Finally, with respect to indicators that were used to evaluate the satisfaction of InterRailers about the quality of services in rail used in Croatia, one can conclude that the indicators that show a greater satisfaction from InterRailers are punctuality of trains, the environment in

existing stations and rail transportation and security at stations and on rail. In turn, the indicators that show lower satisfaction from InterRailers are the location of railway stations, the timing and frequency of cleaning and hygiene in railway transport.

#### **In relation to Accommodation**

In this investigation we can see that the average value on the satisfaction of InterRailers about the quality of services rendered in 3.6684 accommodations is Italian for housing, housing for the 3.7707 and 3.5874 for the Greek Croatian accommodation. Given the scale used to determine the satisfaction of InterRailers (Likert scale consisting of 5 points) it was assumed that all the results we present average values equal to or above 3 - "Sufficient" attribute to the quality of InterRailers satisfied.

Assuming the average values presented above, it is possible to verify that they are all above 3 then verifying that InterRailers are satisfied with the quality of services in accommodation used in Italy, Greece and Croatia.

No differences were significant and positive although it is possible to verify that the average value is higher on the quality of Greek housing and the average value is lower on the quality of Croatian accommodation.

For the indicators used to evaluate the satisfaction of InterRailers regarding the quality of services provided within the Italian housing, one can conclude that the indicators that showed a greater satisfaction from InterRailers in accessibility to housing, hospitality and times of entry and exit from housing. In turn, indicators showed less satisfaction from InterRailers in the time taken to respond to anomalies, quality and comfort of the bedrooms and en-suite.

For the indicators used to evaluate the satisfaction of InterRailers regarding the quality of services provided within Greek housing, it was possible to conclude that the indicators showed a greater satisfaction from InterRailers regarding hospitality, accessibility to housing, the schedules of entry and exit into housing and receptivity on the part of officials. In turn, indicators showed less satisfaction from InterRailers on issues of general hygiene and cleanliness of bathrooms, and bathing quarters.

Finally, with respect to indicators that were used to evaluate the satisfaction of InterRailers in the quality of services provided within the Croatian housing, the conclusion was that the indicators that showed a greater satisfaction from InterRailers regarding hospitality, the times of entry and exit the accommodation and value for money. In turn, indicators showed less satisfaction from InterRailers regarding the location of housing, accessibility to housing, the response time anomalies and bathrooms, shower facilities.

#### **In relation to Catering**

The average value of satisfaction of InterRailers on the quality of the services provided in catering was 3.9689 for the Italian catering, 4.0484 for Greek catering and 4.0597 for Croat

catering. Taking into account the scale used to determine the satisfaction of InterRailers (Likert scale composed of 5 points) it was assumed that all the results that show average values equal to or greater than 3 - "Sufficient" attributed to the InterRailers quality of satisfied.

Assuming the average values presented above, it is possible to verify that they are all above 3 then verifying that InterRailers are satisfied with the quality of services in catering used in Italy, Greece and Croatia.

No differences were significant and positive although it is possible to verify that the average value is higher on the quality of Croat catering and the average value is lower on the quality of Italian catering.

The indicators that were used to evaluate the satisfaction of InterRailers regarding the quality of services provided under the Italian catering, one can conclude that the indicators that showed a greater satisfaction from InterRailers in regards location, hours of operation and quality of food (taste, aroma, texture, presentation). In turn, indicators showed less satisfaction from InterRailers in matters of reliability of service, menu variety and value for money.

The indicators that were used to evaluate the satisfaction of InterRailers in the quality of services provided under the Greek catering, one can conclude that the indicators showed a greater satisfaction for the environment of InterRailers accommodation, dining experience and the relationship between cost and value. In turn, indicators showed less satisfaction from InterRailers regarding waiting times, hygiene and cleanliness and quality of equipment.

The indicators that were used to evaluate the satisfaction of InterRailers in the quality of services provided in Croatian catering, one can conclude that the indicators showed a greater satisfaction from InterRailers in matters pertaining to the number of hours of operation, the environment and the relationship between housing and money value. In turn, indicators showed less satisfaction from InterRailers regarding waiting times, hygiene and cleanliness and quality of equipment.

#### **With Regard to Tourist Entertainment**

The average value of satisfaction of InterRailers on the quality of the services provided in Tourist Entertainment was 3.9075 for tourist entertainment in Italy, 3.7910 in Greece and 3.4410 in Croatia. Given the scale used to determine the satisfaction of InterRailers (Likert scale consisting of 5 points) it was assumed that all the results we present average values equal to or above 3 - "Sufficient" attribute to the quality of InterRailers satisfied.

Assuming the average values presented above, it is possible to verify that they are all above 3 then verifying that InterRailers are satisfied with the quality of Tourist Entertainment in Italy, Greece and Croatia.

Although satisfied, is to emphasize that there are significant differences in satisfaction InterRailers about the quality of tourist entertainment for all three destinations, InterRailers are more satisfied with tourist entertainment in Italy than with the tourist entertainment in Greece and Croatia. Although positive, the lowest mean value is related to the quality of Croat tourism entertainment.

The indicators used to assess satisfaction with the quality of InterRailers tourist entertainment in Italy, concluded that there was greater satisfaction from InterRailers regarding the existence of cultural, historical and cultural heritage and diversity of museums. In turn, indicators showed less satisfaction from InterRailers regarding the shortage of equipment for sports activities, retail shopping centers and theme parks.

The indicators that were used to assess satisfaction with the quality of InterRailers of Greek tourist entertainment, it is possible to conclude that the indicators that showed greater satisfaction from InterRailers regarding historical and cultural heritage and nightlife. In turn, indicators showed less satisfaction from InterRailers on music festivals, retail shopping centers and theme parks.

The indicators that were used to assess satisfaction with the quality of InterRailers of Croatian tourist entertainment, it is possible to conclude that indicators showed greater satisfaction from InterRailers on the quality of beaches (river beach), swimming pools, parks and nightlife and gardens. In turn, indicators showed less satisfaction from InterRailers regarding the lack of art galleries and exhibitions, variety of museums, cinema, theater and entertainment and commercial areas.

Tourism is not just another sector, but rather a constellation of activities different in nature, not always unique to tourism, which converge in the same end: to transport, accommodate, feed and provide services that contribute to a pleasant stay to all those that travel, nationals or foreigners, moving to a different destination from the usual, with intention of stay for a limited period of time. It is a global view.

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**COMPANIES' COMMITMENT AND ATTITUDE TOWARDS ENVIRONMENTAL  
MANAGEMENT – FINDINGS OF A STUDY OF THE  
AUSTRIAN TRANSPORT SECTOR**

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**Abstract**

Environmental management has become an important business topic throughout the last decade. Concepts like corporate social responsibility and sustainable development are frequently discussed. Nevertheless, the issue still remains very complex with disparities in different business branches. Road transport is in this respect still regarded to be one of the main sources of greenhouse gas emission. Thus it should be an objective of every renowned company to implement a state-of-the-art environmental management scheme that is adjusted to the business focus and continuously enhanced. However measures might often be taken only if they have a positive impact on results or the companies' viability. The intrinsic involvement of the management and its commitment is therefore indispensable. In this paper we discuss the status of the implementation of environmental management based on a survey of Austrian transport for hire or reward companies or businesses in other fields regularly performing own account transport. We show significant differences between companies declaring themselves to practice environmental management actively and others which do not focusing also on managers' attitudes and commitment towards environmental management measures in the respective companies and give indications for political as well as corporate action.

**Keywords:** environmental management, sustainable transport, attitudes, commitment, transport for hire or reward, own-account transport

**Background**

The latest UN Climate Conference in Cancun 2010 once more underlined global efforts towards environmental protection (United Nations, 2011). Although consensus could not be reached in every topic and some questions still remained unacknowledged a trend is clearly visible. Many industries even regard this development as a chance for new markets and growth. As a consequence product innovations and research in the field of environmental protection and sustainability are commonly supported. Furthermore companies in many sectors stop considering sustainable management as a burden but rather appreciate it as a helpful tool in the long-term perspective, namely as one way to improve customer relation and image in order to be better distinguished from their competitors.

Outshined by industrial production though, transport is still a serious pollution factor. On the one hand CO<sub>2</sub>-emissions of the different transport modes intensify the greenhouse effect (OECD 2010), on the other hand negative external costs are boosted (Verhof 1994, pp. 3-5). Therefore politicians and researchers are striving for solutions and innovations in the transport sector that help to improve the situation of all stakeholders involved. Two basic aspects seem to be essential in this respect. Firstly, the current degree of the implementation of environmental management in companies conducting transport; secondly, corporate decision-makers' awareness and attitudes. Both factors could be seen as preconditions for further progresses at the corporate level leading to a better performance of national economies in environmental matters (e.g. emission targets).

However in order to reach global or national objectives it will be necessary that according actions are also taken on the individual company level. Hence the implementation of corporate environmental management is of crucial importance and therefore stands in the focus of this paper. Following Ajzen's "theory of planned behaviour" (Ajzen, 1991) attitudes and commitment towards environmental managements can be seen as most important prerequisites for further steps (Kaiser et al., 1999).

The term "environmental management" (EM) refers to an environment-orientated management of a company (Müller-Christ 2001, p. 4). It involves all activities and decisions that are necessary to minimise the environmental pollution caused by the company (Baumann, Kössler & Promberger 2005, p. 17). EM is closely linked sustainable management where again a more holistic approach is taken: The triple bottom line approach subdivides sustainability into social, ecological and economical development (Elkington 1999, pp.72-73). Accordingly, corporate EM measures have to be assessed in the framework of ecological, social and economical objectives. Although a positive effect on ecology remains the main goal of EM the implementation of a measure is highly dependent on the economical impact. If the trade-off between cost savings and environment protection can be resolved, a measure is likely to be realised and to persist as managers in the first instance need to be oriented at their company and its objectives:

Since Adam Smith's "invisible hand" (Smith, 1776) established economic theory regards companies as rational entities heading for maximum profit or maximum profitability. Some economists even believe that profit maximisation is a company's only (social) responsibility (Friedmann, 1970). However over time but still already starting back in the first half of the 20<sup>th</sup> century opinions seem to have changed and so have the attitudes of managers (Hay&Grey, 1974). Modern management theory accepts the interests of different stakeholder groups but considers the customer as focal point in order to ensure the viability (Beer, 1984) of the company and thus corporate sustainability (Woodruff, 1997). In models it could even be shown that profit-maximisation need not be the best way to survive (Schaffer, 1989).

Based on these thoughts one might argue that any measure – and thus also measures related to EM – taken by a reasonable manager will be taken only if it has a positive impact on profit and/or corporate (in the sense of “economical”) sustainability. Reasons for taking a particular action can therefore be (Alberti et al., 2000)

- the legal framework or social pressure and norm (enforcing a certain action),
- a foreseen improvement of the company’s image (linking the action indirectly to profit/economic sustainability)
- or – best of all – a direct positive effect on results/economic sustainability.

If EM is thus perceived as an opportunity for profit increase and/or economic sustainability, managers shall wish to take advantage of it and commit themselves to its implementation. Therefore it is necessary that the management regards EM as a chance for new opportunities in this respect.

To be well prepared for future business and environmental challenges, a management system that continuously deals with environmental issues in order to perform successfully in the long run might be advantageous (Klassen & McLaughlin, 1996, Melnyk et.al, 2003, Dahlström et al., 2003). Most research focussed on EM in manufacturing business, (Kassisis and Soteriou, 2003) showed its relevance for the services industries. It remains unclear, however, whether managers would also take actions that are environmental friendly though but not useful from the economic perspective, be it merely profit increase or sustainability in a broader sense. If they did, commitment could be regarded as ‘excessive’ as – regardless of the school a managers feels to belong to – there would be no economical justification for it but rather a value based or ethical one. Only little research has treated this important topic (Bansal & Roth, 2000).

## **The Project**

The project presented in this paper was focusing at Austrian companies operating either in transport for hire or reward (including haulers, transport companies and freight forwarders with own trucks) or businesses belonging to other industries but regularly performing transport on own account. The latter group was subdivided into the sectors “industry”, “trade” and “craft”, respectively.

To depict the degree of EM implementation vis-à-vis the managers’ commitment and attitudes towards EM a basic distinction was made between those companies declaring themselves to be active in EM and those which did not. Differences with respect to budget, costs, the use of eco-friendly vehicles, employee trainings etc. were considered.

Thus, the following research questions are discussed:

- How do companies describing themselves as EM-active differ from others regarding their strategic and operational management? Which differences occur between small and large enterprises?
- How do decision makers of the respective companies evaluate the importance of EM and sustainability in general for their company?
- What is their attitude towards sustainability and environmental management measures and possible trade-offs?

### **Empirical Approach**

In the course of the entire project several stages were followed in order to develop a broad knowledge basis and to take into account the state-of-the-art in EM in the field of corporate transport in practice. At first websites of different companies belonging to the respective sectors were reviewed and analyzed. In a next step specific research topics were identified and discussed with practitioners of the field. Therefore, several experts of the carrying trade as well as from companies with regular own account transports were consulted in structured face-to-face interviews. On this basis a questionnaire was developed, pretested and eventually launched. In a final step the data was processed and analyzed.

The project started in early 2010. The quantitative survey was conducted by means of an online questionnaire between July and November 2010 and addressed to environmental managers or CEO's of companies in the respective fields. It contained mostly closed questions and appraisals of different statements to assess the attitude towards EM and its implementation. Companies were randomly selected from a publicly accessible member database run by the Austrian Chamber of Commerce (membership is mandatory for all companies based in Austria). Then, companies within the sample were contacted by telephone and a competent target person was identified, approached and encouraged to participate. If this person agreed to do so, a web link to the online questionnaire was sent by direct email. The preceding telephone contact was necessary as in published registers no information on persons in charge of EM is available. It also helped to increase the response rate. Computer Assisted Web Interview (CAWI) was chosen as it is convenient to complete for most respondents. Furthermore it allows complex issues to be illustrated clearly and it is budget friendly (Diekmann, 2007). The most severe problem of many online questionnaires, namely the lack of a specific population (Bosnjak, 2002), is solved by the fact that the target group could be specifically defined and contacted beforehand. It could further be presumed that internet access is generally available for persons within the sample. Divergence loss was minimised by contacting the appropriate respondents in person by telephone in advance.

### **Results**

A total number of 259 questionnaires were registered of which 70% fully completed the online survey. 43% were appending to the group of transport for hire or reward companies

(including haulers, transport companies and forwarders with own-name operations meaning that they operate own trucks) while 47% belonged to the group of businesses in other fields regularly performing own account transport. 10% did not respond to that question.

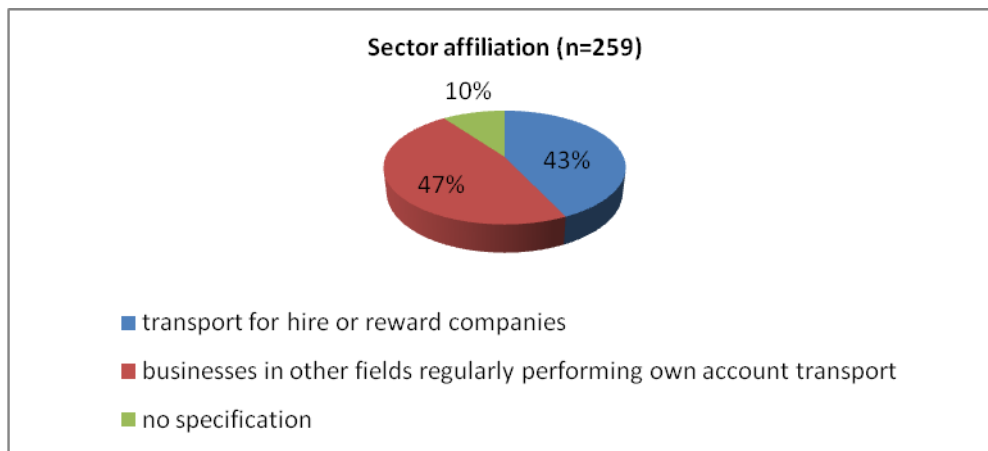


Figure 1: Sector Affiliation

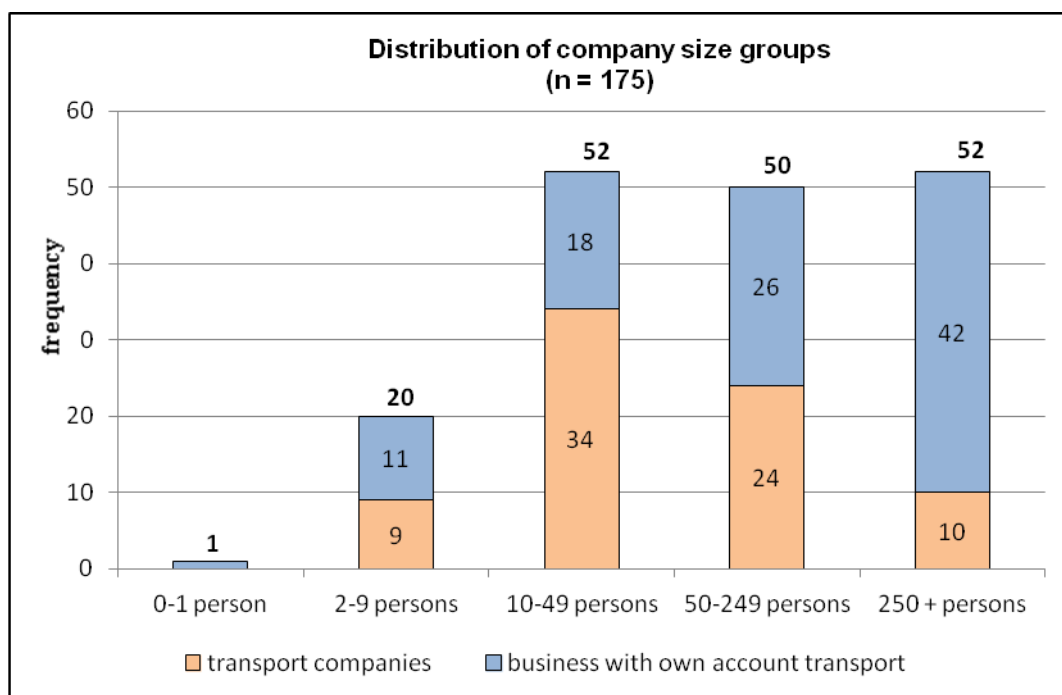


Figure 2: Distribution of company size groups

**Company size**

The size of the companies was classified according to the number of employees. A total of 175 companies stated their number of employees. Following the European Commission's definition of small, middle and medium-sized enterprises (European Commission, 2003) they were subdivided into five groups, illustrated in figure 3.

- Group 1: 0 to 1 person
- Group 2: 2 to 9 persons
- Group 3: 10 to 49 persons
- Group 4: 50 to 249 persons
- Group 5: 250 and more persons.

Group 3 (10-49 persons) and group 5 (250 and more persons) were most frequently represented with 52 companies each. While in middle-sized companies (group 3) transport companies prevailed, other businesses with regular own account transport held the vast majority in very large companies (group 5). These groups were closely followed by group 4 (50 to 249) with 50 companies in total. Here, the ratio between transport companies and businesses with own account transport was balanced. 20 participating companies had 2 to 9 employees (group 2) and only one company fell into group 1 (0 to 1 person) – (Fig. 3).

**Vehicle fleet**

A total of 174 companies stated the number of their officially registered vehicles. Again five groups were formed as follows:

- Group 1: 1 to 9 vehicles
- Group 2: 10 to 19 vehicles
- Group 3: 20 to 49 vehicles
- Group 4: 50 to 99 vehicles
- Group 5: 100 and more vehicles

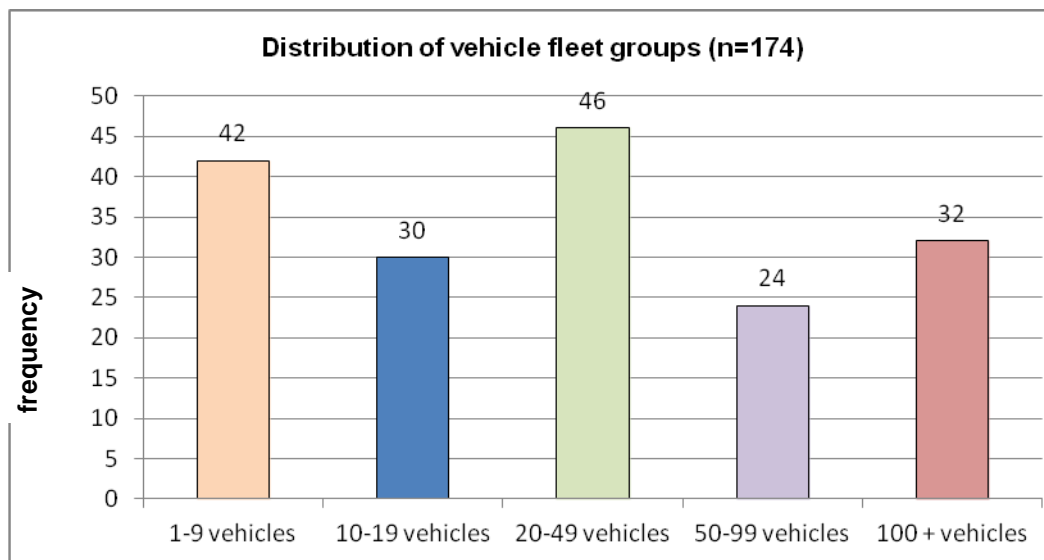


Fig. 3. Distribution of vehicle fleet groups

The largest group (46) contained companies that licensed between 20 and 49 vehicles, closely followed by the group of companies holding only a few vehicles (42). The smallest group (24) included companies with 50 to 99 vehicles, companies with medium and large fleets ranked in between.

#### Correlation of company size and fleet size

One will expect that – regarding the sectors on trial – companies that employ more personnel hold more vehicles. A scatter plot and a correlation test should support this assumption. For a clearer visual illustration extreme values above 900 employees or vehicles were filtered out.

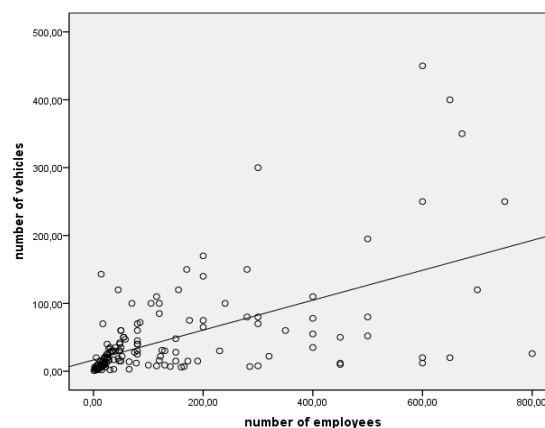


Figure 4: Correlation between company size and vehicle fleet

The result of the scatter plot demonstrates a clear positive correlation which is underlined by the embedded positive sloped straight line. Furthermore a Pearson's correlation test showed a rather strong and significant correlation (0,573). Therefore it can generally be stated that the more vehicles a company holds the higher the number of employees and vice versa.



This matter of fact also reduces the need for further statistical tests as it can be assumed that results related to both variables measuring company size are similar.

### Practice of active EM

To examine the companies' implementation of EM the respondents who were either decision makers or environmental officers were asked: "Does your company actively practice EM?" 43% of them approved while 57% negated as figure 6 illustrates.

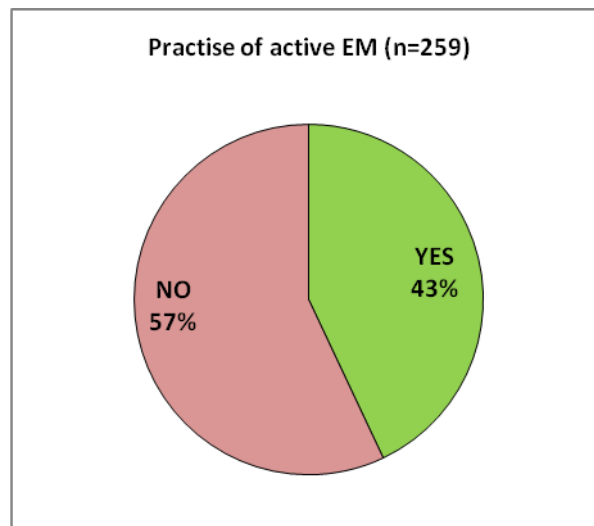


Figure 5: Practice of active environmental management

In a next step the self declared "environmentally-active" companies (n = 111) were asked to agree or disagree to given reasons for the implementation. Multiple answer selection was accepted. The most frequently stated reason for the implementation was the awareness of the increasing importance of EM in the future (74 approvals). 65 companies named legal necessities for a reason to perform environmentally friendly, closely followed by "image improvement" (64). Furthermore the distinction from competition (61), the reduction of costs by environmental protection methods (52), customer demand (42) and a competitive advantage (39) made companies introduce EM. In contrast, "social force" (7) was barely a reason for the implementation of EM. On the other hand companies which admitted not to practice active EM (n = 148) primarily reasoned that they do not see any necessity yet.

### Comparison of different groups concerning practice of active EM

Comparing transport for hire and reward companies and others regularly performing own account transport concerning the practice of active EM showed the distributions in figure 7.

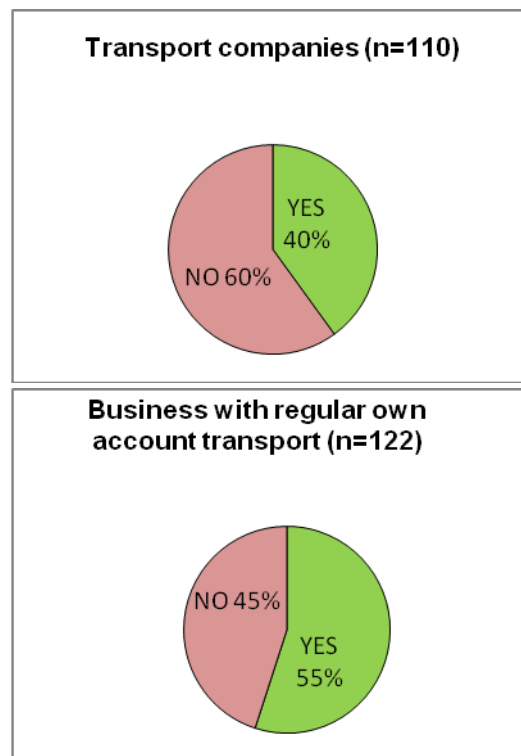


Figure 6: Practice of active EM within specific sectors

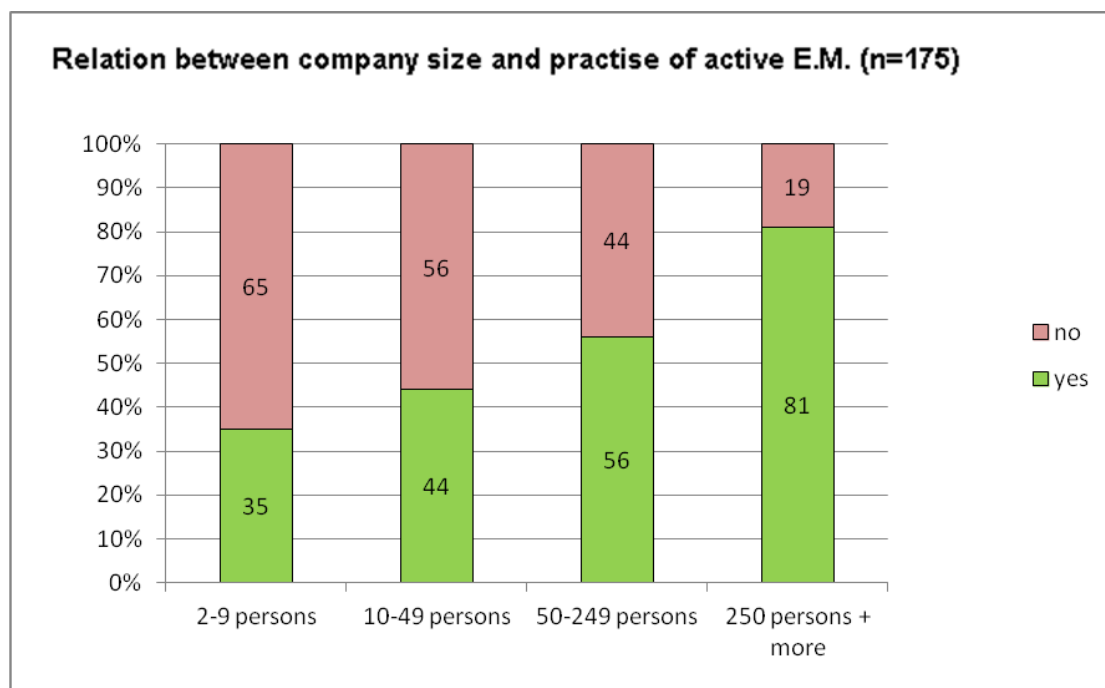


Figure 7: Relation between company size and practice of active EM

The figures demonstrate that a slight majority of businesses regularly performing own account transport actively practiced EM while 60% of the transport for hire and reward companies negated this question.

Putting the different company size groups into contrast concerning the practice of EM a distinctive trend could be observed. Namely, the bigger the company the stronger was the approval to the practice of EM (Fig. 8).

#### Coherences between the affiliation to selected groups and the practice of EM

In a first step, the coherence between the affiliation to one of the two distinct groups and the practice of EM was examined. Therefore, transport for hire or reward companies and businesses in other fields regularly performing own account transport were contrasted concerning this matter. A Chi-Square-Test yielded the following results.

			Does your company practice active EM		Total
			yes	no	
affiliation to sector	Transport companies	Count	44	66	110
		Expected Count	52,6	57,4	110,0
	own account transport	Count	67	55	122
		Expected Count	58,4	63,6	122,0
Total		Count	111	121	232
		Expected Count	111,0	121,0	232,0
Chi-Square Test					
	Value	df	Asymp. Sig. (2-sided)		
Pearson Chi-Square	5,159	1	,023		
N of Valid Cases	259				

Tab. 1. Cross tabulation: practice active EM & sector affiliation

The results show the existence of a significant coherence – even though it was a rather weak one (p-value of Pearson Chi-Square = 0,023). Nevertheless, it could be proven that – taking the numbers of expected and actual counts into account – transport companies are more likely not to practice EM actively. On the other hand businesses with regular own account transport rather perform environmentally-active.

Again a Chi-Square-Test clearly showed a significant coherence (p = 0,000 between the size group and the active practice of EM. Companies with fewer employees admit rather not having implemented EM yet while especially very large companies (250 and more persons) declared to act eco-friendly.

### Environmental aspects in the companies' decision making process

In a next step, the decision making process of the participating companies was examined. Therefore, the respondents were asked to indicate on a scroll bar to what extent environmental aspects were considered in the companies' decision making processes (with 0 = not at all considered; 100 = totally considered).

A mean value of 65 indicates that the companies well considered environmental aspects in their decision making processes. In addition, it could be shown that the companies that declared themselves EM-active differed from the group of non-active companies.

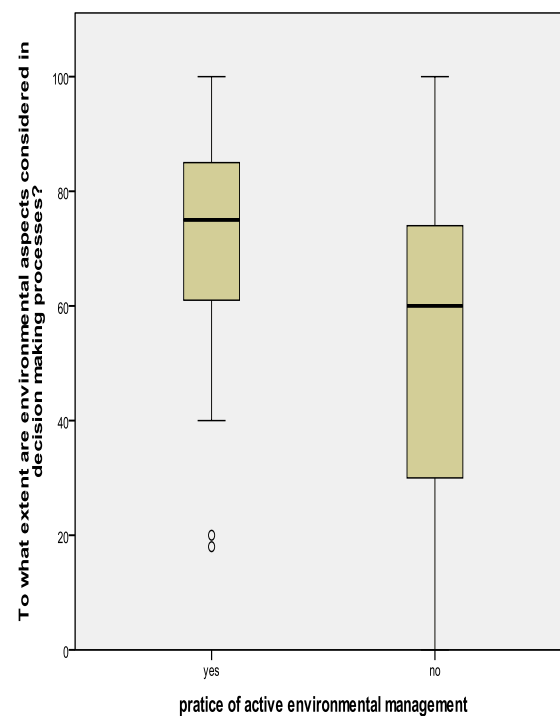


Fig. 8. Environmental aspects in decision making process

	active environmental m.		N	Mean	Std. Deviation	Std. Error Mean
extent of environmental aspects decision making pr.		yes	93	73,66	17,336	1,798
		no	62	51,37	29,678	3,769

Tab. 2. Group statistics: active vs. non-active: aspects in decision making process

The comparison of the groups' box plots show that EM-active companies considered environmental aspects to a higher extent. They had a mean value of 74 while non-EM-active companies reach a value of 51 on average. A t-test for equality of the means proved that the difference between the groups was highly significant. Still, it can be noticed that a mean of 51 for the group of companies that admitted not to practice EM shows that environmental

aspects are considered at least to some extent in the decision making processes. A rather high standard deviation (29.7) implicates, however, that within this group there are companies that consider them thoroughly while others disregard them completely.

				<i>t-test for Equality of Means</i>		
		<i>F</i>	<i>Sig.</i>	<i>t</i>	<i>df</i>	<i>Sig. (2-tailed)</i>
<i>extent of environmental aspects in decision making pr.</i>		25,584	,000	5,894	153	,000

Tab. 3. T-Test: active vs. non-active: aspects in decision making process

### Attitude towards sustainability

A company's performance is very often decisively dependent on the attitude of its management (Melnyk, Sroufe, Calatone 2003). As a first step, the attitude of the companies' decision makers or environmental officers towards sustainability was measured. They were asked to evaluate the degree of importance of sustainability in their company using a scroll bar (with 0=no importance at all; 100=highest importance) and to specify to what extent sustainability was considered in terms of employee treatment and investments.

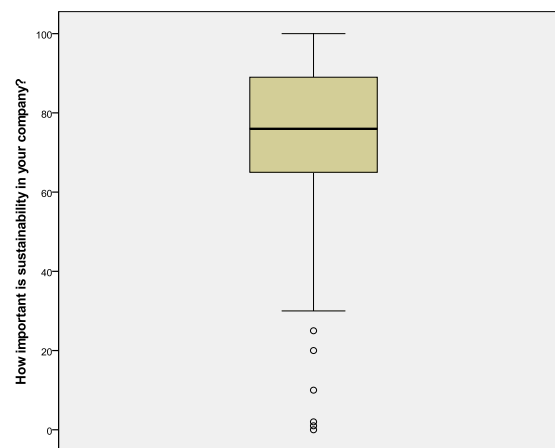


Fig 9: importance of sustainability

A mean of 73 indicates that, in general, sustainability was regarded as rather important (N=213). It was also rated as rather important regarding employee treatment (mean=72) and investments (mean=73). Taken into account the commitment to practice EM actively, it can be observed that EM-active companies significantly evaluated sustainability as more important than “inactive” companies (t-test:  $p=0,008$ ). Though, in terms of employee treatment, the two groups only differed very weakly (t-Test:  $p= 0,048$ ) and regarding investments no difference

at all could be observed (t-Test:  $p = 0,096$ ). A one-way anova shows that all company size groups consider sustainability as equally important (anova:  $p = 0,325$ ).

In a final statement concerning the impact of sustainability the decision makers were asked to forecast the importance of sustainability in the forthcoming years (on a scale with -100=importance will decrease significantly; +100=importance will increase significantly). The respondents ( $N=201$ ) predicted an increasing importance of sustainability in the future (mean=+49). This result is equally shared by both the companies that practiced active EM and those who did not (t-test:  $p = 0,45$ ). Furthermore, no significant differences between the company size groups were observed (one-way anova:  $p = 0,182$ ).

#### **Attitude towards different environmental actions**

To expose the companies' attitude towards the environment and for a better understanding of taken actions the respondents were asked to evaluate given measures concerning EM in their company. 162 companies on average classified given environmental actions whether they are unimportant, neutral or very important for their company. The following measures were most frequently rated as unimportant:

- Use of biomass
- Environmental auditing/reporting
- Use of passive houses
- Energy self supply.

Chi-square-Tests show that there was no coherence between the company size and the evaluation of these measures. They were considered as unimportant regardless of company size.

The environmental measure rated most important was waste reduction. Almost 90% classified it as "very important". Also recycling, process optimisation and the efficient use of resources were rated as very important (>70%).

Further important actions are:

- Efficient lighting
- Heat insulation
- Further training for employees
- Investments in latest technology.

Again Chi-square-tests gave evidence on coherences between the company size and the evaluations. Bigger companies considered process optimisation, efficient use of resources and

further training of employees significantly more important than smaller companies. For the other measures that were rated as important no relation to the company size was observed.

### Attitude towards transport-related actions concerning EM

Respondents were asked then to evaluate given transport-related measures as very important, neutral or unimportant. Figure 10 shows the measures most frequently rated as important and unimportant.

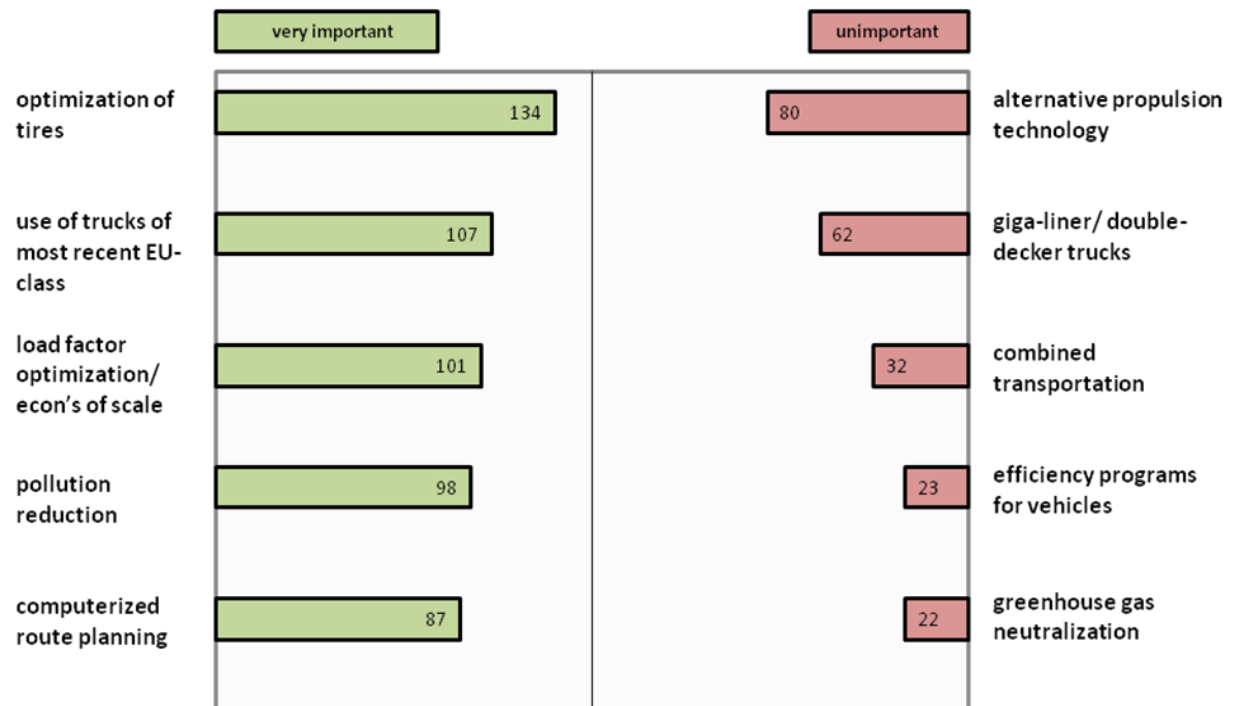


Fig 10: Importance of transport-related measures

162 companies responded on average. Optimisation of the tires was thereby by far considered as most important, followed by the use of the trucks belonging to the most recent EU-class and the optimisation of load factors and economies of scale. Furthermore, pollution reduction and computerised route planning is rated important. On the contrary, alternative propulsion technology is seen as most unimportant followed by giga-liners (heavy weight vehicles) and double-decker trucks. In addition, combined transport, efficiency programs for vehicles and greenhouse gas neutralisation were rather unimportant measures for the respondents. For almost all measures no coherence between the company size and the attitude was observed. Only “combined transport” was rated significantly more often as unimportant by smaller companies.

### Certificates

There are only few methods to identify sustainable or environmentally-active companies on an overall basis. An indicator in this respect might be EM certificates –a standardised mean to show commitment to the protection of the environment. The two best known institutions in

Europe that issue specific certificates to companies which observe given standards and comply with regulations concerning environmental performance, are the ISO and the EMAS. By showing an environmental-friendly attitude companies expect to improve both their business performance and their image. Thus, in the next section the representatives of the companies were asked about their attitude towards certification and the possession of certain certificates. In a first, step they could evaluate the importance of certificates (0 = not at all important, 100 = very important). A total of 162 companies see certification neither as very important nor as important but are rather neutral (mean: 57). Though, the comparison of environmentally-active and non-active companies (t-test) showed differences in their attitudes. The respondents of environmentally-active companies (mean: 67) evaluated certificates significantly more important than those of non-active companies (mean: 43). Nevertheless, the bottom line is that in general certification is not yet respected as much as some institutions would probably like them to be.

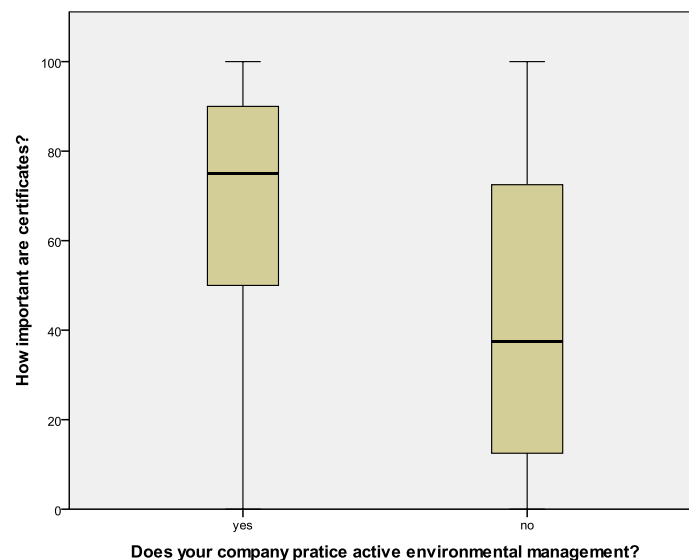


Fig. 11. Importance of certificates

A total of 92 companies stated to be certified. A Qui-Square-test gave evidence about a highly significant coherence between the practise of active EM and the possession of certificates. Environmentally-active companies rather held certificates in comparison to the “non-active”. The two most common certificates were the ISO 9001-certificate (frequency: 60) concerning quality management and the ISO 14001 (33) focusing on environmental management. The strongest reason for certification was customer request. A total of 63 companies explicitly stated that they were not certified. The majority of them did not see any necessity yet. Furthermore, high expenses were affiliated with the possession and an unfavourable cost-benefit-relation prevented them from applying. A lack of qualified staff apparently was no reason.



### Vehicles with alternative propulsion technology

Road freight vehicles and busses with hybrid or electronic propulsion are already offered by almost all major automobile manufacturers (IAA, 2010). However, the respondents evaluated alternative propulsion technology as unimportant and the vast majority did not own such vehicles. Only 28 of the participating companies had vehicles powered by alternative propulsion technology. Out of those 23 belonged to the group that considered themselves as EM-active. The most frequently named reason for the purchase was the positive effect on the environment and the economical energy consumption. A majority of the companies did not hold such vehicles because they considered the technology as not sufficiently developed yet and the acquisition and maintenance costs as too high. A lack of interest in new technologies or failed field tests is no reason.

### Decisions in trade-off settings

Eventually respondents were asked to evaluate their accordance (again on a scale from 0 to 100) to three statements addressing possible trade-offs related to:

- As a consequence of an effective environmental measure one employee of your company would become redundant. Would you carry out this measure? Surprisingly managers would give up social objectives for the sake of an environmental one (mean = 65,3). However the loss of an employee might be associated with cost savings and thus cause the acceptance. .
- As a consequence of a effective environmental measure yield would decrease in 0.5%. Would you carry out this measure?
- Does your company practice environmental management to achieve a good image?

		<i>As a consequence of an effective environmental measure one employee of your company would become redundant. Would you carry out this measure?</i>	<i>As a consequence of an effective environmental measure yield would decrease in 0.5%. Would you carry out this measure?</i>	<i>Does your company practice environmental management to achieve a good image?</i>
N	Gültig	143	125	128
	Fehlend	116	134	131
Mittelwert		65,27	52,47	53,47
Median		75,00	51,00	60,00

Tab. 4. Statement results

Statements 2 and 3 are evaluated equally at average (means of 52,5 and 53,5, respectively) indicating that there is a certain chance that such decisions are taken but no clear decision to

either side. For statements 1 and 3 a t-test showed significant differences between EM-active and non-active companies at  $p < 0,05$  with a higher acceptance of EM-active firms; for statement 2 no difference could be proven. Controlling for company size only for statement 3 a significant impact could be shown with higher acceptance for larger companies.

## Conclusion

Only 43% of a total of 259 participating companies described themselves as being active in environmental management. Especially larger companies carried out EM due to the awareness of its growing importance in the future, image improvement and the distinction from the competitors.

Sustainability in general was considered important throughout the whole sample regardless of company size and the approval of active EM. According to the respondents this importance would increase in the future.

Although the automotive industry puts more and more emphasis on vehicles with alternative propulsion technology, the majority of the interviewed companies did not hold such vehicles. They considered the technology as not sufficiently developed and related costs as too high. Therefore, it is necessary to support further research and development and to provide financial aid in order to encourage transport service providers to invest in an environmental-friendly fleet. As alternative propulsion technology is clearly rated as unimportant, further campaigns to improve the attitude towards these new technologies are necessary. Also the development of respective standards (e.g. for recharging batteries and related power stations) as well as the promotion of systems practicability seems indispensable.

A majority of 57% of the participating companies clearly stated not to practice EM actively. This might be interpreted as surprising and to some extent unexpected as politicians keep launching several programs, campaigns and aids in this respect. According to the relation between company size and active practice of EM, the non-active companies mainly belong to the group of smaller companies, which – as a consequence of a lack of market power – are usually exposed to higher economical and market pressures. Furthermore, they rather operate in the domain of transport for hire or reward, a market with a high rate of competition, which supports the latter presumption. This could be seen as an indication for further, more specific corrective political action, particularly targeting at smaller transport companies. This could either be done by an according legal framework (barring the risk of a competitive disadvantage for the domestic transport industry and leading to an increased rate of flagging-out of national trucks) or by incentives (like financial aid or tax allowances). Nevertheless, even the self-declared non-active group did consider environmental aspects at least to some extent in their decision making processes. They also rated sustainability in

general as important and predicted an increasing importance during the coming years. In addition, the attitude towards environmental measures did not significantly differ between small and large companies. All this raises several questions regarding the disproportionately high amount of small companies within the non-EM-active group:

- Are smaller companies of the transport sector economically able to perform environmentally friendly?
- Which other barriers exist preventing companies from implementing EM?
- Do companies have sufficient information about opportunities to improve their environmental performance? Are they well aware that performing ecologically can yield economical improvements and thus raise profitability?

These challenges might lead to new programs in order to strengthen the awareness as well as public funding and to encourage companies to improve their environmental performance. Moreover, these issues should also be addressed in further research projects focusing on the efficiency and effectiveness of political measures as well as on the state-of-the-art, specific needs and barriers of small enterprises and ways to a successful implementations of EM systems in an overall sustainable framework.

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## MOBILITY OF THE SIGHT AND HEARING IMPAIRED – BARRIERS AND SOLUTIONS IDENTIFIED

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### Abstract

Persons with sight or hearing impairment are a significant part of the population. When using public transport numerous specific problems have to be overcome. However those two groups are often not recognized as having special needs and demands, rather they are mistaken as blind or deaf. Taking the completely different mobility barriers for these groups into account, the current situation is not satisfying.

In order to reveal the most common and most hindering specific problems to passengers with reduced eye sight or hearing a qualitative short-study as well as a large scale research project were initiated sequentially. The results are based on interviews with persons directly concerned, their representatives, authorities and transport companies as well as on discussions in related internet-fora. Problems and Solutions were gathered and segmented into four categories, namely problems at stops and stations, in vehicles, general mobility problems and public perception.

It is shown, that most measures proposed could be implemented with little to no cost as many problems are merely resulting from a lack of awareness, empathy or insufficient training. Furthermore the implementation of several measures would not only improve access to public transport for the two specific groups but for almost all passengers.

**Keywords:** Sight impaired, Hearing impaired, definition, barriers, solutions

### Introduction

Every day hundreds of millions of people use public transport to reach their workplace, do their shopping, get to their leisure activities, visit friends and family and go on holidays. Be it by bus, tram, subway, train, ship or plane, most of them take the services provided to them for granted and do not spend time considering these conveniences.

Two special interest groups who are often hindered to use these basic services are in the focus of this article. The sight and the hearing impaired constitute two significantly sized passenger segments with special needs and barriers that are widely ignored by public transport service providers. However the public transport systems represent quite often the only possibility for these people to be mobile, i.e. to get to destinations they want to reach as they are unable to use individual transport means like cars, motorbikes or bicycles.

People with visual or hearing impairments represent a significant part of the population. Using public transport services they have to overcome numerous specific problems and obstacles. Quite often they are not even recognized as a group for themselves with special needs and demands but rather mistaken for blind and deaf people. Taking into account that mobility barriers for these groups are completely different, this situation, of course, is not acceptable.

In order to reveal the most common and most hindering specific problems people with sight and hearing impairments are confronted with and to collect proposals to solve them, a qualitative short-study based on interviews with persons directly concerned, their representatives, authorities and transport companies as well as on discussions in related internet-fora respectively was conducted. Problems at stops and stations, in vehicles, general mobility problems and public perception were taken into account. To further the understanding of the specific needs, barriers and possible solutions a large scale project was proposed. The well elaborated and accurate research plan was deemed beneficial and was accepted for funding. Thus, starting with a thorough literature review in online databases as well as libraries of several universities, the results gained in the pre-study were evaluated and partly confirmed partly rejected.

## **BaCkground**

The two groups of the sight and the hearing impaired represent large segments of the population who often are not recognised as having to overcome specific barriers and needs concerning the use of public transport services.

There are no exact figures for the size of the two respective groups, neither in Europe nor in Austria, but a dedicated module of the micro census survey by Statistics Austria showed that roughly 3.8% of the population (or 318.000 people) suffer from persistent sight impairments and about 2.5% (202.000 people) are hard of hearing. Both groups tend to include older persons with females representing a majority of the persons concerned. In contrast only around 8.000 persons in Austria are blind and another 8.000 are deaf. (Leitner, 2007) Although the sizes of the groups are not exactly estimated, other research projects dealing with persons with reduced mobility (PRM) and public transport often estimate quite the same amounts of passengers as are presented here.

Therefore measures taken for the first two groups reach a by far wider number of persons. Taking into account the utility those solutions provide to “normal” sighted or hearing people every measure helps basically all passengers and is not merely restricted to the target groups in focus – following the principle “Design4all” – and thus could show an opportunity for transport companies to improve their profit situation.

In addition to the economic benefits a company may generate through a clear focus on the needs and barriers of sight or hearing impaired passengers there is a strict legal requirement on several levels of legislation stating the minimum requirements for impaired persons. The most general and the only “law” with global reach is the UN Convention on the Rights of persons with disabilities, which clearly states that it

is to “promote, protect and ensure the full and equal enjoyment of all human rights and fundamental freedoms by all persons with disabilities” (United Nations, 2006). The EU as well as the United States have issued several other legal guidelines and regulations such as the Americans with Disabilities Act (ADA) (Department of Justice, 2008), the EU disability strategy (COM, 2010) or the EU disability action plan. (COM, 2007) On the Austrian national level the constitution as well as regular legislation prohibit the discrimination of disabled persons and state that free and equal access to all field of daily living has to be granted.

It is not the authors’ intention to play any groups off against each other, but to increase the sensitivity for the needs of the sight and hearing impaired. Eventually it is necessary to identify problems, show ways to easily solve them and keep pushing towards a continuously improving dialog between the persons affected, their representatives and the transport service as well as technology providers in order to support the mobility of sight and hearing impaired passengers. This was also emphasised in several previous studies (Fürst and Kuhar, 2009; Fürst, 2010; Fürst and Vogelauer, 2011)

## Definitions

As a first step it is necessary to clearly identify the two target groups of sight or hearing impaired passengers. This is of particular importance, as there are several parameters determining the actual level of hearing and seeing with some restrictions not necessarily decreasing the ability to be mobile in public transport. Therefore it was one of the main tasks to clearly differentiate between mobility-restricting factors and others.

### Sight impairment

Based on interviews with experts, including ophthalmologists, orthoptists and optometrists, six main parameters for the quality of seeing could be identified.

1. **Visual acuity** (visus cum correctione, v.c.c; 1.0 is the average normal eyesight) determines the distance in which an opening of 1° in a standard Landolt-circle can be assessed. As the visual acuity uses a logarithmic scale the most often found translation of decimal values into percentage quotations is not applicable. Persons with low visual acuity show severe problems when using public transport services, as the ability to read information texts and electronic displays is decreased. Therefore navigation and resolution of information is restricted to close proximity objects. This parameter is also the commonly used one by official regulations like the ICD10 (which also includes field of vision) shown in the table below.

<i>Category of visual impairment</i>	<i>Visual acuity with best possible correction</i>	
	<i>Maximum less than:</i>	<i>Minimum equal to or better than</i>
1	6/18	6/60
	3/10 (0,3)	1/10 (0,1)

	20/70	20/200
2	6/60	3/60
	1/10 (0,1)	1/20 (0,05)
	20/200	20/400
3	3/60	1/60 (finger counting at 1 metre)
	1/20 (0,05)	1/50 (0,02)
	20/400	5/300 (20/1200)
4	1/60 (finger counting at 1 metre)	Light perception
	1/50 (0,02)	
	5/300	
5	No light perception	
9	Undetermined or unspecified	

Table 1: Classification of severity of visual impairment recommended by a WHO Study Group on the Prevention of Blindness, Geneva, 6-10 November 1972. (WHO Technical Report Series No. 518, 1973)

The term "low vision" in category H54 comprises categories 1 and 2 of the table, the term "blindness" categories 3, 4 and 5, and the term "unqualified visual loss" category 9.

If the extent of the visual field is taken into account, patients with a field no greater than 10 o but greater than 5 o around central fixation should be placed in category 3 and patients with a field no greater than 5 o around central fixation should be placed in category 4, even if the central acuity is not impaired.

Source: World Health Organization: <http://apps.who.int/classifications/apps/icd/icd10online/>

The three values in the respective lines in the ICD-10 table refer to the different notations that are used in different countries worldwide. According to ICD-10 chapter 7 block H54 categories 1 and 2 can be classified as "low vision", 3, 4 and 5 as blindness. (WHO, 2011)

2. **Contrast vision** is a measure of the contrast a person is able to perceive. The lower the contrast of electrical displays or signs is, the harder it can be read. The best contrasts can be reached by using white and black whereas light blue on white or dark gray on black surfaces is mostly irresolvable. To measure the contrast level between an object and its background there are several commonly used scales like Michelson (1972) (ratio of the difference in light density to the sum of light density of both objects), Sanders & McCormick (ratio between the difference in maximal and minimal light density to the maximal light density) (Ziefle, 2002) and Bjoerset & Brekke (1980) (ratio between the light density of the foreground to the light density of the background). The higher the needed contrast of a person, the harder it is to use public transport services as badly contrasted objects i.e. door-opening buttons and levers, guidance systems and



displayed information might not be distinguishable for the respective person. The figure below illustrates several colour combinations and their respective contrast values.



Figure 1: Colours and their respective contrasts (Bundesministerium fr Gesundheit, 1996)

The "K"-values in figure 1 relate to Michelson-contrasts and the colour codes are based on a CMYK-scale (Cyan, Magenta, Yellow and Black).

3. The **field of vision** defines the angle that can be conceived by the respective person, the average for normal sighted persons is a 180° horizontal and 130° vertical angle. Several deceases, such as retinitis pigmentosa, can negatively influence the visual field and therefore reduce the angle in which a person is

alerted to movement. This results in increased need for head movement when using public transport services, but does not directly influence the ability to utilise those.

4. **Colour vision** is the general ability to see and differentiate colours from one another. Persons with a red-green weakness or blue-yellow weakness cannot distinguish between the respective colours, but can differentiate the intensity/contrast levels of the colours. Due to this persons with a slight colour weakness are still able to determine between colours such as red and green as long as the saturation is high enough (intense red or green). However, as most guidance systems do not solely rely on colour coding the restrictions to using public transports are very limited.

5. **Movement vision.** With decreased movement vision persons are unable to focus faster moving objects, such as cars, busses or trains or the stimulus of a moving object is slower detected. This leads to critical situations when crossing streets and miscalculating the speed of traffic or simply ignoring moving objects. However there is little public transport providers can do to compensate for this impairment and the general ability to use public transports is not limited.

6. **Stereoscopic vision.** Persons who lost their stereoscopic vision cannot exactly estimate the distance to objects. This constraint is however not excluding those persons from using public transport as most information can be obtained regularly. With persons not born with a stereoscopic vision disorder the brain is even able to slightly accommodate for this loss. What has to be taken into account is that strongly contrasted environments help the respective passengers navigate more easily as through the relation of object sizes and markings, the position in space can be anticipated to a certain extend.

### **Hearing impairment**

While there is a large variety of factors influencing sight impairments, hearing impairment can be measured with one value only, namely the level of sound that can be heard or the auditory threshold of a person. While there are two main forms of hearing impairment, conductive and sensor neural hearing loss, both result in an increase of the hearing threshold level.

The measurement can be performed through several different tests, with the “hearing distance”-test being one of the most common. According to the guidelines the hearing distance is defined as the distance in which at least half of the words spoken by an examiner can be repeated correctly by the test person. Another test was designed by Boenninghaus and Röser (1973) where two tables are used, one for the distance in which whispered and normally spoken words are repeated correctly and one for an audiometric test. Those two values are then combined to determine the level of acoustic impairment.

## Method

This chapter is going to present methods used in the two projects constituting the results in this article. It has to be stated, that the results from the pre-study clearly influenced the work in the research project as they were taken as the starting point for further and more thorough research.

### Pre-Study Method

In a qualitative short study mobility barriers for the sight and hearing impaired have been addressed. On the basis of a literature research a survey guideline with several open questions to be used in structured expert interviews was developed. The interviews were restricted to Austria, but the results might still be transferable to other countries.

To get a comprehensive picture not only persons directly affected by a sight or hearing impairment were interviewed but also their representatives in associations or support groups as well as public authorities and responsible persons from transport companies (Table 2).

<i>Interview Partners</i>	<i>Count</i>
<i>Visually impaired Persons</i>	11
<i>Acoustically impaired Persons</i>	5
<i>Associations</i>	3
<i>Transport companies</i>	4
<i>Authorities</i>	2

Table 2: Persons interviewed

Furthermore dedicated threads were opened in internet-based discussion fora in order to reach also those affected persons who are not mobile (Table 3).

<i>List of discussion boards</i>	<i>URL</i>
<i>Nahverkehrsforum: Train Simulator</i>	<a href="http://www.tssf-forum.de/yabbse/index.php?board=24">http://www.tssf-forum.de/yabbse/index.php?board=24</a>
<i>Hamburger Nahverkehrsforum</i>	<a href="http://forum.bahninfo.de/list.php?5">http://forum.bahninfo.de/list.php?5</a>
<i>Nahverkehr-FFM</i>	<a href="http://forum.nahverkehr-ffm.de">http://forum.nahverkehr-ffm.de</a>
<i>Hear-it</i>	<a href="http://www.german.hear-it.org/forside.dsp?area=242">http://www.german.hear-it.org/forside.dsp?area=242</a>
<i>Schwerhörigen-Forum</i>	<a href="http://www.schwerhoerigenforum.de/cgi-bin/cutecast/cutecast.pl">http://www.schwerhoerigenforum.de/cgi-bin/cutecast/cutecast.pl</a>
<i>Menschen mit Behinderungen</i>	<a href="http://www.menschen-mit-behinderungen.info/forum/register.php">http://www.menschen-mit-behinderungen.info/forum/register.php</a>
<i>Das Forum für sehbehinderte und blinde Menschen</i>	<a href="http://f24.parsimony.net/forum56094/">http://f24.parsimony.net/forum56094/</a>
<i>Taubenschlag</i>	<a href="http://www.taubenschlag.de/">http://www.taubenschlag.de/</a>

Table 3: List of internet-fora

Table 4 shows the basic structure of the interviews which were slightly adapted according to the respective interview partner.

<i>Subjects</i>
<i>Estimation of the size of seeing and hearing impaired persons in the population</i>
<i>Mobility problems of the affected groups</i>
<i>How are problems detected?</i>
<i>Development of possible solutions</i>
<i>Ways of taking specific measures</i>

Table 4: Contents of the interviews

The interviews were transcribed and detailed lists of the detected problems of hearing and seeing impaired people with regard to their mobility were compiled. The possible solutions raised by interview partners were also included. During several project meetings categories were defined and the problems and solutions were classified accordingly.

## Research Project Method

The research project started with a profound literature search and review on the topics “Sight impaired” and “Hearing impaired” in several databases shown in the table below.

*Sight/visually impaired*

<i>Database</i>	<i>Results Sight</i>	<i>Results Visually</i>
<i>ProQuest</i>	377	4679
<i>EBSCOHost</i>	28	553
<i>GoogleScholar</i>	3020	46.600+
<i>PubMed</i>	9	1767

Table 5: Results for Sight / visually impaired

*Hearing/acoustically impaired*

<i>Database</i>	<i>Results Hearing</i>	<i>Results acoustically</i>
<i>ProQuest</i>	3772	0
<i>WISO</i>	13	0
<i>GoogleScholar</i>	70.200+	72
<i>EBSCOHost</i>	552	0
<i>PubMed</i>	5228	67

Table 6: Results for Hearing / acoustically impaired

The results were then reduced to the articles with a relation to mobility of the respective user groups. Additionally the project partners were asked to contribute with their knowledge and resources to increase the size of the available data pool. This led to an extension of the search with additional topics such as “Hard of hearing” or “Persons with reduces mobility”.

The resulting convolute of articles, books and other papers was then classified according to their main topic. It was eventually possible to identify 4 main categories in which most of the material could be fitted into. These are shown in the table below.

<i>Article categories</i>
<i>Definitions</i>
<i>Policy making</i>
<i>Needs and Barriers</i>
<i>Solutions and Aides</i>

*Table 7: Categories for literature review segmentation*

Based on these four categories the existing barriers, needs and solutions were updated and a more elaborate listing of results was developed. In addition the main target group for the specific solutions were identified and added to the tables.

## Results

The following tables show the results combined short study as well as the first results of the research project. To allow for easier understanding a segmentation into four areas was assigned. These are “stops and stations”, “vehicles”, “other/general mobility problems”, and “public awareness”.

### Stops and stations

The following table depicts commonly occurring problems at stations and the surrounding area.

<i>Identified problem</i>	<i>Possible solution</i>	<i>Mainly for</i>
<i>Complex use of ticket machines</i>	<i>Possibility to increase the size of text.</i>	<i>Sight impaired</i>
	<i>Voice output on demand</i>	<i>Sight impaired</i>
<i>Readability of timetables</i>	<i>Timetables placed not too high – legibility has to be guaranteed (e.g. using reading aids, loupes, etc.)</i>	<i>Sight impaired</i>
	<i>Pre-printed timetables in large print</i>	<i>Sight impaired</i>
	<i>Decrease of distance between glass and timetable to allow reading with low vision aids</i>	<i>Sight impaired</i>

	<i>Use of antireflection glass for showcases</i>	<i>Sight impaired</i>
<i>Displays</i>	<i>Extended information on displays</i>	<i>Both groups</i>
	<i>Use of contrasting colours</i>	<i>Sight impaired</i>
	<i>Increase of font size</i>	<i>Sight impaired</i>
	<i>Decreased height of mounted displays to eye-level and increased accessibility</i>	<i>Sight impaired</i>
<i>Incomprehensible announcements at stations</i>	<i>Show announcement on displays and info-screens ("two-senses-principle")</i>	<i>Both groups</i>
	<i>Use of induction technology, especially at larger stations</i>	<i>Hearing impaired</i>
	<i>Information per SMS upon requests</i>	<i>Both groups</i>
	<i>Announcements available through MMS</i>	<i>Both groups</i>
	<i>Free hotline with tape-service for important information</i>	<i>Both groups</i>
	<i>Clear, slow and understandable tape-records and announcements</i>	<i>Both groups</i>
<i>Inadequate guiding systems</i>	<i>Installing additional guiding systems</i>	<i>Sight impaired</i>
	<i>Purpose-check of existing guiding systems by affected persons</i>	<i>Sight impaired</i>
	<i>Including affected in planning process</i>	<i>Both groups</i>
	<i>IT-based guiding systems (web-based, cellular)</i>	<i>Both groups</i>
<i>Multi vehicle stations</i>	<i>Clear splitting of station areas for different lines</i>	<i>Sight impaired</i>
	<i>Clearly visible display of the line arriving next</i>	<i>Both groups</i>
	<i>Announcements of approaching vehicle</i>	<i>Sight impaired</i>
<i>Station signposting</i>	<i>Bigger font sizes</i>	<i>Sight impaired</i>
	<i>Use of clearly visible markings, paying attention to contrasts, height and place</i>	<i>Sight impaired</i>
<i>Stations in rural areas</i>	<i>Safe footpaths</i>	<i>Both groups</i>
	<i>Speed-limitations for other traffic in the station area</i>	<i>Both groups</i>
	<i>Relocation of stations aside from main roads</i>	<i>Both groups</i>
<i>Specially trained staff</i>	<i>Especially at central stations more support personnel</i>	<i>Both groups</i>
<i>Entering and leaving vehicles</i>	<i>No traffic on lanes between vehicle and station while dis-/embarkation</i>	<i>Both groups</i>
<i>Information at stations</i>	<i>Continuous information through Bluetooth or IR</i>	<i>Both groups</i>
	<i>Downloadable web-based route-planning and on-trip use</i>	<i>Both groups</i>
<i>Elevators at stations</i>	<i>Emergency-button for hearing impaired persons</i>	<i>Hearing impaired</i>
	<i>Acoustic information</i>	<i>Both groups</i>

Table 8: Problem identification and possible solutions for the stops and station area

As one of the main problematic factors the missing or misleading guidance systems could be identified. Especially sight impaired often exhibit problems with missing contrast levels of floor bound systems. Hearing impaired on the other hand often reported problems when using elevators or service hotlines with

missing or no visual output, so that they were not able to identify the problem in a case of emergencies. Further areas with regular problems were (overhead) signposts that were illegible or acoustic announcements at stations which were identified merely as background noise.

## Vehicles

The means of transport as the second most important factor in public transport pose the following problems to sight and hearing impaired.

<i>Identified problem</i>	<i>Possible solution</i>	<i>Mainly for ...</i>
<i>Use of ticket machines on vehicles</i>	<i>Voice output on demand</i>	<i>Sight impaired</i>
	<i>Bigger font size</i>	<i>Sight impaired</i>
<i>Legibility of network plans</i>	<i>Plans at eye-level, focus on legibility</i>	<i>Sight impaired</i>
	<i>Driver has plans in large print</i>	<i>Sight impaired</i>
	<i>Network plans in large print available</i>	<i>Sight impaired</i>
<i>Displays on vehicles</i>	<i>Show announcements on displays ("two-senses-principle")</i>	<i>Both groups</i>
	<i>Check used colours with the affected</i>	<i>Sight impaired</i>
	<i>Font size easily readable</i>	<i>Sight impaired</i>
<i>Quality of announcements</i>	<i>Optical display of announcements</i>	<i>Both groups</i>
	<i>Use of induction-technology</i>	<i>Hearing impaired</i>
	<i>On-demand information about next station (Bluetooth)</i>	<i>Both groups</i>
	<i>SMS- or MMS-queries</i>	<i>Both groups</i>
	<i>Free hotline with tape-service for important information</i>	<i>Both groups</i>
	<i>Take employees for test drives to let them perceive the comprehensibility and quality of announcements</i>	<i>Both groups</i>
	<i>Pronunciation, clarity and speed of announcements and tape-records</i>	<i>Both groups</i>
<i>Automating</i>	<i>Mobility training for affected supported by transport companies</i>	<i>Both groups</i>
<i>Distance vehicle – pavement</i>	<i>Drivers to stop close to pavement</i>	<i>Sight impaired</i>
	<i>Use of low-floor-vehicles</i>	<i>Both groups</i>
<i>Information in the vehicle</i>	<i>Device to be informed about the route, the next stop etc. Upon request</i>	<i>Both groups</i>
	<i>On-demand general information via bluetooth</i>	<i>Both groups</i>
	<i>Downloadable web-based route-planning and on-trip use</i>	<i>Both groups</i>
<i>Doors</i>	<i>Large tactile door opening buttons</i>	<i>Sight impaired</i>

Table 9: Problem identification and possible solutions for vehicles

For sight impaired passengers the size of the network plans as well as the positioning within the vehicle was reported as a main problem. As with the rocking of the vehicle it gets increasingly hard to keep track of

the correct column or line small font sizes and the inability to approach the plans and displays prevents sight impaired from using most of them.

The quality of spoken announcements as well as the missing of the former was commonly criticised by hearing impaired persons. In addition the incomprehensibility in combination with fast speech and missing signal tones to increase the awareness of the passengers was pointed out. Badly comprehensible announcements were also a topic for the sight impaired, as they often have to rely on the announced station name as they are unable to read the displayed textual information.

### General mobility problems

Table 10 shows the more general mobility problems sight or hearing impaired are facing while travelling from or to home or their destination.

<i>Identified problem</i>	<i>Possible solution</i>	<i>Mainly for ...</i>
<i>Information about transport on the internet</i>	<i>Possibility to increase the size of fonts and inverted colours</i>	<i>Sight impaired</i>
	<i>On-demand voice output of site</i>	<i>Sight impaired</i>
<i>Road signs as barriers</i>	<i>Place on gantries</i>	<i>Sight impaired</i>
	<i>Use of max. permiss. height (2.2 m)</i>	<i>Sight impaired</i>
	<i>Use of protective coatings</i>	<i>Sight impaired</i>
<i>Bollards, hydrants, advertising pillars, green spaces, cordons</i>	<i>Use signal colours</i>	<i>Sight impaired</i>
	<i>Double cordons with connecting elements</i>	<i>Sight impaired</i>
	<i>Replace by fixed railing</i>	<i>Sight impaired</i>
<i>Construction site security</i>	<i>At least to crossbars</i>	<i>Sight impaired</i>
	<i>Signal colours for scaffoldings</i>	<i>Sight impaired</i>
	<i>Solid barriers at building pits</i>	<i>Sight impaired</i>
	<i>Barriers with construction fences</i>	<i>Sight impaired</i>
<i>Weather conditions</i>	<i>Stricter regulations for snow removal and gritting</i>	<i>Both groups</i>
	<i>Fixed cordons when danger of roof avalanches</i>	<i>Both groups</i>
	<i>Tree and bush cutting</i>	<i>Both groups</i>
<i>Railroad crossings without gates</i>	<i>Installation of gates</i>	<i>Both groups</i>
	<i>Tactile floor markings</i>	<i>Sight impaired</i>
	<i>Flashlights in the floor before train arrives</i>	<i>Both groups</i>
	<i>Tow away parked vehicles</i>	<i>Sight impaired</i>
	<i>Restaurant menu tables on the wall, restaurant tables not on the pavement</i>	<i>Sight impaired</i>
<i>Other obstacles on pavement</i>	<i>No placards/advertisements covering signs</i>	<i>Sight impaired</i>
	<i>Removal of different levels, gaps</i>	<i>Both groups</i>
	<i>Tactile and optically contrasted markings</i>	<i>Sight impaired</i>
<i>Cycle tracks</i>	<i>Involvement of seeing and hearing impaired people</i>	<i>Both groups</i>



<i>Identified problem</i>	<i>Possible solution</i>	<i>Mainly for ...</i>
	<i>Distinct separation by advertisements or similar</i>	<i>Sight impaired</i>
<i>Architecture</i>	<i>Easily visible handrails</i>	<i>Sight impaired</i>
<i>Glass walls</i>	<i>Use of non-transparent glass</i>	<i>Sight impaired</i>
	<i>Use of safety glass</i>	<i>Sight impaired</i>

Table 10: Identification and possible solutions for general mobility problems

As the most hindering factor for the mobility of sight impaired when going to or from the station badly placed security measures for construction sites as well as street side based obstacles such as bollards, hydrants or advertising pillars with low contrasts to the surrounding floor were reported. Furthermore signs at head height pose a severe injury risk.

With the increasing implementation of cycling lanes alongside sidewalks an additional safety risk for sight impaired is created if the respective lane is not separated with clear signs and the cyclists do not show the adequate behaviour.

Especially in rural areas railroad crossings without gates and no optical signalling systems were identified as potential risks. Further many stations in these areas show badly placed signposts, missing plans or no support for impaired passengers at all.

### Public awareness

For sight or hearing impaired potential passengers the general lack of awareness as well as the insufficient training of staff is one of the most fundamental sources of mobility restrictions. In addition planners and architects without specific knowledge are often unaware of the impacts their, often highly praised, designs have on the mobility of the two groups.

<i>Identified problem</i>	<i>Possible solution</i>	<i>Mainly for ...</i>
<i>Inadequate training of staff and planners</i>	<i>Special courses focusing on different disabilities and impairments for architects, planners, drivers and other staff of transport companies</i>	<i>Both groups</i>
	<i>Lobbying by associations</i>	<i>Both groups</i>
	<i>Brochures, information material</i>	<i>Both groups</i>
<i>Unawareness of specific problems</i>	<i>Improve publicity of related information platforms</i>	<i>Both groups</i>
<i>Research &amp; Development</i>	<i>Include affected people in research &amp; development</i>	<i>Both groups</i>
<i>Lack of awareness and empathy</i>	<i>Information campaigns</i>	<i>Both groups</i>
	<i>Special events like "Dialog im Dunkeln"</i>	<i>Both groups</i>

Table 11: Problem identification and possible solutions within the field of public awareness

As most current planners have never had the possibility to learn about the specific needs of sight or hearing impaired persons it would be highly indicated to include the respective persons and their representatives in projects currently being developed to allow for a direct exchange between the groups.

Furthermore specific courses at universities and other high-level educational institutions should be developed and offered to all stakeholders in the public transport sector to allow for a boarder dissemination of the existing knowledge.

## **Conclusions and implications for further research**

As can be seen in the above tables, there is a large amount of barriers to sight or hearing impaired passengers in public transport services. These barriers range from the stations and vehicles of public transport service providers to the doorsteps of the impaired to the minds of staff and planers. While the physical barriers are the most visible, the mental ones are the most persistent and hardest to combat. However most of these can be solved or at least reduced with little to no effort and are therefore easy to eliminate for service providers.

Further a reduction or even elimination of these barriers would not only benefit the sight or hearing impaired but also most other passengers of public transport services as the general navigation is eased and the quality of the system overall is increased.

It has to be clearly stated, that without the cooperation of persons concerned, transport service providers, technology as well as infrastructure and transport means providers there will be no real possibility to find cost efficient and easy-to-implement solutions for both sides. Therefore it is highly indicated, that further research in the field of solution development for sight of hearing impaired passengers in public transport is conducted.

What was also made obvious during the current research project was the missing information on the general needs of sight and hearing impaired as well as the sizes those two groups. Most current data is based on self-assessment or self-rating and can therefore hardly be judged as reliable. There is hardly any scientific evidence available that would quantify the groups based on reliable definitions.

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**COMMITMENT AND IDENTITY: AN EXPLORATION INTO THE INTEGRATIVE, INTERACTIVE  
AND EMERGENT NATURE OF COMMUNITY  
POLICY MAKING AND IMPLEMENTATION**

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**Abstract**

Social networking is changing the world of international government, finance and business. Amongst other things members of social networks are demanding greater transparency in corporate and government institutions. Research shows that there is a change in the balance of power in decision making and this in turn is leading to more innovative and sustainable solutions. Community led (bottom – up) innovation projects using social networking technology are emerging as a leading source of creative power engaging the wisdom of crowds as opposed to the single - mindedness of policy makers. Research shows that transparency, shared commitment, empathy and trust play an essential role in their success. Consequently, for community led networks to be effective, their members must be competent in building and maintaining excellent inter; intra; and extra - personal relationships. Analysing data from multiple sources participating in the European Commission's "Digital Agenda 2020" programme, the paper concludes that the success of this and programmes like it will depend on the desire of members to acquire history - making identities by maintaining identity defining commitments across the network. Implications for theory and research are discussed.

**Key words:** Knowledge economy; innovation diffusion; trust and commitment.

**Introduction**

Community led social networks are driving changes in policymaking that are invalidating existing practices. With over 1 billion people online worldwide, community led social networks are a force of unprecedented power and for the first time in human history, mass cooperation across space and time is happening. Whether engaged in business, government, finance or philanthropy, community led social networks are gaining increasing popularity yet their success requires specific competences related to the ability to satisfy deep concerns with commitments that matter (Gadman and Cooper, 2009). Research has shown that individuals participating in community led social networks have distinct ideas about personal and collective identity (Callon, 1980; Van de Ven 1986) and this can lead to disagreement which can impede the transformation process (Dougherty, 1992). While it has been shown that some amount of disagreement is useful for producing more innovative solutions (Amabile, 1996), the evidence suggests that insurmountable disagreements result in delays, suboptimal compromises and most often, failure to ever build a sustainable community. According to Gadman (1996) an effective balance between positive and negative disruption is established when actors gain trustworthy identities by maintaining identity defining commitments across

the community network. Advances in neuroscience have linked commitment and identity to oxytocin, a single neuropeptide which, amongst other things helps generate empathy, generosity and trust. However, oxytocin has a very short shelf life and as a consequence the quality of social interactions cannot be taken for granted and require constant attention. Evidence suggests (Gadman and Cooper. 2009) that high quality community networks produce synergistic results when concerns are addressed through committed action. For example, in business “crowdsourcing” (Howe, 2006) has been shown to inject fresh ideas into traditional manufacturing processes, speed up production cycles and cut costs by gathering ideas from sources outside of their immediate employee community. This cannot happen without a clear understanding of the drivers of concerns at various levels in the business and the committed action of individuals to address those concerns.

### **Commitment and Trust in Social Networks**

Recent studies suggest that social networks engender trust and the more they are used, the greater the levels of trust they generate. According to Zak (2011), trust goes to the heart of our economic and social systems and is essential for successful economic transactions and that nations with higher levels of trust enjoy stronger economies than those on the other end of the spectrum. This link between trust and prosperity explains the difficulties encountered by New Member States and Accession Countries as they seek to adjust to privatisation in the European Union? Research shows that the systematic corruption which led to the fast acquired personal wealth following privatisation in Russia still exists in these New Member States and Accession Countries. For these fledgling communities, notions of transparency and freedom of information are anathema to the self – interests of business oligarchs whose powerbases are made up of relatives or close associates of government officials, even government officials themselves, not to mention criminal bosses.

Even in such corrupt communities, Gadman (1996) argues that trust and commitment remain essential to their sustained success because they form a tightly controlled community even if motivated by fear and greed. So whether for good or evil, commitment to alleviate concerns plays an essential role in determining the outcomes of purposeful relationships (Abrahamsson and Livari, 2002). Gadman and Cooper (2009) suggest that it takes a special type of leader to build and maintain commitment based communities. (Savage 1996, Gadman 1996, Adams 2004). Long before social networking technology existed, Heidegger (1962[1927]) reminded us that: “We are naturally world disclosers and by means of tools, technology and coordination we awaken coherent spaces or worlds which make possible a distinct and pervasive way in which things, people and selves appear and in which certain ways of acting make sense” (p.17). Much emphasis today is placed on social networking technology but much less is known about the community based networks they enable, especially why some succeed where others fail. Gadman and Cooper (2009) believe this is because ICT is only one component in a complex web of human and technological dynamics which have at their centre the need for trust (Ridderstrale and Nordstrom 2004, Flores, 1998). Like other social networks, community based networks are webs of relationships that generate material or social value

through complex dynamic exchanges of both tangible and intangible goods, services and benefits. They challenge existing theories of transaction cost economics, which regard organisations as efficient contractual instruments (Coase, 1937; Williamson, 1985) by demonstrating that efficient contracting depends upon effective cooperation, without which successful competition would not be impossible. While dinosaurs like Alan Sugar still operate within the “your fired” paradigm, it is clear that the values underpinning that paradigm are inconsistent with those required to run new internet based models of collaboration and cooperation seen in successful social networks. At their core, community led social networks are characterised by values of transparency, shared commitment, empathy and trust. Research show that when these values are skilfully enacted, they lead to the free flow of information and the generation of knowledge across an ever widening and inclusive landscape of participants. The purposes and principles behind community networks are more consistent with theories of knowledge transformation (Nonaka and Takauchi, 1995) in that they comprise of individuals capable of self - organising to a point where there is no breakdown in the cost and quality of the contract. They do this through orchestrating the “speech acts” (Austin, 1962; Searle, 1975) which make up network of commitments (Winograd and Flores, 1987). These commitments drive and coordinate action among the members of the network. These examples suggest a more synergistic relationship between transaction cost (Coase 1937) reasons to organise and those based on commitment and knowledge (Conner and Prahalad 1996) in that both offer some economic advantage to members. Conner and Prahalad (1996:478) go so far as to say that the primary contribution of the knowledge – based view is to round out transaction cost theory by recognising knowledge based transaction costs. Unfortunately, because the organisational models supporting this approach tend to be highly nuanced and pluralistic (Hock 1999, von Hippel 2002) many community led initiatives fail because their members fear loss of identity and control and consequently fail to take advantage of the power which comes from well coordinated and committed networks of people.

In considering the challenges associated with knowledge disclosure, diffusion and utilisation (Spinosa, Flores and Dreyfus 2001) across community led networks, the paper shows that while their popularity continues to grow, the diffusion and manifestation of innovation becomes more challenging when increasing levels of personal and financial commitment are required (Mauer, Rai and Sali, 2004). This paper concludes that the success of community based social networks depends on the desire of participants and the organisations they represent, to be authentic (Heidegger, 1962) by maintaining identity defining commitments across the network (Gauntlett 2002, Spinosa et al., 1997). This holds significant implications for theory and future research.

## **Commitment and Identity**

The paper explains why and under what circumstances people in community based social networks become committed and how this leads to identity creation. One view is that people identify with the organisation of which they and the recipients are a part (Kogut and Zander 1996). Such identity when linked to shared values, beliefs and assumptions might be considered a cultural identity (Schein 1992, Laine –

Sveiby 1991) or disclosive space (Spinosa, Flores and Dreyfus, 2001) and might also be reflected in such things as shared coding schemes (Hansen; Nohria; Tierney 1999), language and cognitive schema (Winograd and Flores 1997), the convention and rules by which people coordinate their behaviour and decision making (McKinney and Gerloff 2004) shared moral values and convergent expectations (Flores 1993). In other words it reflects committed participation in a shared cultural identity (Weeks and Galunic 2003).

According to Spinosa, Flores and Dreyfus (*ibid*), core assumptions behind community based networks is that stakeholders participate by converting what they know, both individually and collectively, into tangible and intangible value that they offer to the network to satisfy deep collective concerns. Stakeholders accrue value by engaging their natural potential as they realise new worlds of possibility in the new disclosive space. A natural consequence of this awakened reality is the establishment of an identity as someone who makes life worth living for themselves and those around them. Successful community based social networks are made up of people with this motivation.

March and Cyert (1963) recognised that firms are not monolithic profit – maximising entities but rather complex and structured systems whose overall behavior is affected by decisions made sequentially and independently by their members (Cyert and March 1963; Cohen, March and Olsen 1972; March and Olsen 1972). Consequently, it is possible to conclude that organisations are comprised of autonomous individuals who utilise possibly different methodologies to achieve some level of performance (Malone and Smith 1988). Differences create pressures for isomorphic adaptation and emphasise the need for legitimacy (DiMaggio & Powell 1983). At the organisational level, institutional theory posits that legitimacy is a key success factor for organisations, defining legitimacy as acceptance of the organisation by its environment (Meyer & Rowan, 1977). Consequently, legitimacy is gained by adopting positioning strategies which indicate conformance to the essential characteristics of the institutional environment. It is also the means by which organisations and their constituents define their identities and in so doing favourably shape their environment for their own ends (Gauntlett, 2002). In order to explore the ways individuals maintain legitimacy while forming their identity in community based networks, it is necessary to understand what kind of practices they perform such that they produce personal and network identities that matter. According to Flores and Spinosa (1998), people are considered history making or entrepreneurial (Spinosa, *et al.*, 1997), when they involve two interrelated activities: interpreting which actions are appropriate given their intense concerns and positioning their actions so that they are accepted by those who matter. Developing such an identity engages listening which ultimately influences others to adopt a point of view more closely aligned with that of the influencer and to take on new practices which change the way the world appears to people. This history making capability requires a keen awareness of intense personal commitment and the skilful expression of that commitment in action in some domain of interaction. Heidegger's (1962 [1937], pp. 352-8; 434-44) emphasis on shared public spaces offers such a domain and an opportunity to explore community based networks like ERISA, to examine the positioning strategies of their members and the public and personal identities they create.

## **Identity Building, the Internet and Architectures of Participation**

According to Adams (2004) the internet is revolutionary not because of the great search engines and enormous library of interconnected information but because it's two - way communications technology allows large numbers of people to interact with each other. While some interactions such as those on Facebook and Twitter might be considered trivial, many more are purposefully designed to satisfy the concerns of large communities. The quality of these interactions is measured by the strength of the commitments generated as one person or group promises to deliver results to another person or group in such a way that ultimately there can be agreement that the promise was met and the need satisfied (Winograd and Flores 1987; Flores and Spinoso 1998)). In other words, commitment structures deliver value because they are held together by the strength of the collective promises and actions of their members and identity built on the extent to which a person's word is their bond. For example, they commit to be reliable and they adopt positioning strategies like letting others know what's going on. Alerting them if problems arise and offering counter - proposals designed to resolve the problem to another's satisfaction. They use the internet to build legitimacy through core commitment structures based on trust (Winograd and Flores 1987). Table 1 describes six aspects common to all commitments.

Depending on the focus of commitment and the circumstances, an actor may be committed to a community network in different ways. According to Von Hippel (2001), they may feel its benefits (affective component). They may have an emotional and rational investment in the project which drives their continued participation (durability component). Finally, the community may be bonded by the strength of the collective promises of its members (normative component). Most researchers agree that it is the affective component which is the most desirable (Meyer and Allen 1997; Gadman and Cooper, 2009) because it is that aspect which enables bonding at each level of commitment.



Table 1. Six Aspects of Commitment

<i>Aspect of Commitment</i>	<i>Description</i>
<i>Focus</i>	<i>Defines the target of one's commitment. This target can be an organisation, project, community, etc.</i>
<i>Strength</i>	<i>Defines how deeply an actor or group is attached to an entity. An actor is more or less committed than simply being committed or not.</i>
<i>Conditions</i>	<i>Define what has to be done in order to fulfil the requirements of the commitment. E.g. explicit requests outlining conditions of satisfaction.</i>
<i>Durability</i>	<i>Depending on the commitment target, the durability of the personal contract varies. E.g. commitment to career may last a lifetime while commitment to a project is shorter term.</i>
<i>Essential Forms</i>	<i>At least three forms of commitment exist: Affective, normative and compliant. These form a composite which changes over time. Because they engender attachment they are regarded as the essence of commitment.</i>
<i>Levels</i>	<i>The unit of analysis in commitment studies. 1) Individual commitment 2) group or team 3) organisation. Each can have a commitment towards an entity</i>

This paper shows that successful community based networks are made up of conversation generated commitment structures that bond members to each another. This rich network of commitments delivers value by addressing the deep concerns of community members and ultimately the beneficiaries of their work. The essential purpose of community based networks is integrative interaction producing results greater than the sum of individual actions (Richardson 2004). Because people make up community based networks the currency of commitment is the making of requests which are met with promises that are kept. This suggests that richly synergistic communities are like magnets attracting people who enjoy this affective component of commitment. Especially when it enables them to “show up in the world” and in so doing, make a difference “in the world” that makes a difference such that the world is not the same as a result of their actions. Ironically, in the ERISA programme this quality appears present at every level in the community except the executive level. Even with these exceptions, a small dedicated group work diligently to address the concerns of the community and are beginning to established an identity for both themselves and ERISA as a potential history making event (Richardson 2004, Olson 1965). According to this community - collective model (von Hippel and von Krogh 2003) newcomers share with existing members and derive benefits from revealing their ideas (Callhoun 1986; Taylor & Singleton 1993). This is possible because their ideas can be reviewed and commented upon by others and in terms of learning benefits, the group's feedback can be direct and specific to the newcomer. Such architectures of participation (Raymond, 1999) include low barriers to entry by newcomers and some mechanism for balancing the need for control with the need for improvisational innovation. This architecture of participation allows for a free market of ideas in which anyone can put forward proposed solutions to problems; it becomes adopted, if at all, by acclamation and the organic spread of its usefulness. Ultimately, the reward for such rich networking is the ability to progress toward levels of knowledge and discovery beyond those achieved by conventional means

especially awareness of one's own identity through core commitment revelation. Research on the core commitment structures of community based networks has not been well established, let alone compared to those of traditional communities and the overall lack of a theory of suggests a qualitative grounded approach to develop analytical categories and propositions (Glaser & Strauss 1967; Meyer, 1997; Strauss & Corbin 1990).

The theory development in this paper is based on the European Region Information Society (ERISA) an association of European regions seeking to accelerate the impact of ICT on the quality of life of citizens, business profitability and government processes. The paper is organised as follows; firstly it provides a review the research method employed in the study. It then provides a history of ERISA related development data. It then proceeds to theory induction by an analysis of contributing behaviour exhibited by members of the ERISA community. The paper concludes by discussing implications of the study for theory and research.

## **Research Method**

This section describes the research method employed in the study. It proceeded in three phases: Sampling of the case, data gathering, and data analysis. One case was selected in order to increase the depth of the analysis, acquire and report experience with the gathering of new and unfamiliar data (Numagami 1998). ERISA was sampled because it was hoped that it would reveal areas as yet undiscovered in current research into identity creation in community based networks. ERISA also offered an ideal sample because it was in the initial stages of enabling each member region to move from policy to practice in the key areas of government, infrastructure, health, inclusion, education and business. As is common with such grand schemes, these noble intentions are rarely followed by committed action and as such offer a rich source of data into the challenges of moving from policy into practice. The data in this paper covers the second phase of the European Broadband Portal (EBP11), a key ERISA programme which commenced in January 2011 and is due to run until December 2012. The research studies events occurring during its critical launch phase, especially the challenges of transforming policy into practice. Data were gathered from a number of different sources and occurred between April and October, 2011. The analysis was inspired by the writings of Winograd, Flores and Spinoso (Winograd and Flores 1987) on commitment based networking and its relationship to the Gadman and Cooper (2009) concept of Open Source Leadership. Leadership and membership of these networks requires a description and explanation of commitment characteristics and their relationships, which together describe the process of developing commitment in a community based network. The characteristics, relationships and actors performing them are identified and described in this section on the basis of the analysis. Flores draws on the works by Heidegger (1962 (1937)), Kierkegaard (1985) and Hegel (1979) but rather than giving any detailed description of the philosophical underpinnings of their writings, the intent here is to further elaborate the interpretation of Flores (1993) and Gadman and Cooper (2009) as it relates to understanding the dynamics of leadership, commitment and its operation in community based networks. Winograd and Flores (1987) have opened the discipline of tracking, mapping, and combining commitments based on the constituting power of human speech. In their writings on

computers and cognition, they have stated that there is a general structure for forming commitments for actions to satisfy concerns. Concern, to them, is an ongoing generalisation of need. Through the focus on concerns and commitments, new views of the world emerge. One of these views is “the identification of the new institutions arising alongside old ones”. This is explained as follows: “Mapping social institutions in terms of their concern and commitment structure tells us what is genuinely new and what is a new way to accomplish old goals” (Flores & Spinoso 1998, p. 357). In this paper the social institution to be mapped is the ERISA European Broadband Portal (EBP11) community as it takes on a radically new approach to Broadband infrastructure development across Europe. If this is accepted, EBP11 can be seen as a new institution arising alongside more traditional ones and possibly a genuinely new way to achieve sustained results. “If we are to evaluate whether a change has occurred, we have to look at the changes in concerns and commitments, *i.e.*, the changes taking place in the respective actors’ commitment networks. Once we become familiar with the way commitments drive action, we no longer believe that we have to understand in advance all component parts of whatever social action we seek. Rather, we see that we must identify concerns and begin forming commitments to address them. Open Source Leadership (Gadman and Cooper, 2009) is the basic organising skill that forms and manages commitments to deal with concerns. On the basis of one commitment, many others can be grown” (Flores & Spinoso 1998, p. 357). Data were gathered from seminars, workshops, round tables and a series of interactive conferences (I – Conferences) with secondary sources coming from documents on the European Broadband Portal (e.g. original concept papers, WIKIs, magazine articles, news features and links to other projects attempting similar challenges).

### **ERISA History and Development Characteristics.**

This section provides a brief history of The European Regional Information Society Association (ERISA), its wider context, objectives and an overall characterisation of the development process. ERISA was awarded the service contract for the creation, animation and maintenance of the second phase of The European Broadband Portal (EBP11) by the European Commission. The development of the European Broadband Portal was initiated by the European Commission (DG Information Society & Media) following an open Call for Tender for the supply of a “Web Portal for Exchange of Good Practice for Broadband Deployment”. The project commenced in January 2008 and lasted for a period of 30 months. Following a review and approval this second phase commenced in January 2011 and runs until December 2012.

The EBP11 programme seeks to put in place a coherent on - line community of relevant stakeholders, providing them with the tools for effective sharing of experiences and good practices and a participatory environment for seeking common and shared solutions. Their aims are as follows:

- Stimulate the exchange of best practices and the sharing of experiences;
- Utilise the broadband blueprints to deliver the practical solutions that change people’s lives
- Facilitate demand aggregation and joint procurement;

- Act as a central information platform, publishing calls for tender, expressions of interest, awards and other notices;
- Become in this way a virtual meeting point between community broadband champions, suppliers and rural, urban, municipality, regional and national governments;
- Permit sparsely populated areas to coordinate their demands for broadband, establishing a critical mass for technological solutions, next generation access and such as satellite, that provide large coverage.

The EBPII blueprints are designed to “bridge the gap” from policy to practice, to bring solutions to life, to make a vision a reality and to contribute directly to the “Digital Agenda”(Europe 2020: A strategy for smart, sustainable and inclusive growth).

### Theory Induction

In this section, propositions are developed towards a theory of core commitment structures in community based social networks engaged in the process of innovation. Through the application of commitment based community networking, the propositions are grounded in documented strategies of people diffusing innovative ideas through synergistic community action. According to Abrahamsson (2002) the key concepts constituting the basis of such networks are actors, drivers, concerns, actions and outcomes. In this paper, three levels of actors were considered: individual, group and organisation (Hage, 1980; Curtis *et al.* 1988). With the exception of the executive level, changes at ERISA (EBPII) happened at each of these levels in a way that appeared to increase performance across the whole network. The leadership action primarily took place at the organising level where maintaining uniqueness and direction was critical in effecting a balance between ethical / moral, relational, inspirational and institutional capital. Here questions such as “do we have the right people to support the innovative process?” and “can we clearly define the economic, environmental and social benefit?” were asked and answered. Each operating level was defined and mapped against phases such as developing the commercial model and financial plans and their supporting technical architecture and engaging stakeholders to work in joint collaboration with ERISA. These operational stakeholders represented a range of concerns e.g. local and regional authorities were concerned about access to broadband in their territory. While national authorities were concerned about implementing national broadband strategies. Community and other groups were concerned about lack of access to affordable broadband. Industry players and associations were concerned about their engagement in successful public private partnerships. National and European policy makers were concerned about access to ICT and its impacts at local and regional levels. So with these concerns, it was possible to understand the drivers of commitment.

## Commitment Drivers

Research in other disciplines (e.g., Sabherwal & Elam 1995, Meyer & Allen 1997) has shown that the development of commitment is influenced by various drivers. The drivers identified in organisational behavioral literature were mapped to the proposed four categories. Project drivers reflect the objective features of the EBP11 project, such as costs and benefits. They indicate reasons for EBP11 to exist. Psychological drivers involve key individuals in the project, reflecting properties such as the need for identity as an achiever, past historical success, *etc.* Social drivers originate from a group rather than an individual. These drivers are, *e.g.* power and politics, or public identification with the EBP11 project. Finally, structural drivers represent the contextual conditions surrounding the project: the environment for EBP11 activities. A potential driver is anything affecting the commitment of the actors and can occur in the macro and micro environment as well as within the organisation, group or team.

## Concern and action

The research sought out evidence of the strength of a person's commitment by observing patterns and frequency of activity directed at addressing concerns. For example, in ERISA high levels of commitment were evidenced by a small number of people at the concept and design stages while those at executive level appeared more interested in posturing and rhetoric than actually causing anything of any significance to happen. The concepts of concern and action together constitute commitment however, action by itself does not bring about commitment but might be interpreted as a sign. This is consistent with the views expressed by the behavioral school of commitment research which emphasises the role of action as commitment target. "[...] commitment targets should be actions rather than objects, as it is virtually impossible to describe commitment in any terms other than one's inclination to act in a given way towards a particular commitment target" (Oliver 1990, p. 30). Consequently, the research sought out evidence of the strength of a person's commitment by observing patterns and frequency of activity directed at addressing concerns. For example, in the EBP11 project much of the early conversation took place among highly committed team leaders who, unlike the senior executives who played a major part (at the improving and integrating levels) in setting up the initial communications infrastructure. One shortcoming of the research was an inability to say for sure exactly what the deep psychological drivers were and how they were directed toward meeting the overarching concerns of the project. Consequently, while it was not possible to accurately gauge the level of commitment held by the Senior Executives of ERISA, their patterns of actions make levels of commitment to EBP11 difficult to assess.

## Outcomes

Only actions produce outcomes and outcomes bear relevance in this research since it has been shown that it is on the basis of outcomes that future actions are planned (Newman & Sabherwal 1996). In EBP11 unintended outcomes took the form of dissatisfaction with across national and regional boundaries, which subsequently lead to difficulties in co - operation between different groups. Unintended outcomes were also

positive. For example, accidental discoveries cleared the way for new EBP11 activities (that were initially not intended). Intended outcomes reflected the fact that the EBP11 project looks highly likely to achieved the goals set for it despite poor executive leadership.

## Conclusions and Implications

The purpose of this paper was to apply a commitment based analytical model (Abrahamsson, 2002) to the ERISA EBP11 programme to understand the motivations and strategies supporting the desire of its actors to engage in the development of a Broadband Infrastructure across Europe. The research suggests that commitment based community networks are primarily concerned with the effective diffusion of innovative ideas. The study shows that in order to shift the concerns of a culture, community network leaders must clearly articulate and gain buy in to the challenge to be addressed. They must create and maintain clear focus and develop a shared sense of commitment among participants. The research reveals a complex interaction between the commitment drivers and the successful outcomes of the project especially the unfolding and alteration of commitments in time and through time at the improving, operating and integrating levels as circumstances change. In particular, it shows how over time the objective features of ERISA EBP11 in terms of cost and benefits diminish as obstacles are encountered and psychological and social drivers play a greater part. Indeed it is possible to say that ERISA EBP11 could potentially fail over time if attention is not paid to such changes in the concerns of its network of commitments.

The study has implications for research into the impact of community based networking strategies on strategic management. Firstly, it is important to recall that much strategic planning in business is preoccupied by public reputation, i.e. what the public recognises as important about the institution and its tradition. Did Steve Jobs create an entire organisation that shared his balance of concerns - for the back - end yes, but for usability first and foremost? The new focus on strategy in both business review articles and in boardrooms reveals the confusions and difficulties corporations are having over determining their self - image (Porter 1980, Prahalad and Hamel 1990). In taking the position that personal and corporate identity is neither wholly the result of total commitment (Gergen 1991) nor wholly the result of recognition - based identity (Hegel (1979), the implications require a deeper consideration of the challenges surrounding collaborative community models especially those based on the Web (Wilde and Hax 2001).

Secondly, by suggesting that personal and community identity are outcomes of the well positioned enactment of a compelling concern to make something better than it was before, how do business leaders develop successful positioning strategies such that their committed actions result in the emergence of a new world alongside the old? Thirdly, empowerment of individuals is a key part of what makes community networks successful, since in the end innovations tend to come from small groups, not from large, structured efforts. The study shows that community based networks don't rely on containment or tight control of the environment to maintain their position, but rather, an exquisite balance and ability to respond to rapidly changing conditions. This kind of responsiveness is hard for a large network to achieve, but not impossible,

especially in the presence of the kind of competition that virtual networking brings. Finally, the Internet is a community based network's greatest asset, making massive decentralised projects possible. On the other hand, intellectual property is its nemesis and has the potential to stifle and restrict the creative capacity of free - thinking scholars, programmers, scientists, designers and engineers. There is increasing evidence to suggest that a philosophy, a strategy and a technology have aligned to unleash great innovation. The internet is simple, yet its power is profound. The power to bring people together in committed conversations that produce outcomes far greater than the sum of the individual parts. The distribution of knowledge is the key contemporary task and if knowledge empowers people, are contemporary systems ready for the disruptive influence of 'openness'?

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**PUBLIC SUPPORT ON YOUNG TUSCAN WINE FARMERS: PERTs OR PESTs POLICIES?****Gaeta, Davide<sup>1</sup>; Begalli, Diego<sup>2</sup>; Corsinovi, Paola<sup>3</sup>**

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**Abstract**

The specific objective of this work is to analyze how public agricultural resources are allocated to the young Tuscan vigneroni (between 18 and 40 years old) and if their distribution creates “leverage” effect on the principals financial values. Taking into account the economic face of sustainability, we must concentrate our attention on the long-term economics of the young farmers on the basis of their recent financial performance. The results are obtained by the sum of total expenditure (I and II pillar of CAP and CMO wine sector) from 2005 to 2009, crossed with the financial values: principal items of revenues and the costs. Then was calculated the profitability and its impact on revenues, without the weight of public support and the support. This research was triggered by a combination of factors: Public Support, Financial Value and Public Choice theory (PEST and PERT policies). From the first results seems that the public support has balanced only in part (5.8%) the lack of profitability of young winemaker. Thus income as not changed the lose in the gross profit margin GPM, but it only covers some of the cost sustained. If there was no support the effects would have been more dramatic, especially for the future of vigneroni.

The research can be a helpful instrument to evaluate if the political objectives of the policy makers are coherent with the actual agricultural public support between the research data or if exists a conflict efficiency and effectiveness of agricultural spending.

**Keywords:** young winemakers, wine support, CMO, Italy

**Introduction**

The impact of the effect of public support especially in the crisis period, can be relevant for agriculture development and farm competitiveness. The theme of public intervention on market failure can be discussed under different aspects. Taking into account the economic and policy face, the attention of these studies are concentrates on the long-term economics of the vigneroni on the basis of their recent financial performance (Gomez et al., 2009). The aim is to contribute to the analysis of agricultural policies, in particular of the Common Agriculture policy CAP, trough expenditure. It is an exercise that is central to economic policy analysis since the majority of policies are implemented through the expenditure. And the analysis of the

expenditure, actually, provides a great opportunity for researchers and policy evaluators at all stages of the evaluation process. The research has chosen to study young farmers because without doubt their future will effect the primary sector and analyze how public resources are allocated among them. The scenario of Italian agriculture is characterised by great changes and challenges, however only 6% of Italian agriculture enterprises are managed by young farmers<sup>33</sup>. It is a relevant argument because agriculture is amongst the sectors driven by the socio economic system and the Common Agricultural Policies (CAP) is the second highest expense for the EU. Farm subsidies and their widespread implications have played an important role in the structure of the CAP. The Common Policies regulation has undergone many changes over the last 50 years. The policy makers and agriculture lobbies have been discussed and argued against (Becker, 1983). The CAP still retains its position as the largest component of European Union expenditure, accounting for approximately 42% of the total European Union planned budget for the period 2007-2013 (Gorton et al., 2009; Swinnen, 2010). The concept of policy sustainability, can be described how the ability of the existing array of policy interventions to continue. Even within this context there are shades of meaning. One usage is where the policy initiates a response that continues after the instrument is withdrawn, such as may happen when an investment grant stimulus farm productivity in a way that raises income and leads to higher levels of saving and investment without the need for further assistance. Another usage, more relevant in the present context, is where the cost of the instrument changes, an unsustainable policy being one where the costs escalate to the extent that they present budgetary difficulty or are no longer considered commensurate with the benefits created or are in other ways no longer acceptable. Looking at the Appropriations for Commitments for the year 2009<sup>34</sup>, the incidence of the CAP on the EU budget was a total of 40.7 percent (split into 30.5 and 10.2 percent respectively between Pillar I and II). A similar figure, 41.3 percent (31.1 and 10.2 per cent between I and II Pillar) was recorded in 2008. The effects and efficiency of farm income support has been widely discussed over recent decades. The CAP of the EU has been the subject of much criticism both for the budget resource it uses and for the distortions it creates inside the EU and on world markets (Swinnen et al., 2010). It is important to note, that the CAP, in the course of its evolution has been accompanied, by a number of structural measures that directly or indirectly have had environmental objectives regarding protection and control (Coleman, 1998; Kay, 1998).

The wine sector with its Common Market Organisation (CMO) system has been partially treated in a different way, due to lobby pressures and market structural characteristics (Gaeta, 2009). The CMO for wine has gradually evolved since 1962, with the most important regulations being adopted in 1987 (Reg. 822/87) and 1999 (Reg. 1493/99). The latest CMO regulations entered into force on 1st August 2009 (Reg. 479/2008). This Regulation concerns a voluntary grubbing-up scheme where uncompetitive producers and surplus wine is being removed from the market; gradual withdrawal of distillation subsidies until 2012 (phasing out

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33 *Istat-Eurostat analysis of 2007 showed there is a ratio of one young farmer "under 35", in Italy there are 13 agriculture from more than 65 years.*

34 *Source: CAP post-2013: Key graphs and figures, November 2010, [http://ec.europa.eu/agriculture/cap-post-2013/graphs/graph1\\_en.pdf](http://ec.europa.eu/agriculture/cap-post-2013/graphs/graph1_en.pdf)*

measure) for crisis distillation, potable alcohol distillation and the use of concentrated grape must measures. This aid can be allocated for development of incentive envelopments such as wine promotion, restructuring vineyards etc.<sup>35</sup>

In short, in the current debate on the present and future of the CAP, an assumption generally accepted on the weight of this policy on the overall budget is that its incidence lies just above 40 per cent, and that the ratio between Pillar 1 and 2 is more or less 3:1. Is this a legitimate assumption? Does the evidence of the amount of money received by its recipients endorse this postulate?

## Literature Review and Objectives

The majority of studies on the political economy of the CAP use different empirical models, relating indicators of policy distortions to a set of political indicator variables, or more descriptive methods to analyse the historical development of the CAP and its context, as well as motives behind certain decisions and ideology (Harvey, 1982; Pearce, 1983; Tracy, 1984; Moyer et.al, 1990; Josling et.al, 1991; Olper, 1998; Ackrill, 2000). Most economic analysis of public policies are focused on the allocation of public support such as market failure. In the food agricultural systems around the world, instances of market failures are easily identified. As Arrow has shown (Arrow, 1964), a complete set of risk markets represents a sufficient condition under which a market equilibrium is a Pareto optima. Moreover, general equilibrium formulations with incomplete markets have demonstrated clearly that market failure is a fact of life. In the most general sense, a government wishing to intervene to correct market failures must design a set of rules to reduce transaction costs of the private economic system. This essay will argue that agricultural policy in the UE has led to both the enhancement of efficiency through "productive policies" and the transfer of wealth and income to special interests through redistributive or "predatory policies." These two activities can be labelled as PESTs and PERTs. PEST policies, or political-economic-seeking transfers, are meant to redistribute wealth from one social group to another and are not explicitly concerned with efficiency. In contrast, PERTs, or political-economic resource transactions, are intended to correct market failures or to provide public goods; these policies have neutral distributional effects, at least in design (Rausser, 1982). The net effect of PERT policies is to increase the size of the pie. A review of the history of public policy in agriculture reveals not only tension between the PERT and PEST roles of the public sector, but also some coordination between these two types of activities. As different interest groups pressure the political process, the government trades off PESTs and PERTs in its attempts to acquire, balance, and secure political power. At times this has led to combinations of programs that appear incoherent. For example, conservation programs require the retirement of vulnerable acreage, while crop price supports penalize premature land retirement and create incentives for overutilization of vulnerable acreage. These apparent incoherencies, however, result from institutional arrangements that generate a government portfolio of productive and predatory policies. In

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<sup>35</sup> The Reg. 479/2008 has maintained that policies with objective to regulate winegrowing potential (Gaeta, 2009) and Reg. 555/2009 laying down detailed rules for implementing Reg. 479/2008. The reform CMO wine has been included in the CAP unique: Reg. 1234/2007.

such a world, the challenge for economists is to design and advocate policies that are both economically productive and politically sustainable (Rausser, 1982). The “farm problem” has been described in one context or another by different types of market failure, instability, excessive market power of the middlemen, inadequate returns for invested capital, unacceptable uncertainty, private risk aversion which exceeds society's risk aversion, and so on. Governmental intervention is introduced to provide a remedy to such problems through collective action (Becker, 1981). Much of this literature is based on the presumption that governmental intervention in some broad sense improves efficiency. This positive sum game view of governmental intervention also presumes a political economy which improves the allocation of resources. In one fashion or another, the policies introduced by the government reduce the transaction cost that would exist if the “invisible hand” were to operate (Rausser, et.al.,1982). However, in modern literature there are important gaps and several facets about the study of distributive agricultural policy, efficient support, and their impact of gross margin and the incidence on farmers revenues.

The innovative and specific objective of this work is to analyze how public resources are allocated among the young wine farmers (between 18 and 40 years old) and if their distribution creates leverage for major financial values. Indeed, this paper analyzed the leverage of public support on the gross profit margin, than the farmers profitability for discussing about the efficiency of regional agricultural and wine policies (Begalli et. al., 2009). The paper aims to verify if the political objectives of the policy makers are coherent with the actual agricultural public support between the research data or if exists a conflict efficiency and effectiveness of agricultural spending, such as Public Choice and PERts and PESTs theory discussion (Buchanan, 1962; Rausser, 1982)

## Methodology

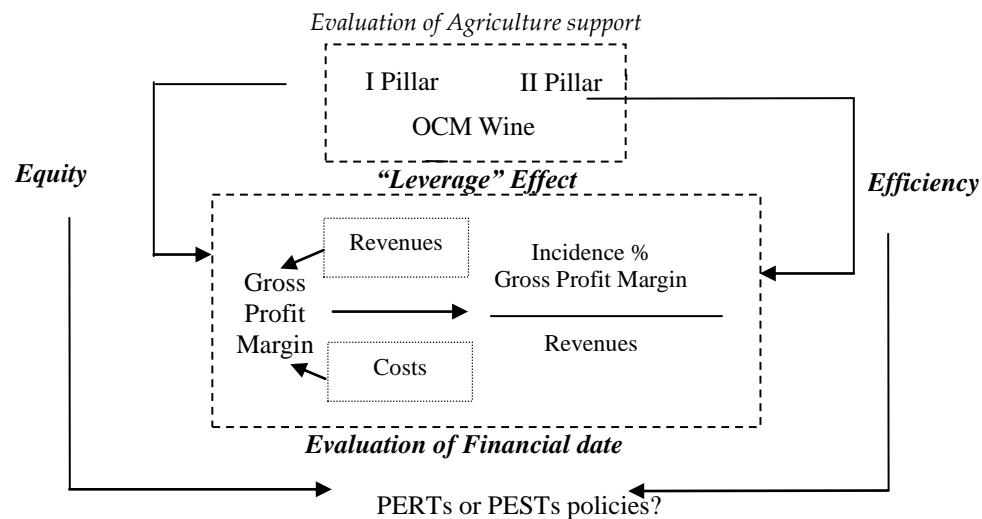
The focus of the paper is analysed one small group of 27 wine and grape producers pinpointed in the provinces of Florence and Siena in Tuscany where the wine produced is mainly Chianti and Chianti Classico<sup>36</sup>. As seen in figure 2.1, the research considers two types of data. The first data set is represented by the distribution of agricultural public support on the young wine farmers from 2005 to 2009<sup>37</sup>. This data was obtained from the Tuscany Agency for Agricultural Payments (ARTEA) database. In this paper are considered nine agriculture policies: single farm payments (PUA) as the I Pillar policy; agro-environmental, setting up of young farmers, Farm investments and modernisation, diversification in activities not linked to agriculture, woodland reforestation, private land improvement, Rural Development Services and Consulting Services as the II Pillar policy and the vineyard reconversion and restructuring indicator corresponds to the specific CMO policy and represents a subset of both the Total Farm support and sustainability support indicators.

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<sup>36</sup> In this work, research survey groups were made of 131 young wine makers but only 27 farmers were presented.

<sup>37</sup> Payments are considered in two the different support policies: RDP in 2000-2006 and RDP in 2007-2013 (Reg. 1872/2003; Reg. 1257/1999); CMO wine sector Reg. 1493/99, Reg.479/2008; Reg. 555/2008).

Fig. 2.1 Data and methodological framework



The second data set is represented by the financial values (Revenues and Costs) of young vignerons members of the Confagricoltura of Florence<sup>38</sup>. The results are obtained by the sum of total public support from 2005 to 2009, crossed with the financial values: principal items of revenues and the costs<sup>39</sup>. Then was calculated the profitability and its impact on revenues, without the weight of public support and the support (sum of the revenues and farm support) to verify if there is leverage on the gross profit marginal values and to what measures.

Then, the paper tries to verify the combination of PERTs and PESTs policies: if the political objectives of the policy makers are coherent with the actual agricultural public income between the research data (I, II pillar and CMO wine) or if exists a conflict efficiency and effectiveness of agricultural spending.

## Results

### Analyses of public support

The effective real amount of total farm support, for the young farmers' group considered, are distribution by years and policies (I, II pillar and CMO wine) shown in table 4.1.1. The total annual farm support indicator, as seen, was obtained by the analyses of 1<sup>st</sup> and 2<sup>st</sup> pillar of CAP<sup>40</sup> an CMO wine (only the

38 Confagricoltura is one of three unions in the agricultural sector. It is the most important Italian trade union. agriculture lobbyist.

39 These costs concern only those of production (Labor and financial expenses costs were not considered).

40 The first pillar refers to the single farm payments. Mainly for olive oil sector and cover crops (cereals).

vineyards reconversion and restructuring policy). It is the sum of single nine policies for each of the years considered. Looking at the table we see that on the total farm support, the Rural Development (II Pillar) weighs 61.4%, compared to 30.2% of I pillar and 8.3% CMO wine policies. But, the distribution of public support from 2005 to 2009 follows a different path<sup>41</sup>: the first pillar, as direct support to farmers (without the obligatory investment) is increasing. The second, linked to rural development and competitiveness is declining but represents only 0.3% of the total paid from Tuscany at 15<sup>th</sup> October 2010. The CMO wine policies keep track of the oscillations, probably due to vineyard reconversion policy that has been put into operation during the years 2004-2009 in compliance with CMO in wine.

*Tab.4.1.1 Amount and distribution percentage of the support by policies, years 2005-2009*

	<b>CAP (I pillar)</b>		<b>CAP (II pillar)</b>		<b>CMO wine</b>		<b>Total Farm Support</b>
	€	%	€	%	€	%	€
<b>2005</b>	31.303	14.3	153.787	70.2	33.938	15.5	219.030
<b>2006</b>	49.398	19.0	204.225	78.6	6.291	2.4	259.914
<b>2007</b>	44.966	62.9	13.387	18.7	13.190	18.4	71.542
<b>2008</b>	65.636	40.7	81.233	50.4	14.266	8.9	161.136
<b>2009</b>	123.775	37.6	186.965	56.7	18.724	5.7	329.464
<b>TOTAL</b>	<b>315.079</b>		<b>639.598</b>		<b>86.409</b>		<b>1.041.087</b>

The different sources of public support are highlighted in table 4.1.2. It shows that the amount of the total farm support (from 2005-2009) for policies and their percentage on the total contribution.

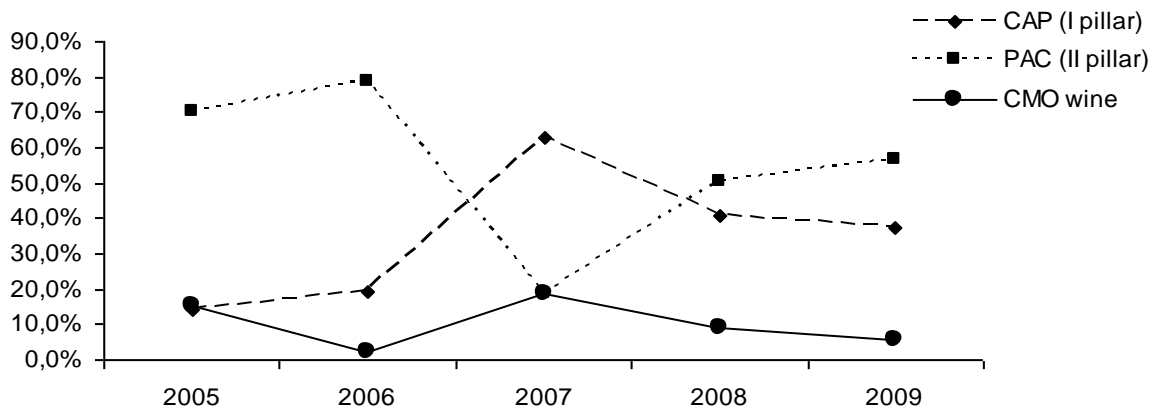
<sup>41</sup> The Tuscany region has received for the period from Rural Development 876,140,965 million Euros (from the program 2007-2013), equal to 4.97% of the Italian Rural Development budget. From 15th October 2010 (Italian Ministerial data), Tuscany has been Granted only on the 21.30% of the total support. Regarding the distribution its mainly improving the competitiveness of agriculture and forestry.

Tab.4.1.2 Amount and distribution percentage of the support by single policies, from 2005 to 2009

Policies		Total Farm Support 2005-2009	
		€	%
Single farm payments	I Pillar	315.079	30.3
Agro-environment	II Pillar	392.772	37.7
Setting up of young farmers	II Pillar	80.000	7.7
Farm investments/modernisation	II Pillar	83.977	8.1
Divers. in activit. not link.to agriculture	II Pillar	34.933	3.4
Vineyards reconver./ restructur.	(CMO wine)	86.409	8.3
Woodland reforestation	II Pillar	35.913	3.4
Rural Development services	II Pillar	9.000	0.9
Technical assistanced	II Pillar	3.000	0.3
TOTAL		1.041.087	100

The first information about analysis of the different sources of public support is the role of the first pillar subsidies (single farm payments) and the agro-environmental measures. They are indicators of direct support to farmers' income. A significant amount of funding comes from the I pillar subsidy percentage (single farm payments, a direct public farm support) cover 30.3% of the total support: a value that is still very high. Agro-environmental policy (37.7%) and farm investments (8.1%), represents the most important sources of funding given that these rural development measures transfer the total support. The policies linked to sustainability, Vineyard reconversion policy represents 8.3% of the total support. Taking into account other policies: setting up of young farmers (7.7%), diversification in activities not linked to agriculture (3.3%), woodland reforestation, private land improvement policies (3.4%), rural development services and technical assistance are the remaining quota and the lowest support rates. Among the problems that involves the business public support system, a great impact issue on the effectiveness of the contribution is represented by the time discontinuity of financial transfers. The lowest level of total farm support (II Pillar) was obtained in 2007 like in Fig. 3.1. This is partly due to the budgetary problems of paying entities that are, in turn, subject to financial derivatives in comparison with the EU or the Ministry of Agriculture.

Fig. 3.1 Percentage variation compared to 05-09 period by policies, years 2005-2009



### Effects on revenues and costs

The paper analyses the principal revenue items: grape sales, wine sales, olive oil sales, lees agritourism (farm holidays) and other revenues and the principle costs items analyses. In terms of marginality the work shows the distribution of total revenues (R) and costs (C) for the period 2005-2009, the difference between revenues and costs the gross profit margin (GPM), and the percentage incidence of revenues whit Public Support (GPM/Rt).

Table 4.2.1 shows the distribution from 2005 to 2009 and the average for farm of total revenues (R), total farm support (FS) and the sum of revenues and farm support (Rt); costs (C) and the percentage of gross profit margin, without FS (GPM) and with FS (GPM/Rt). As has been discussed, the level of public funding is a part of company revenues. For this reason public support acts as a cushioning variable for the effect of negative gross profit margin. Looking at the table while the and therefore the GPM is reduced by 11% in five years form 57.1% in 2005 to 46.1% in 2009. The last two columns where is show the percentage of the gross profit margin on revenues without a farm income (GPM/R) and with public support (GPM/Rt) during the period 2005-2009. There is an incidence of public support which has a leverage effect of 5.8%. That is not covering nor the lack of GPM nor the increase of costs.



Tab.4.2.1 Distribution of revenues and costs and a proportion of gross profit margin on revenues with public support. The leverage of public support

	<i>Revenues (R)</i>	<i>Total Farm Support (FS)</i>	<i>Costs (C)</i>	<i>Total Revenues Rt (R + FS)</i>	<i>GPM (R-C)</i>	<i>GPM (Rt-C)</i>	<i>Incidence GPM/R</i>	<i>Incidence GPM/Rt</i>
	€	€	€	€	€	€	%	%
<b>2005</b>	1.162.889	219.030	499.480	1.381.919	663.409	882.439	57.1	63.8
<b>2006</b>	1.166.643	259.914	495.451	1.426.558	671.191	931.106	57.5	65.2
<b>2007</b>	1.669.879	71.542	678.325	1.741.421	991.553	1.063.096	59.3	61.0
<b>2008</b>	1.874.818	161.136	968.051	2.035.954	906.766	1.067.902	48.3	52.4
<b>2009</b>	1.771.925	329.464	968.964	2.101.390	802.961	1.132.425	46.0	53.9

## Conclusions

The analysed case study, even if it refers to a particular area and group, highlights some considerations that can be extended globally to public support efficiency and the real effectiveness of the sustainable economic policies. As already discussed, public support is concentrated in two policy interventions. A significant quota of funding comes from 1<sup>st</sup> pillar subsidies (30.3%), the second Agro-environmental measures, as indicators of direct support to farmers' income are 37.7% of the total. They represents the most important source of funding given that this rural development measure transfers the total support. Among the Rural Development (RDP II pillar) policies linked to competitiveness, vineyard reconversion policy cover 8.3% of the total support and farm investments the 8.0%. The most significant results of the survey about principal revenues and costs items analyses, show the reduction of the gross margin as the difference between revenues and costs. This is caused by the increase in farm costs, they have increased by 50% between 2005-2009 and the revenues remain constant. The paper confirms that the public support has leverage on the gross profit margin. However the reduction of gross profit margin quota from 2005-2009 shows that costs have increased much more than leverage support. The incidence of GPM/R respected GP/M represented only the 5.8%. Thus public support as not changed the lose in the GPM, but it only covers some of the cost sustained. If there was no support the effects would have been more dramatic, especially for the future of vigneron. The reduction of profit has effected of rural development measures because: it is difficult to find the co-financing quota for these measures and in relationship to the reduction in bank guarantees above all for young farmers. Paradoxically where investments are necessary to improve competitively, the resources and incentives are lacking. Agricultural policy is a complex web of interventions covering output markets, input markets, trade, public good investments, renewable and exhaustible natural resources, regulation of externalities, education, and the marketing and distribution of food products. Do these massive governmental interventions correct for market imperfections, lower transaction costs, effectively regulate externalities, and enhance productivity? Or are these programs the result of manipulation by powerful commodity or agricultural interest groups actively engaged in rent-seeking or

directly unproductive activities? (Buchanan and Tullock 1962; Krueger 1974; Bhagwati 1982). On the basis of economic theory cited in the introduction it is possible to note the “distance” between the correct efficient decision, the equal redistribution of public funding and its correct application. The application and redistribution is inspired by the criteria of Public Choice more than Pareto’s efficiency. The results of public allocation and measures, seem to be identified in Rausser definitions about the PERTs and PESTs policy (Rausser, 1983). The policies that are generated to correct market inefficiencies and failure that have the aims to improve a hypothetical collective welfare system, PERTs policy (it is the aim of II pillar of the CAP), finish in configuration as PESTs intervention made for private interest of the decision makers. (In the Tuscany Rural development program, for the vigneroni there are only seven main financial measures where by farmers can obtain funding. But the other measures how efficient are they? Economic policy is the result of debates and political pressure what role should the pressure groups play against the institutions and policy-makers. With reference to the theory of Downs in the context of Public Choice, political parties in a democracy formulate policy strictly as a means of gaining votes (Downs 1957). But, what will the future for young vigneroni be after 2013, when the future of the CAP and market are still uncertain?

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## IMPACT OF OPTION TRADING ON INDIAN STOCK MARKET

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### Introduction

An option is a contract between two parties whereby one party acquires the right, but not the obligation, to buy or sell a particular commodity or instrument or asset, at a specified price, on or before a specified date.

NSE started trading in index futures, based on popular S&P CNX Index, on June 12, 2000 as its first derivatives product. Trading on index options was introduced on June 4, 2001. Futures on individual securities started on November 9, 2001. Trading in options on individual securities commenced from July 2, 2001. While BSE started future trading, based on Sensex, on June 9, 2000. It was followed by trading in index options on June 1, 2001; in stock options and single stock futures (31 stocks) on July 9, 2001 and November 9, 2002, respectively. Index options recorded turnover of US \$ 1,778,459 million during 2009-10, an increase of 115.14 % over the turnover of US \$ 732,385 million during 2008-09. Index option accounted for 50.26 % of the total turnover during the 2009-10, followed by the trading in stock futures at 21.43 %.

Volatility is defined as relative rate at which the price of securities moves up and down. Volatility is found by calculating annualized standard deviation of daily change in price. If the price of stock moves and down rapidly over short period of time, it has high volatility. If the price almost never changes, it has low volatility. There are two opposite school of thought on the impact of derivative trading on the volatility of stock market. One school of thought argues that introduction of derivative trading lead to reduction in volatility. They are proponents of '**Market completion**' or '**stabilizing forces**' Hypothesis. Other school of thought argues that introduction of derivative trading led to increase in volatility. They are proponents of '**Destabilizing forces**'.

In the literature, researchers have found that the average daily return of the market is not same for all days of the week. This is generally referred as "day-of-the-week-effect". The day-of-the-week-effect has attracted the attention of the many researchers because it is believed to be one of the factors contributing to the volatility. The study of day-of-the-week effect continuous to be very important because the existence of significant day-of-the-week effect would be very useful for developing profitable trading strategies. Investor could buy stocks on days with abnormally low returns and sell stocks on days with abnormally high returns. According to French (1980) stock prices should rise higher on Monday than on other days because the time between the close of trading on Friday and the close of trading day on Monday is three days, rather than the

normal one day between other trading days. But empirical studies have documented that average return on Friday is abnormally high, and the average return on Monday is abnormally low for most of developed countries like U.S.A., U.K. and Canada. While in developing markets, the abnormally low returns appears on Tuesday.

This paper intends to achieve the following objectives:

1. To examine the impact of option trading on volatility of Indian stock market.
2. To investigate the impact of option trading on day-of-the-week effect of Indian stock market.
3. To compare the impact of option trading on NSE and BSE.

## **Literature Review**

### **Volatility of stock market:**

Singh and Mehta (2010) investigated the relationship between trading volume and stock return volatility in selected Asian stock Indices. The author had used the GARCH (1, 1) model to analyze the volatility and to forecast in the return series for these individual stocks indices in Asia. He found that coefficient estimates for the volatility equation are highly significant for all series. He observed that the time series of stock returns for all the stock indices are not temporally independent processes and tend to have volatility clustering and temporal dependence.

Debashish (2008) studied the impact of future trading on the jump volatility of NSE Nifty stock index by using FPE/ multivariate Granger causality technique. He also considered other macro economic variables like term structure of interest rates, volatility of the NSE Junior index, risk premium, inflation rate and industrial production index and found that future trading activity is not force behind the jump volatility. Moreover, volatility of other macroeconomic variables are not responsible for volatility in stock prices of NSE Nifty.

Mallikarjunappa and Afsal (2008) studied impact of future trading on spot market volatility on CNX Bank Nifty, a sector based index by using GARCH model and Chow test for parameter stability. The results showed that derivatives doesn't have any stabilizing (or destabilizing) effect by decreasing (or increasing) the volatility.

Samanta and Samanta (2007) analyzed the impact of introducing index futures and stock future on the volatility of underlying spot market in India. He considered S&P CNX Nifty, Nifty Junior and S&P 500 and used GARCH model for the study. He found that there is no significant change in the volatility of spot market, but the structural changes in the volatility to some extent. He also found mixed result in spot market volatility in case of 10 individual stocks.

Vipul (2006) used S&P CNX Nifty Index and individual stocks (both derivative and non derivative) to study the impact of derivative trading on the stock market volatility. He applied extreme value measure of

volatility and GARCH model and found strong evidence of reduction in Extreme Value and GARCH volatility on the introduction of derivatives for all the underlying (except Nifty).

Mohan et al (2004) analyzed the data of S&P CNX Nifty to measure the impact of future trading on the volatility of NSE of India and concluded that change in volatility of the underlying stock market could not be completely attributed to the introduction of future trading.

Nagaraj and Kiran (2004) studied the impact of introduction of the NSE Nifty index futures on Nifty Index volatility using ARMA-GARCH model. They also examined the effect of September 11 terrorist attacks on the Nifty spot-futures relation and found that the relation between futures trading activity and spot volatility has strengthened, implying that the market has become more efficient and assimilating the information into its prices

Hetamsaria and Deb (2004) explored the impact of index futures on the Indian stock market volatility using GARCH model and have shown that the introduction of futures results in a reduction in the spot market volatility. It also showed that domestic market factors represented by the NSE 500 had a significant effect, in determining the volatility of the Nifty index but the other international factors are found to have insignificant effect.

Shenbagaraman (2003) explored the impact of introduction of derivative trading on cash market volatility by using data on stock index futures and options contract traded on S&P CNX Nifty for the period of Oct 1995 to Dec 2002. He used GARCH model and found that no change in the volatility, but the nature of volatility seems to have changed post futures.

Nath (2003) used the IGARCH model to study the behavior of stock market volatility after the introduction of futures and concluded that the volatility of Nifty index had fallen in the post future period.

Thenmozhi (2002) used the variance ratio test and Ordinary Least Square Multiple Regression Technique to study the impact of the introduction of Nifty index futures on underlying Nifty index volatility in the Indian markets and concluded that futures trading have reduced the volatility in the spot market.

#### **Day-of-the-week effect:**

Padhi (2010) tested the presence of day-of-the-week effect in Sensex, Nifty, BSE100, BSE500 and S&P CNX Nifty by using GARCH (1, 1), GARCH-M (1, 1), EGARCH and GJR model and found the presence of day-of-the-week effect in Nifty only.

Chia and Liew (2010) examined the day-of-the-week effect and asymmetrical behavior of BSE Sensex for pre-9/11 and post-9/11 sub periods by using EGARCH and EGARCH M models and found asymmetric market reaction to positive and negative news and significant presence of day-of-the-week effect regardless of sub periods.

Chander et al. (2008) examined day-of-the-week effect in Indian stock market by using BSE Sensex, BSE 100, S&P CNX Nifty and S&P CNX 500 for two sub periods: 1) pre rolling settlement period, April, 1997-December, 2001; and 2) post rolling settlement period, January, 2002- March, 2007. The results report lowest Friday return in pre settlement period. However, Friday returns were highest and Monday returns were the lowest in post settlement period.

Raj and Kumari (2006) investigated the presence of seasonal effects in the Indian stock market by applying regression models. The negative Monday effect and the positive Tuesday effects are not found in India. Instead the Monday returns are positive while the Tuesday Returns are negative.

Sarma (2004) investigated day-of-the-week effect for BSE30, BSE100 and BSE 200 stock index and found some seasonality in daily return.

Bahttacharya et al. (2003) examined the presence of day-of-the-week effect in Indian Capital Market By using OLS and found significant positive returns on non-reporting Monday. However, they found significant positive return on non-reporting Thursday and Friday by using GARCH model.

Chaudhury (1991) was the first to report day-of-the-week effect. Broca (1992) found lowest mean return on Wednesday, instead of Monday as exhibited by developed countries.

#### **Research gap:**

This study is different from the existing literature on the basis of three grounds. Firstly, only one study has been conducted on impact of option which has not considered indices of BSE. Secondly, no study has been conducted on impact of option trading on day-of-the-week effect. Thirdly, it tries to compare volatility of NSE with volatility of BSE.

### **Research Methodology**

#### **Data collection:**

To study the impact of option trading on Indian stock market, closing prices of two indices are considered: S&P CNX Nifty and BSE Sensex. The closing price of S&P 500 is used to isolate the effect of world stock market from the impact of option trading. The data on these indices is collected from the website of NSE and BSE. The data is collected for 16 years and whole period is divided into two parts:

For S&P CNX Nifty: Pre-option period (01-04-1995 to 03-06- 2001) and post-option period ( 04-06-2001 to 31-03-2011)

For BSE Sensex: Pre-option period ( 01-04-1995 to 31-05-2001) and post-option period (01-06-2001 to 31-03-2011)

**Methodology:**

All the results were computed on the basis of  $R_t$  which is rate of return  $r$  in period  $t$ , computed as logarithmic first difference of closing price. Descriptive statistic is used to check the behaviour of the series. ADF is applied on returns to check the stationarity of the time series. The null hypothesis of the tests is:

$H_0$ : There is unit root in time series.

$H_1$ : There is no unit root in time series.

Following is the equation of ADF test:

$$\Delta Y_t = \beta_1 + \beta_2 t + \delta Y_{t-1} + \sum \alpha_i \Delta Y_{t-i} + \varepsilon_t$$

Another method is:

$$\Delta Y_t = \beta_1 + \delta Y_{t-1} + \sum \alpha_i \Delta Y_{t-i} + \varepsilon_t \text{ without trend}$$

Where  $\beta_1$  is constant,  $\beta_2$  is coefficient on time trend and where  $\Delta Y_{t-1} = (Y_{t-1} - Y_{t-2})$ ,

$\Delta Y_{t-2} = (\Delta Y_{t-2} - \Delta Y_{t-3})$ , etc.

The main assumption of ordinary regression model is that the errors have the same variance throughout the sample. This is also called homoscedasticity model. If the error variance is not constant, the data are said to be heteroscedastic. Therefore, heteroscedasticity will cause the OLS estimates to be inefficient. In case of heteroscedasticity, GARCH family models are used. To check the heteroscedasticity, ARCH LM test is used. Engle (1982) introduced a new approach for modeling heteroscedasticity in a time series. He called it the ARCH (Autoregressive conditional heteroscedasticity) model. The process by which the variances are generated is assumed to be as follows:

$$\sigma_t^2 = \alpha_0 + \alpha_1 \mu_{t-1}^2 + \dots + \alpha_p \mu_{t-p}^2$$

This equation is known as  $p^{\text{th}}$  order ARCH process.

The null hypothesis is:

$H_0$ : There is no arch effect.

$H_1$ : There is arch effect.

GARCH M model with additional regressor is used to study volatility and day-of-the-week effect because it considers day-of-the-week effect in the variance equation. This model includes variance which is appropriate measure of risk in conditional mean equation. ARCH-in-mean or GARCH-M model was originally proposed by Engle, Lilien and Robins (1987). This model is based on the assumption that return and risk go together; higher the risk, higher the return. If the volatility of the asset returns, which signifies risk, is time varying, the logical extension of 'risk-return tradeoff theory' suggests that during the period of high volatility, the asset return will be high as compared to period of low volatility.



Following is the equation used for GARCH M model:

Conditional mean equation:

$$R_t = \alpha_0 + \sum_{i=1}^n \alpha_i R_{t-1} + \alpha_2 R_{S\&P500-1} + \alpha_3 M + \alpha_4 T + \alpha_5 Th + \alpha_6 F + \lambda h_t^2 + \varepsilon_t$$

Conditional variance equation:

$$h_t^2 = \delta_0 + \delta_1 M + \delta_2 T + \delta_3 Th + \delta_4 F + \beta \varepsilon_{t-1}^2 + \gamma h_{t-1}^2$$

Where  $\lambda$  is a measure of the risk premium, as it is possible that the conditional variance, as proxy for the risk, can affect stock market returns. If  $\lambda$  is a positive, then the risk averse agents must be compensated to accept the higher risk. M, T, TH and F are the dummies of Monday, Tuesday, Thursday and Friday, respectively.  $\beta$  measure the effect of recent news on volatility. The sum of  $\beta$  and  $\gamma$  measures the persistence of volatility in the stock market.

## Findings and Discussion

As a step toward investigating whether introduction of option trading has changed the behaviour of stock market, descriptive statistic is computed for both pre-option and post-option period. Table 1 presents the result of descriptive statistic for both periods. Visual inspections of the results of descriptive statistic indicates that mean return has increased in post option period. The figures obtained for the standard deviation estimates, provide an initial view of volatility, where, by comparing the two periods (pre-option and post-option), it seems that volatility has decreased over time. Both the series exhibit skewness and excess kurtosis ( $>3$ ). The results of Jarque-Bera test reject the null hypothesis of normality.

Table 1  
Descriptive Statistic

Indices	Mean		Standard Deviation		Skewness		Kurtosis		Jarque Bera Test	
	Pre	Post	Pre	Post	Pre	Post	Pre	Post	Pre	Post
S&P CNX Nifty	9.81X10 <sup>-5</sup>	0.00067	0.01738	0.01675	0.03383	-0.28831	5.93971	11.681	550.1319	7670.513
									(0.0000)	(0.0000)
BSE Sensex	6.07 X10 <sup>-5</sup>	0.00069	0.01782	0.01665	-0.01704	-0.1116	5.00864	10.546	251.5663	5792.828
									(0.0000)	(0.0000)

*p values are reported in parentheses*

ADF test is applied at first log difference with intercept, trend and intercept and none. Table 2 presents the result of unit root test. The ADF test rejects the null hypothesis of unit root in both pre and post option period which implies that returns of both S&P CNX Nifty and BSE Sensex are stationary. Therefore, it can be inferred that both the series are integrated of order one, i.e., I (1).

Table 2  
ADF Test

Indices	Intercept		Intercept & Trend		None	
	Pre	Post	Pre	Post	Pre	Post
S&P CNX Nifty	-24.1039	-22.4035	-24.0959	-22.3989	-24.1119	-22.408
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
BSE Sensex	-23.61043	-22.35011	-23.6024	-22.3453	-23.6184	-22.3546
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)

*p values are reported in parentheses*

We need to check the heteroscedasticity of the series as least square method tends to be inefficient because of its assumption of homoscedasticity. In case of heteroscedasticity, GARCH family models are used. In order to check the heteroscedasticity, ARCH LM model is applied. The results of ARCH LM test are reported in table 3. ARCH LM test reject the null hypothesis of no arch effect for both the indices in pre and post option period. In summary, the return series of S&P CNX Nifty and BSE Sensex seem best described by an unconditional leptokurtic distribution and possesses significant conditional heteroscedasticity.

Table 3  
ARCH LM Test

Indices	F-statistic		Obs*R-squared	
	Pre	Post	Pre	Post
S&P CNX Nifty	8.627249	28.61933	74.33073	233.6868
	(0.0000)	(0.0000)	(0.0000)	(0.0000)
BSE Sensex	8.763809	30.87202	75.38049	250.2526
	(0.0000)	(0.0000)	(0.0000)	(0.0000)

*p values are reported in parentheses*

For a closer examination of pre-option and post-option conditional volatility, the GARCH M model is fitted to the data. Panel A of table 4 reports the results of mean equation. The coefficient of  $\alpha_1$  shows that relation of returns of S&P CNX Nifty and BSE Sensex with their lagged returns decreased significantly in post-option period. The value of  $\alpha_2$  indicates that the relation of lagged S&P 500 with the return of S&PCNX Nifty and BSE Sensex is insignificant in both pre and post-option period which implies that prices of S&P 500 can not be used for predicting stock prices of Indian stock market. The value of  $\alpha_3$ ,  $\alpha_4$  and  $\alpha_6$  shows that return of S&P CNX Nifty are significantly negative on Monday, Tuesday and Friday during pre option period. While the coefficient of  $\alpha_6$  shows significantly negative return on Friday for BSE Sensex during pre option period. During post-option period, there was no significant presence of day-of-the-week effect in returns of both the indices. The value of  $\lambda$  in mean equation is not statistically significant for any of the indices implying that the stock market doesn't provide higher returns during the high volatility period (both pre and post-option period).

Table 4  
GARCH M Model

Panel A				
Mean Equation				
Indices	S&P CNX Nifty		BSE Sensex	
	Pre	Post	Pre	Post
$\alpha_0$	0.002892	0.0007	0.002122	0.000916
	(0.0093)	(0.2541)	(0.1016)	(0.1356)
$\alpha_1$	0.11272	0.084964	0.120249	0.082294
	(0.0001)	(0.0005)	(0.0000)	(0.0004)
$\alpha_2$	-0.00451	-0.007152	0.046558	-0.009753
	(0.886)	(0.7748)	(0.238)	(0.6345)
$\alpha_3$	-0.00545	0.000407	0.000188	0.000644
	(0.0001)	(0.5986)	(0.9004)	(0.4182)
$\alpha_4$	-0.00253	0.00095	-0.002235	-0.000459
	(0.0374)	(0.2705)	(0.0868)	(0.5554)
$\alpha_5$	-0.00223	0.000325	-0.00193	0.000375
	(0.0568)	(0.6931)	(0.1373)	(0.6347)
$\alpha_6$	-0.00298	0.000307	-0.003717	0.000429
	(0.0296)	(0.7053)	(0.0055)	(0.5934)
$\lambda$	1.140388	0.752377	-0.531717	0.713153
	(0.7237)	(0.6519)	(0.8805)	(0.6799)
Panel B				
Variance Equation				
$\delta_0$	-1.96X10 <sup>-5</sup>	-1.77X10 <sup>-7</sup>	3.16 X10 <sup>-5</sup>	2.61 X10 <sup>-5</sup>
	(0.6424)	(0.9893)	(0.3601)	(0.0303)
$\delta_1$	-5.42X10 <sup>-6</sup>	6.05X10 <sup>-6</sup>	3.40 X10 <sup>-5</sup>	-8.04 X10 <sup>-6</sup>
	(0.9185)	(0.7457)	(0.5384)	(0.6473)
$\delta_2$	6.35 X10 <sup>-5</sup>	1.29 X10 <sup>-5</sup>	-5.12 X10 <sup>-5</sup>	-5.07 X10 <sup>-5</sup>
	(0.3742)	(0.5375)	(0.4639)	(0.1109)
$\delta_3$	6.02 X10 <sup>-5</sup>	3.95 X10 <sup>-6</sup>	-3.55 X10 <sup>-6</sup>	-2.22 X10 <sup>-5</sup>
	(0.2361)	(0.8563)	(0.942)	(0.30)
$\delta_4$	7.42 X10 <sup>-5</sup>	1.54 X10 <sup>-5</sup>	-2.85 X10 <sup>-5</sup>	-1.47 X10 <sup>-5</sup>
	(0.0951)	(0.3867)	(0.5518)	(0.3781)
$\beta$	0.108859	0.15217	0.103718	0.142497

	(0.007)	(0.0000)	(0.0002)	(0.0000)
$\gamma$	<b>0.833772</b>	<b>0.825706</b>	<b>0.827488</b>	<b>0.834298</b>
	(0.0000)	(0.0000)	(0.0000)	(0.0000)

*p values are reported in parentheses*

Panel B reports results of conditional variance equation. As per the results of panel B, there are no evidences of presence of day-of-the-week effect in variance equation of S&P CNX Nifty and BSE Sensex for both the period.  $\beta$  measures the effect of recent news on stock market volatility which has increased for both the indices in post-option period. The sum of  $\beta$  and  $\gamma$  measures the persistence of volatility in stock market which has increased for both the indices during post-option period. The option trading has higher impact on volatility of BSE as compared to NSE.

ARCH LM test is applied again to see whether there is any leftover arch effect in the series. Table 5 reports the result of ARCH LM test. ARCH LM test can not reject the null hypothesis of no hetroskedasticity for both the period. Result shows that series don't have any leftover arch effect.

Table 5  
ARCH LM Test

Indices	F-statistic		Obs*R-squared	
	Pre	Post	Pre	Post
S&P CNX Nifty	<b>0.799131</b>	<b>0.654865</b>	<b>7.205515</b>	<b>5.90379</b>
	(0.6171)	(0.7503)	(0.6157)	(0.7495)
BSE Sensex	<b>0.414272</b>	<b>0.828171</b>	<b>3.744248</b>	<b>7.46136</b>
	(0.9281)	(0.5901)	(0.9274)	(0.5892)

*p values are reported in parentheses*

## Conclusions

This article examines the impact of trading in the S&P CNX Nifty index option and BSE Sensex index option on the behaviour of Indian stock market. The distributional properties of the daily return series are first examined to determine whether the GARCH M model can characterize the return series. The GARCH M model appears to be an appropriate model for intraday return series. Parameters of conditional volatility of pre-option and post-option periods are estimated with the GARCH M model and compared to determine if the estimated parameters have, in aggregate, changed significantly after the introduction of option. The empirical results of GARCH M showed some evidences of day-of-the-week effect in S&P CNX Nifty (NSE) and BSE Sensex (BSE) during pre-option period. But these evidences of day-of-the-week effect disappeared after introduction of option trading. The result also indicates the increase in persistence of volatility during post-option period. The insignificant coefficient of variance in mean equation implies that investors will not get higher return during high volatility period.

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## DIFFERENCES BETWEEN MOROCCO AND SPAIN IN THE MEDIA THAT ORGANIZATIONS USE FOR PERSONNEL RECRUITMENT AND THE MEDIA THAT EMPLOYMENT SEEKERS USE TO FIND A JOB

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### Abstract

This paper reports on an explorative investigation into the differences between Morocco and Spain in the types of communication media that organizations use for personnel recruitment and that employment seekers use to find a job. Based on the Information Richness Theory of Daft and Lengel (1984), the Context Theory of Hall (1976), and the value, uncertainty avoidance, of Hofstede (2001), it is expected that the Moroccans use media with higher information richness than the Spanish.

To gain insight into the communication media that Moroccan and Spanish organizations use for personnel recruitment, interviews with comparable organizations in Morocco and Spain were held. Moroccan organizations do indeed more frequently use media high in richness such as professional societies, and Spanish organizations more often use media with a lower level of information richness such as newspapers.

To gain insight into the communication media employment seekers use to find employment, experiments were performed among 100 Moroccan and 95 Spanish respondents. The results did not corroborate the expectations. Although there were many differences between the countries in media job seekers use to find a job, these differences were not related to context and uncertainty avoidance.

Organizations should recognize that employment seekers from cultures other than their own might tend to use different types of communication media to find a job than employment seekers from their own culture do. Employment seekers, in turn, should realize that organizations from other cultures might use a number of other types of communication media to advertise their vacancies.

**Keywords:** International personnel recruitment, media choice in personnel recruitment, culture, job seekers, Morocco, Spain

### Introduction

Since the last half of the nineteenth century, the variety of communication media has increased enormously. Herlé and Rustema (2005, p.23) show that between 1800 and 1992 twelve new media were introduced; these include the telegraph, telephone, personal computers, and the Internet (www). After 1992, even more new media were introduced such as text messaging, videophone, Skype, Twitter.

In spite of the increasing number of possible ways to communicate, business cultures around the globe have not yet become standardised. From the literature, such as in Beamer and Varner (2008); Lane, Distefano, and Maznevski (2006); Saeed (2005); Samovar and Porter (2004); and Victor (1992), it appears that there are significant differences between cultures in the areas of business ethics, organization management, preferred leadership style, the aspects that motivate employees, business letters, annual reports, argumentation, and presentation and negotiation styles

An aspect that has not yet been formally studied is whether cultures also differ in their use of and preference for the different types of communication media such as face-to-face communication, telephone, e-mail, and letters that they regard as appropriate for different types of business communication. There is, although, anecdotal evidence that cultures actually differ in the communication media they prefer and use. The Swiss architects Herzog and de Meuron who built the Olympic stadium of Beijing, the Bird's Nest, said in an interview in August 2008 that they were extremely amazed that the commission to build this stadium, an order worth millions of dollars, had never been drawn up in writing. This nicely illustrates that cultures may differ in the communication media they regard as being appropriate for a particular usage; for instance, in Switzerland, a multi-million dollar order requires a written contract, but in China, an oral agreement is sufficient.

Anecdotal evidence is not the only basis for expecting that cultures might differ in the communication media they regard as appropriate for a certain message; it can also be expected on the basis of a combination of three theories: the Information Richness Theory of Daft and Lengel (1984), the Context Theory of Edward T. Hall (1976), and the value Uncertainty Avoidance of Geert Hofstede (2001). We will first discuss these theories and formulate on the basis of these theories expectations regarding differences between Morocco and Spain in the communication media that organizations use for personnel recruitment (senders' perspective) and that employment seekers use to find a job (receivers' perspective) (2).

In Section 3, we will deal with our study of the types of communication media that organizations use for personnel recruitment. Subsequently, we go into the method of research (3.1), the results (3.2), and our conclusion in light of the expectations.

In Section 4, we deal with the study of the communication media that employment seekers use to find a job. In sequence, we go into the method of our study (4.1), the results (4.2), and the conclusion in light of the expectations (4.3).

Section 5 tries to connect the results of both studies and discusses the striking observation that in neither Morocco nor Spain do organizations seeking personnel use the same communication media as the employment seekers do.



## **Media Choice and Cultural Values**

### **Information Richness Theory**

The Information Richness Theory makes a distinction between media that are high in richness, such as face-to-face-communication, and media that are low in richness, such as memos, reports, and tables. The extent of information richness is determined by the type of cues a medium passes on – verbal, non-verbal, vocal cues (intonation and loudness) for example), how easy it is to give feedback, and the extent to which the message can be tuned to the receiver. The more cues that can be passed on, the easier it is to give feedback, and the more the message can be tuned to the receiver, the higher the information richness of a communication medium (Daft and Lengel, 1984).

Daft and Lengel (1984) analysed managerial information behaviour in the United States with the help of the Information Richness Theory. Media high in richness are used to give information about complex organizational topics and to reduce ambiguity; whereas, media low in richness are used to communicate relatively simple, easy to understand messages. Webster and Trevino (1995) have tested the Information Richness Theory among managers in the United States, and the results of their study confirm those of Daft and Lengel (1984).

The information richness theory was developed in the United States and also tested among US managers. The question arises as to whether this theory also holds true for other cultures. On the basis of two other theories, we can expect that this is not the case: the context theory of Edward T. Hall and the value uncertainty avoidance of Geert Hofstede.

### **Context Theory**

According to the Context Theory (Hall, 1976), cultures differ in the extent to which they use context and situation for the interpretation of a message. In high-context cultures, most of the meaning of a message is deduced from the context in which the words occur; i.e. in non-verbal communication, and the setting of the communication. In low-context cultures, the meaning of a message is primarily deduced from the words. Low-context cultures communicate explicitly, high-context cultures implicitly. In Figure 1, a number of cultures are arranged in a decreasing order of context. Since the context of cultures has not yet been studied as systematically as, for example, the cultural values of Geert Hofstede (Cardon, 2008), the arrangement is mainly based on incidental observations. Although there is an urgent need to develop instruments to measure context and investigate the context of more cultures (Cardon 2008), there is also a collective feeling among culture specialists that the classification as presented in Figure 1 is true (Beamer and Varner, 2008; Victor, 1992).

High context	Asian cultures
	Arabic cultures
	African cultures
	Latin-American cultures
	Italian and Spanish cultures
	British cultures
	French cultures
	North-American cultures
	The Netherlands
	Scandinavian cultures
Low context	Germany
	Swiss-German

*Figure 1 Rough classification of high- and low-context cultures (From Victor 1992, p.160).*

Since high-context cultures rely on context and non-verbal communication for the interpretation of a message, we can expect that persons in high-context cultures prefer communication media such as face-to-face communication that allow them to use these aspects in order to interpret an utterance to media such as the newspaper that does not allow them to use these aspects. In contrast, persons from low-context cultures will have less preference for communication media that allow them to interpret non-verbal information.

If we combine the information richness theory with the context theory, we can expect that information media high in richness will be used more frequently in high context cultures, and that information media low in richness will be used more frequently in low context cultures.

### **Uncertainty Avoidance**

Uncertainty avoidance is one of the five cultural values that Geert Hofstede (2001, p.145-208) uses in order to categorize the cultures of the world. He defines uncertainty avoidance as follows: "Uncertainty Avoidance Index (UAI) deals with a society's tolerance for uncertainty and ambiguity. It indicates to what extent a culture programs its members to feel either uncomfortable or comfortable in unstructured situations. Unstructured situations are novel, unknown, surprising, and different from usual. Cultures that avoid uncertainty try to minimize the possibility of encountering such situations through imposing strict laws and rules, and safety and security measures. The opposite type, uncertainty accepting cultures, are more tolerant

of opinions that are different from what they are used to; they try to have as few rules as possible ...” (Hofstede’s home page at <http://www.geert-hofstede.com/>)

Cultures with high uncertainty avoidance have a much greater need for clarity, preclusion of ambiguity and uncertainty, and legislation. Cultures with low uncertainty avoidance have less need of these (Hofstede, 2001, p.146, 161, 174, & 180). One of the things that might help to meet the needs of persons with high uncertainty avoidance is communication. It is likely, though, that not all communication media will equally reassure them; media that communicates in such a way that nothing of the interpretation of the message can be left to chance will be preferred. If we combine the information richness theory with uncertainty avoidance, we can expect that information media high in richness will be used more effectively in cultures with low uncertainty avoidance than in cultures with high uncertainty avoidance, and that information media low in richness will be used more effectively in high uncertainty avoidance cultures.

### **Expectations**

On the basis of a combination of the Information Richness Theory of Daft and Lengel (1984), the Context Theory of Hall (1976), and the uncertainty avoidance value of Hofstede (2001), we can expect that cultures that differ in context and in uncertainty avoidance will also differ in the communication media they use and prefer. We will investigate whether this holds true in a study of the communication media that organizations use for personnel recruitment (senders’ perspective) and the communication media that employment seekers use (receivers’ perspective) in Morocco and Spain. In figure 1, we have seen that Spanish cultures have a lower context than African and Arabic cultures. Since the Moroccan culture is a mix of African and Arabic cultures, the Moroccan culture has a higher context than the Spanish culture. Morocco and Spain also differ in uncertainty avoidance: the uncertainty avoidance is higher in Spain than in Morocco. On a scale from zero to 100 where zero stands for very low uncertainty avoidance and 100 for very high uncertainty avoidance, Spain has a score of 86 (Hofstede 2001, p. 500); the score of Morocco is 68 (Estimate see <http://www.urbanministry.org/wiki/geert-hofstede-cultural-dimensions>) (Hofstede 2001, p. 500). These differences between Morocco and Spain in context and uncertainty avoidance lead to Expectation 1 from the senders’ perspective and to Expectation 2 from the receivers’ perspective.

**Expectation 1:** Due to the fact that Spain has a lower context and higher uncertainty avoidance than Morocco,

- a. Spanish organizations more often use communication media with low information richness than Moroccan organizations do.
- b. Moroccan organizations more often use communication media with high information richness than Spanish organizations do.

**Expectation 2:** Due to the fact that Spain has lower context and higher uncertainty avoidance than Morocco,

a. Spanish employment seekers more often use communication media with low information richness than Moroccan employment seekers do.

b. Moroccan employment seekers more often use communication media with high information richness than Spanish employment seekers do.

We will deal with Expectation 1 in Section 3 and with Expectation 2 in Section 4.3.

## **Communication Media Used for Personnel Recruitment in Morocco and Spain**

### **Method**

In order to gain insight into the communication media that organizations use for personnel recruitment, an explorative qualitative study was performed. We interviewed five organizations in Morocco and five comparable organizations in Spain (see Table 1, first column) regarding the communication media they used for the recruitment of university-educated HRM managers. We restricted our study to this type of function for two reasons: first, because it is plausible that type of function has an impact on the communication media used for recruitment; and second, we knew we were going to use university students studying to be HRM managers in the experiment that was used to answer Expectation 2 (see 4.1), and we wanted the study of the senders' perspective to be as similar as possible to the study of the receivers' perspective.

### **Results**

Table 1 shows the three communication media that each of the five organizations are said to use most often for the recruitment of university-educated HRM managers.

Table 1 The three communication media that Moroccan and Spanish organizations are said to use most often for the recruitment of university educated HRM managers

Type of organization	Morocco	Spain
Bank	Intranet, assessments, through family, friends, acquaintances	Website organization, job vacancy website, newspapers
Hospital	Unsolicited application, professional society/network, assessments	Website organization, job vacancy website, professional society
Telecommunication-organization	Intranet, employment agency, unsolicited application	Website organization, job vacancy website, newspapers
University	Intranet, newspapers, assessments	Boletín Oficial del Estado, the bulletin of acts of Spain (no other media!)
Call centre	Unsolicited application, through family, friends, acquaintances, job vacancy website	Website organization, job vacancy website, unsolicited application
Total	Through family, friends, acquaintances 2x Assessments 2x Unsolicited application 3x Professional society 1x Employment agency 1x Intranet 3x Website organization 1x Job vacancy websites 1x - Newspapers 1x	- - Unsolicited application 1x Professional society 1x - - Website organization 4x Job vacancy websites 4x Bulletin of acts 3x Newspapers 2x

In order to determine the information richness of the communication media mentioned, we followed Daft and Lengel (1984) and determined for each communication medium the type of cues a medium could pass on (verbal cues, non-verbal cues, vocal cues), whether or not it is easy to give feedback, and whether or not the message can be tuned to the receiver. The results of this analysis are presented in Table 2.

Table 2 Analysis of the information richness of the communication media mentioned by the organizations

Communication medium	Verbal cues	Non-verbal cues	Vocal cues	Feed-back	Tuned to receiver	Information richness
Through family, friends, acquaintances	+	+	+	+	+	5
Assessments	+	+	+	+	+	5
Professional society	+	+	+	+	+	5
Employment agency	+	+	+	+	+	5
Unsolicited application	+	+	+	+	+	5
Intranet	+	-	-	+	+	3
Website organization	+	-	-	+	+	3
Job vacancy website	+	-	-	-	+	2
Bulletin of acts	+	-	-	-	-	1
Newspaper	+	-	-	-	-	1

It is a matter of fact that this classification is anything but univocal. We stated, for example, that there are no *non-verbal cues* in the intranet, website organisation, job vacancy websites; however, aspects such as a logo, a picture, colour, lay-out, and emoticons that could, in principle, occur in these media are non-verbal cues. We did not differentiate the media on these non-verbal cues since we did not know whether the organizations used these cues in their job advertisements. Our analysis of the aspect *tuned to receiver* is neither unambiguous. The website of an organization can be considered to be tuned to the receiver since it may only attract the people who want to work for that organization. Job vacancy websites can also be regarded as tuned to the receiver since they are organized according to the jobs a person seeks. The question is whether a website of an organization is more tuned to the receiver than a job vacancy website is. As can be seen in Table 2, we did not differentiate the media for this aspect.

The last column of Table 2 gives an indication of the media richness of the communication media the organizations said they use most often for recruitment of university-educated HRM managers. If we calculate the richness of all the media used in Morocco (through family, friends, acquaintances ( $2 \times 5 = 10$ ), assessments ( $2 \times 5 = 10$ ), unsolicited application ( $3 \times 5 = 15$ ), professional society ( $1 \times 5 = 5$ ), employment agency ( $1 \times 5 = 5$ ), intranet ( $3 \times 3 = 9$ ), website organization ( $1 \times 3 = 3$ ), job vacancy websites ( $1 \times 3 = 3$ ), newspapers ( $1 \times 1 = 1$ )), we get an information richness score of 61; whereas, we get a score of 39 for Spain (unsolicited application ( $1 \times 5 = 5$ ), professional society ( $1 \times 5 = 5$ ), website organization ( $4 \times 3 = 12$ ), job vacancy website ( $4 \times 3 = 12$ )), newspapers ( $2 \times 1 = 2$ ), bulletin of acts ( $3 \times 1 = 3$ )).

## Conclusion and discussion

Our explorative qualitative study into media differences between Spanish and Moroccan organizations in the media they use for the recruitment of university-educated HRM managers suggests that Expectation 1 indeed holds true. Spanish organizations seem to use communication media with lower information richness

than Moroccan organizations do, and Moroccan organizations seem to use communication media with higher information richness than Spanish organizations do. It should be underlined, though, that this result is only based on a small survey. Besides, the method used to determine the information richness of the communication media is not univocal. More research is definitely needed.

### **Communication Media Moroccan and Spanish Employment Seekers Use to Find a Job**

In order to test which communication media Moroccan and Spanish employment seekers use to find a job as university-educated manager, experiments were performed. In 4.1, we deal with the methodology used; in 4.2, we report the results; and in 4.3, we discuss the results in light of the expectation 2.

#### **Method**

##### **Respondents**

Respondents for Morocco were 100 students of Management, Law or Economy studying at the Université Mohammed 5 in Rabat, the capital of Morocco. Respondents for Spain were 95 students studying Management or Economy at the Universitat de Barcelona; Barcelona is a large town in Spain. The mean age of the respondents was 22 (SD=3.3) for Morocco and 20 (SD=2.4) for Spain; all were about to finish their Bachelor's Degree studies. In Morocco, questionnaires were administered in French as French was the official language of the university where the experiment was held, and in Spain, in Spanish, the official language of Spain.

In order to measure whether the Spanish respondents indeed had a higher uncertainty avoidance than the Moroccan respondents (cf. 2.4), their uncertainty avoidance was measured with the validated measuring instrument of Hofstede (1994), the questions 13, 16, 18, and 19 of the VSM-survey. The data showed that the uncertainty avoidance level of the Spanish respondents was indeed higher than the uncertainty avoidance level of the Moroccan respondents. The difference is even more than expected on the basis of the surveys of Hofstede: 55. Context levels of the respondents were measured by means of the questionnaire of Gudykunst, Matsumoto, Ting-Toomey, Nishida, Kim and Heyman (1996). The difference in context between Morocco (M=2.24, SD=.56) and Spain (M= 2.35, SD=.48), where 5 stands for low context and 1 for high context, was not statistically significant. Our expectation based on the higher uncertainty avoidance levels of the Spanish respondents compared to the lower uncertainty avoidance levels of the Moroccan respondents was similar to the expectation based on the lower context levels of the Spanish respondents compared to the higher context levels of the Moroccan respondents. Because of this, we can still expect that due to the fact that our Spanish respondents have a higher uncertainty avoidance level than our Moroccan respondents a) Spanish employment seekers will more often use communication media with a low information richness than Moroccan employment seekers do, and b) Moroccan employment seekers will more often use communication media with a high information richness than Spanish employment seekers do.

### Materials and measuring instruments

Respondents were presented with the following case: Imagine you have finished your studies and you are now looking for a job that fits in with your studies. In order to find such a job you will use different communication media such as newspapers, Internet, and so on. In the table below you will find a list of communication media that you could use in order to find this job. Please indicate for each of the communication media whether or not you will use it to find a suitable job?

The list contained the communication media mentioned in Table 3. The choice of media in the list was mainly based on the communication media mentioned by the organizations in the first part of the study (see Table 1) and communication media were added that could be used in our view. Table 3 shows the information richness of all the media, based on the same principles as in 3.2 ... and with the same weaknesses.

*Table 3 Communication media presented to the respondents and their information richness*

<i>Communication medium</i>	<i>Verbal cues</i>	<i>Nonverbal cues</i>	<i>Vocal cues</i>	<i>Feed back</i>	<i>Tuned to receiver</i>	<i>Information richness</i>
<i>Through family, friends, acquaintances</i>	+	+	+	+	+	5
<i>Professional society</i>	+	+	+	+	+	5
<i>Employment agency</i>	+	+	+	+	+	5
<i>Social network</i>	+	-	-	+	+	3
<i>Intranet</i>	+	-	-	+	+	3
<i>Website organization</i>	+	-	-	+	+	3
<i>Job vacancy website</i>	+	-	-	-	+	2
<i>Professional journal</i>	+	-	-	-	+	2
<i>Regional newspaper</i>	+	-	-	-	-	1
<i>National newspaper</i>	+	-	-	-	-	1

After the respondents indicated which communication media they thought to use, they had to indicate which three media they preferred.

### Procedure and statistical tests

The questionnaire was handed out in classrooms or at workspaces in corridors of universities. The respondents completed the questionnaires individually in the presence of one of the researchers. The data for Morocco was gathered by Islah Boukhira and for Spain by Lola Nouwens and Malouke Reiniers.

Chi-square tests were used to determine whether there were statistically significant differences between the countries regarding their use of a communication medium, and regarding their preference for a communication medium. The criterion used for statistical significance was .05 for all tests.



## Results

Table 4 shows for each of the communication media presented to the respondents (see Table 3) how many Moroccan and how many Spanish respondents said to use that medium in order to find a job as a university-educated manager. Besides the summarized data for communication media with the same information richness is presented.

*Table 4 Communication media used to find a job as a university-educated manager*

<i>Communication medium</i>	<i>Information richness</i>	<i>Morocco N=100</i>	<i>Spain N=95</i>	<i>Significant difference Morocco versus Spain according to <math>\chi^2</math></i>
<i>Through family, friends, acquaintances</i>	5	71 72%	94 99%	$\chi^2 (1) = 27.31, p = .000$
<i>Professional society</i>	5	48 49%	20 24%	$\chi^2 (1) = 16.03, p = .000$
<i>Employment agency</i>	5	39 39%	76 80%	$\chi^2 (1) = 33.85, p = .000$
<i>Total Information richness 5</i>	5	158 53%	190 63%	NS
<i>Social network</i>	3	48 48%	20 21%	$\chi^2 (1) = 16.03, p = .000$
<i>Website organization</i>	3	77 77%	86 90%	$\chi^2 (1) = 6.50, p = .011$
<i>Total Information richness 3</i>	3	125 62%	106 55%	NS
<i>Job vacancy website</i>	2	86 86%	87 92%	NS
<i>Professional journal</i>	2	62 63%	53 57%	NS
<i>Total Information richness 2</i>	2	148 74%	140 74%	NS
<i>Regional newspaper</i>	1	46 46%	59 62%	$\chi^2 (1) = 5.08, p = .024$
<i>National newspaper</i>	1	67 68%	58 61%	NS
<i>Total Information richness 1</i>	1	113 57%	117 61%	NS

First of all we see that there are not any significant differences between Morocco and Spain for the summarized data for media with the same information richness: media with information richness 5, 3, 2 and 1 are said to be used to the same extent by the Moroccan and Spanish respondents. There are, however, significant differences between the countries in use of the communication media separately. Regarding the

three media with an information richness of 5 - a very high information richness - the professional society is used more often by the Moroccan respondents than by the Spanish respondents. The other two media with a richness of 5 are used more often by the Spanish respondents. One of the two media with a medium information richness (3), the social network is used more often by the Moroccan respondents than by the Spanish respondents, but the other medium with a medium information richness, website organisation, is used more often by the Spanish respondents than by the Moroccan respondents. One of the media with a very low richness (1), regional newspaper, is used more often by the Spanish respondents than by the Moroccan respondents.

Table 5 shows how often the Moroccan and the Spanish respondents mentioned a communication medium in response to the question, "Which three communication media do you have a preference for."

Table 5 Communication media preferred in seeking a job as a university-educated manager

Communication medium	Information richness	Morocco N=100	Spain N=95	Significant difference Morocco versus Spain, according to $\chi^2$
Through family, friends, acquaintances	5	46 20%	49 18%	NS
Professional society	5	23 10%	9 3%	$\chi^2(1) = 7.70, p = .000$
Employment agency	5	7 3%	52 19%	$\chi^2(1) = 34.94, p = .000$
Total Information richness 5	5	76 34%	110 40%	$\chi^2(1) = 6.04, p = .014$
Social network	3	6 3%	1 0,4%	$\chi^2$ could not be performed due to cell < 5
Website organization	3	22 10%	23 8%	NS
Total Information richness 3	3	28 12%	24 9%	NS
Job vacancy website	2	43 19%	27 10%	$\chi^2(1) = 5.17, p = .002$
Professional journal	2	15 6%	17 6%	NS
Total Information richness 2	2	58 26%	44 16%	$\chi^2(1) = 3.86, p = .049$
Regional newspaper	1	12 5%	18 6%	NS
National newspaper	1	41 18%	27 10%	$\chi^2(1) = 4.63, p = .031$
Internet (for example Google)	1	41 18%	53 19%	NS
Total Information richness 1	1	94 42%	98 35%	NS
Total number of media mentioned		226	276	

Table 5 shows a number of statistical significant differences between Morocco and Spain in media preference. Regarding the media with a high information richness (5), the Moroccan respondents prefer the professional society significantly more than the Spanish respondents do, but the Spanish respondents prefer the employment agency more than the Moroccan respondents and overall the Spanish respondents have a higher preference for media with a high information richness (5) than the Moroccan respondents. There are no significant differences between the countries in preference for media with information richness 3, but there are for media with information richness 2. The Moroccan respondents do not only prefer job vacancy websites more than Spanish respondents do, but they also have a higher preference for all media with

information richness 2 than the Spanish respondents have. With regard to media with a very low information richness (1), the Moroccan respondents do prefer the national newspaper more than the Spanish respondents do.

### Conclusion and discussion

Our experiment with 100 Moroccan respondents and 95 Spanish respondents has shown that there are differences between these cultures indeed in use of and preference for communication media in order to find a job as a university-educated manager. Table 6 gives an overview of all the significant differences found.

Table 6 Summary of significant differences in use of and preference for a communication medium in seeking a job as university-educated manager (results in line with expectation are underlined)

Communication medium	Information richness	Use of medium	Preference for medium
Through family, friends, acquaintances	5	Spain > Morocco	NS
Professional society	5	<u>Morocco &gt; Spain</u>	<u>Morocco &gt; Spain</u>
Employment agency	5	Spain > Morocco	Spain > Morocco
Total Information richness 5	5	NS	Spain > Morocco
Social network	3	<u>Morocco &gt; Spain</u>	-
Website organization	3	Spain > Morocco	NS
Total Information richness 3	3	NS	NS
Job vacancy website	2	NS	Morocco > Spain
Professional journal	2	NS	NS
Total Information richness 2	2	NS	Morocco > Spain
Regional newspaper	1	<u>Spain &gt; Morocco</u>	NS
National newspaper	1	NS	Morocco > Spain
Internet (f.ex. Google)	1	-	NS
Total Information richness 1	1	NS	NS

Results that corroborate expectation 2 are underlined. It is clear that only 4 out of 12 significant results are in line with our expectations. Expectation 2a (Spanish employment seekers more often use communication media with low information richness than Moroccan employment seekers do), is only corroborated for the use of regional newspapers (information richness 1), this medium is used more often by the Spanish respondents than by the Moroccan respondents (see Table 4). Expectation 2b (Moroccan employment seekers more often use communication media with high information richness than Spanish employment seekers do), is corroborated for three media: the professional society (information richness 5) and the social network (information richness 3) are used more often by the Moroccan respondents than by the Spanish respondents (see Table 4) and the Moroccan respondents show a higher preference for the use of a professional society (information richness 5) in order to find a job than the Spanish respondents do (Table 5).

Two thirds of the significant results are not at all inline with our expectations on the basis of the differences in context and uncertainty avoidance between Morocco and Spain. Contrary to expectation 2a Spanish respondents more often than Moroccan respondents used family, friends, acquaintances (information richness 5), employment agencies (information richness 5) and website of organizations (information richness 3) in order to find a job (see Table 4) and the Spanish respondents preferred the employment agency (information richness 5) more than the Moroccans and they also had an overall preference for media with information richness 5 than the Moroccans (Table 5). Contrary to expectation 2b Moroccan respondents had a higher preference than Spanish respondents for job vacancy websites (information richness 2), all media with information richness 2 and newspapers (information richness 1) (see Table 5).

The results of our experiment show that culture has impact on the media that job seekers use to find a job, but it is still unclear which aspects play a role in this choice. Cultural factors such as context and uncertainty avoidance definitely do not have the impact that we expected, since our expectations are anything but corroborated. Further research is needed to gain insight into the factors that determine why Moroccan and Spanish job seekers differ in the media they use in order to find a job.

### **The Impact of Culture on Media Choice and Practical Implications**

The two studies reported on in this article reveal similarities and differences between Morocco and Spain in media choice for both personnel recruitment (section 3) and seeking employment (section 4). Moroccan and Spanish organizations use a number of similar media for personnel recruitment: website of the organization, job vacancy websites and newspapers are for example used in both countries, although not to the same extent (Table 1). The differences between the countries in media choice for personnel recruitment suggest that context and uncertainty avoidance indeed have impact on this choice. The Spanish organizations more often used communication media with low information richness than the Moroccan organizations did and the Moroccan organizations more often used communication media with high information richness than the Spanish organizations did.

Regarding the media job seekers use to find a job Moroccan and Spanish job seekers use a number of similar media: in both countries family, friends, acquaintances, websites of organizations, job vacancy websites and newspapers are very frequently used, although not to the same extent. The many differences between Morocco and Spain in media job seekers use to find a job are –surprisingly- not in line with what we expected on the basis of context and uncertainty avoidance (Table 4 and 5). Apparently other factors play a role in the media choice of job seekers. Which factors that are calls for further research.

The results of our study have some practical implications. A first interesting result is that there is no complete fit between the media organizations use for recruitment and the media job seekers use. The employment agency and professional journal is for example often used by the Spanish respondents (Table 4), but never mentioned by the Spanish organizations (Table 1). The Moroccan respondents say to use often the website of an organization, a job vacancy website, newspapers (Table 4), but these media are hardly

mentioned by the Moroccan organizations. Organizations could improve their personnel recruitment by fine-tuning the media they use for recruitment to the media job seekers employ.

Organizations that want to recruit employees from other cultures should realize that employment seekers from other cultures might use different communication media to find a job than employment seekers from their own culture do. Ideally they should adapt their communication media to their target group.

Finally, employment seekers should realize that organizations in another culture may use different communication media to advertise a vacancy than organizations in their own culture do.

\* This article is partly based on the Bachelor's theses International Business Communication, of Islah Boukhira, Malouke Reiniers and Lola Nouwens which were written under the supervision of the author.

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## PREDICTING GREEK INTERNET USERS' INTENTIONS TO USE ONLINE SHOPPING: EMPIRICAL EVIDENCE USING AN EXTENDED TECHNOLOGY ACCEPTANCE MODEL

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### Abstract

This study develops and validates an extended model to predict internet users' intentions to buy online using a Business-to-Consumer (B2C) e-commerce platform, based on the Technology Acceptance Model (TAM). TAM has been introduced and applied as a reliable and robust model for predicting users' adoption determinants of different technologies. However, researchers usually integrate additional constructs to the original model in order to improve its predictive power. Hence, in the proposed model, in addition to ease of use and usefulness, compatibility with the technology, an element of Innovation Diffusion Theory (IDT), and perceived risk are also proposed to be considered as determinants of customers' attitudes and intentions toward on-line shopping acceptance. The model was validated using data collected from 931 internet users and analyzed using Partial Least Squares Path Modeling technique (PLS-PM). The results provided substantial support for all the proposed hypotheses and showed the significance of the extended constructs. The implications of the results to both researchers and practitioners are discussed at the end of the paper.

**Keywords:** E-commerce in Greece, Adoption intentions, Technology acceptance model, Innovation diffusion, Perceived risk

### Introduction

Following the advancements of information and communication technologies (ICTs), new modes of shopping have been emerged in recent years. A new channel for Business-to-Consumer (B2C) transactions is e-commerce which helps organizations to reduce costs, expand their businesses to national and international markets, achieve high rates in sales growth, and introduce effective pull-type supply chain management to reduce inventories and overheads. For consumers the advantages of e-commerce include saving of time, better prices, more product choices, faster order processing, availability of goods 24 hours a day, 365 days / year, from almost any location, quicker delivery of digital products, experience by receiving a wealth of product information etc. (Vijayarathy, 2004; Turban and King, 2003).

Despite the rapid growth of the B2C e-commerce over the past few years, the rate of e-commerce adoption varies from country to country, because of differences in personal characteristics of the consumers, different cultures, different legal framework and different technical infrastructure (Barbonis and Laspita, 2005). In Greece, online shopping has emerged recently. A recent national survey carried-out by Focus BARI (2008),

reported that internet penetration in Greece is 42%. 23% of internet users have purchased products from online stores and their population size was estimated to be around 700.000 people. Despite the fact that 37% of internet users in Greece are heavy users (more than 30 hours per week), however, around three out of four internet users have denied using online shopping so far. Based on these figures, Greece is among the European countries with the lowest levels of e-commerce penetration. While e-commerce has become an important issue powered by the growth of the internet, there are limited empirical studies in Greece exploring consumer behavior in the online shopping channel (Kardaras and Papathanasiou, 2000; Karayanni 2003; Maditinos et al., 2010; Saprikis et al., 2010). Most of these research efforts are exploratory in nature or their results cannot represent the e-commerce situation in Greece due to sampling limitations, so as they are not able to provide a clear strategy for the development of e-commerce in Greece. Thus, in order to obtain a more accurate picture of Greek online shopping development in the years to come, it is of great importance to understand the reasons of internet users' denial to buy online, and what is required from them to start thinking about e-commerce alternative.

There are a lot of studies providing insights into the reasons leading to e-commerce adoption. Among the most widely accepted approaches are Technology Acceptance Model (TAM) (Davies, 1989) and Innovation Diffusion Theory (IDT) (Rogers, 1995). TAM is particularly attractive for its parsimony and its good predictive performance in a variety of IT adoption contexts, particularly in a work-setting. However, for the adoption and use of online shopping, other relevant factors besides perceived usefulness and perceived ease of use should be considered in order to come up with a more powerful model toward explaining customer's intentions to buy online. A very promising approach is the combination of TAM with IDT and customers' perception about risks incurred by e-commerce systems' usage, in order to explain customers' decision mechanism toward acceptance or rejection of the new technology. Similar approaches have already been used in the contexts of e-commerce, mobile commerce/payment, and broadband acceptance (Agarwal and Karahana, 1998; Vijayasarathy, 2004; Chen et al., 2002; Tan and Teo, 2000; Wu and Wang, 2005; Chen, 2008; Oh et al., 2003).

Drawing on the above perspectives, this study is based on the Theory of Perceived Risk (TPR), the Innovation Diffusion Theory and the Technology Acceptance Model (TAM) to discuss the relationships between consumers' beliefs about e-commerce, including its usefulness, ease of use, compatibility and risk, their attitudes toward online shopping, and finally their intentions to buy online.

The rest of the paper is set out as follows. The next section presents the previous literature and sets out the hypotheses of this study. These are followed by the methodology of this study. Then, the paper presents the results of the empirical study in achieving the goals set above. Discussion and conclusions are provided in the last section.



## Literature Review and Research Hypotheses

The combination of TAM with IDT is explained in the subsequent sections, and the most important relevant research efforts conducted in the field of e-commerce are analyzed. Then the nature of perceived risk and its influence on on-line shopping adoption are examined. Finally, based on the literature review, the respective research hypotheses are presented.

### Technology acceptance model (TAM)

The Theory of Reasoned Action (TRA), proposed by Ajzen and Fishbein (1980), is a well-established model that has been proven successful in predicting behavior across different contexts. Davis (1986) has used TRA to develop TAM for predicting IT usage. According to Davis et al. (1989), while TRA can be used to explain virtually any human behavior, TAM is mainly used to provide an explanation of the relationships between the computer acceptance determinants across a broad range of end-user computing technologies. According to TAM, a person's belief determines his/her Attitude toward things. An Attitude is a kind of perceived behavioral control, and its enhancement will influence positively Behavioral Intentions and result in actual behavior. The original TAM suggests that two beliefs – Perceived Usefulness (PU) and Perceived Ease of Use (PEOU) – are instrumental in explaining the variance of customer's Attitude (ATT), then PU along with customer's ATT determine customer's Behavioral Intentions (BI). PU is defined as the degree to which a person believes that using a particular system would enhance his/her performance, while PEOU is defined as the degree to which a person believes that using a particular system would be free of effort. Furthermore, PEOU is also hypothesized to be a predictor of PU (Venkatesh and Davis, 2000). These two factors can be easily understood by system developers and can be taken into account during system's requirement analysis and other system's development stages.

TAM is one of the most accepted theories aiming to predict and explain new information technologies acceptance and use (Lee, Kozar, and Larsen, 2003). With regards to e-commerce adoption, TAM was used to predict on-line shopping acceptance either from a general perspective (Teo et al. 1999, Salisbury et al. 2001, Park et al. 2004, Shih 2004) or from a specific perspective by analyzing the usage of a specific virtual store (Gefen and Straub 2000, Chen et al. 2002, Gefen 2003). Therefore, using TAM as the basis for studying consumer intention to buy online is a highly valid approach.

### Innovation Diffusion Theory (IDT)

IDT has been extensively used in IT and IS research framework (Karahanna *et al.*, 1999). IDT was proposed by Rogers in 1962 to explain how an innovation is accepted and diffused within a social system (Rogers, 1995). According to IDT, innovation adoption or rejection begins with consumer awareness of the innovation, and diffusion is a process through which an innovation is communicated via certain channels over time among members of a social system. IDT has been widely applied in predicting IT adoption behavior. It suggests a set of five innovation attributes to explain the rates of adoption by users. More specifically, Rogers (1995) postulated that an innovation is more likely to succeed and be more readily

adopted if its relative advantage, as a consequence of its introduction, is evident; if it is compatible with the potential customers' past experiences, beliefs and the way they are accustomed to work; if it is easy to understand and use; and if it is trialable and observable prior to adoption.

However, previous studies including the meta-analysis of 75 diffusion papers conducted by Tornatzky and Klein (1982), found that only relative advantage, compatibility and complexity were consistently related to innovation adoption. For this reason, only these three attributes can be used in predicting and explaining customers' behavioral intentions to buy online.

### **Relationship between TAM and IDT**

Although originated from different disciplines, there is a complementary relationship between TAM and IDT. Moore and Benbasat (1991) found that the relative advantage construct is similar to PU, and the complexity construct is similar to PEOU. This suggests that TAM and IDT reconfirm each other's findings, which enhance the confidence in the validity and reliability of these approaches (Chen *et al.*, 2002). Thus, the only important innovation characteristic that is not included in TAM reasoning is Compatibility. Compatibility is evaluated by assessing the innovation's compatibility with existing values and beliefs, previously introduced ideas and potential adopters' needs (Rogers, 1995). Chen *et al.*, (2002) and Vijayasarathy (2004) combined the original TAM with the Compatibility construct of IDT to explain customer's Attitude about online shopping systems. Moreover, Chen *et al.*, (2002) found a relation between Compatibility and PU, a result which was also determined by Moore and Benbasat (1991).

### **Perceived risk and its influence on online shopping decision**

From their very beginning, consumer behavior studies have considered and analyzed the role of risk in customer's buying decision process (Bauer, 1960; Cunningham, 1967). As risk cannot be measured objectively, the majority of these efforts have considered perceived risk (PR) which is defined as "*the consumer's subjective belief of suffering a loss in pursuit of a desired outcome*" (Pavlou, 2003). Gatignon and Robertson (1985) identify that uncertainty in an innovation is a direct determinant of acceptance. On the other side, consumer behavior theory argues that uncertainty and perceived risk are equivalent concepts and can be used indistinctly (Peter and Ryan, 1976; Stone and Gronhaug, 1993; Crespo *et al.*, 2009). In the context of e-commerce, perceived risk influence has been analyzed from very different theoretical approaches. Several authors have noticed that perceived risk in e-commerce context has a negative effect on online shopping behavior (Park, Lee and Ahn, 2004), intention to adopt e-commerce (Salisbury *et al.* 2001; Featherman and Pavlou, 2003; Pavlou 2003; Crespo and del Bosque, 2008), attitude toward usage behavior (Shih 2004; Vijayasarathy; 2004) and perceived usefulness of the system (Shih, 2004). The current study is using the above framework in order to determine consumer's perceived risk beliefs about e-commerce and its impact on adoption decision process.

### Proposed model and research hypotheses

The proposed research model illustrated in Fig. 1 adopts TAM belief-attitude-intention behavior relationships.

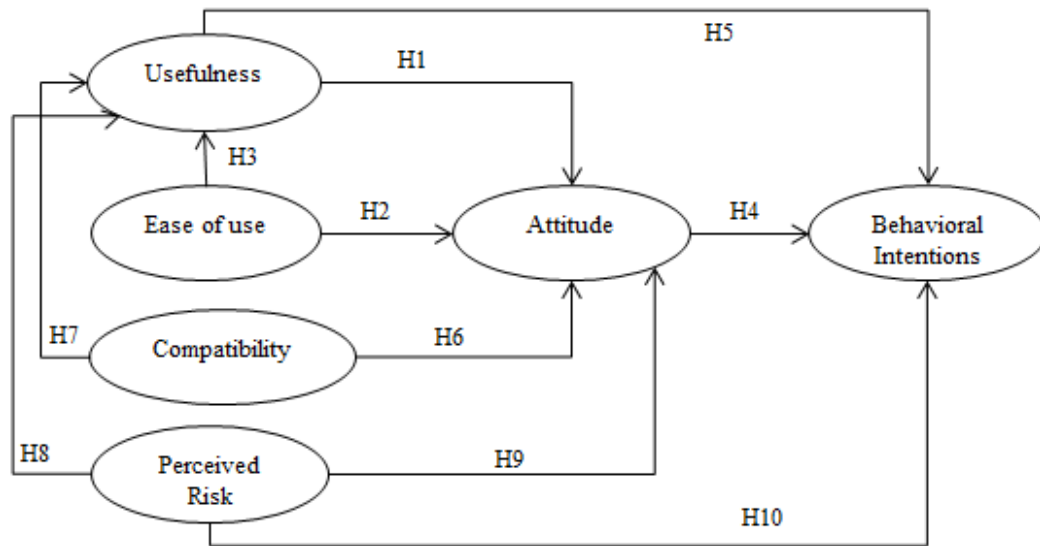


Fig. 1: E-commerce Adoption Model

These relationships can be stated in the following hypotheses.

**H1.** There is a positive relation between consumers' attitude toward online shopping and their beliefs about its usefulness

**H2.** There is a positive relation between consumers' attitude toward online shopping and their beliefs about its ease of use

**H3.** There is a positive relation between customers' beliefs about online shopping usefulness and their beliefs about its ease of use

**H4.** There is a positive relation between consumers' intention to use online shopping and their attitude toward it

**H5.** There is a positive relation between consumers' intention to use online shopping and their beliefs about its usefulness

**H6.** There is a positive relation between consumers' attitude toward online shopping and their beliefs about its compatibility

**H7.** There is a positive relation between consumers' beliefs about online shopping usefulness and its

compatibility

**H8.** There is a negative relation between consumers' attitude toward online shopping and their beliefs about its risk

**H9.** There is a negative relation between consumers' intention to use online shopping and their beliefs about its risk

**H10.** There is a negative relation between consumers' beliefs about online shopping usefulness and their beliefs about its risk

## Research Methodology

In order to empirically validate the proposed e-commerce adoption model and the hypotheses previously stated, a cross sectional survey aimed at internet users in Greece, aged 18+, without previous online transactions was used.

### Questionnaire structure and measurement scales

A questionnaire was employed to collect data from Greek internet users without previous experience in online shopping. Likert scales (1–7), with anchors ranging from “strongly disagree” to “strongly agree” were used for all belief items to ensure statistical variability among survey responses for all items measured. The items of the questionnaire were adapted from existing and well tested scales offered by the extant literature. In particular, the scales for measuring perceived ease of use, perceived usefulness, attitude and behavioral intentions were adapted from the original TAM instrument (Davis, 1989; Davis *et al.*, 1989; Taylor and Todd, 1995) and subsequent applications of TAM to e-commerce and other technology acceptance studies (Taylor and Todd, 1995; del Bosque and Crespo, 2010; Vijayasarathy, 2004). The measurement items for perceived risk were adapted from the studies of Featherman and Pavlou (2003) and Crespo and del Bosque (2008). The measurement items for compatibility were adapted from the studies of Moore and Benbasat (1991) and Taylor and Todd (1995). In order to maintain the technical and conceptual equivalence of these instruments, a translation and back-translation strategy was applied during the development of the Greek version of the questionnaire. Two bilinguals translated the measures, originally written in English, into Greek, and then another two bilinguals translated the Greek-written measures back in English again. A third person was used to compare both the original and the back-translated versions of the survey instruments and highlight any discrepancies in meanings. After the review process, these five persons had a meeting to discuss and resolve the problems found during the review process. These problems were resolved along with the correction of some syntax errors. The former version of the questionnaire was given to three experts from the e-commerce industry to evaluate the preliminary design of the survey instruments. Based on their comments and suggestions, some of the wording and format of the questionnaire were modified to enhance its readability. Finally, a factor analysis was performed on the data collected from the pilot study. The results were satisfactory, given that the five expected factors corresponding to the five intended constructs clearly

emerged and all factors' Cronbach's alpha values were well above the commonly accepted threshold value of 0.70.

### Data collection and sample profile

As Tan and Teo (2000) state, web-based surveys are appropriate when the target is internet users and a short time frame for responses is required. Thus, this study was carried out through an online survey aimed at internet users of age 18+ in Greece without online shopping experience. An online questionnaire was posted on the Internet using Google docs facilities. To reach participants a "snowball" data collection technique was used. In order to guarantee the representativeness of the sample, quota stratification was employed taking as a basis the Greek internet users' profile resulted from the annual research conducted by Focus BARI during 2008. The sample was defined in accordance with two demographic criteria: gender and age. 100 appropriately trained university students were used to approach 10 individuals each, satisfying the quota strata determined above, and asked them to participate in the online survey. The data were collected during June and July 2010.

The research work obtained 955 responses of which 24 were eliminated because they were incomplete. Table 1 provides the socio-demographic profile of internet users in Greece (Focus BARI, 2008) and those of the obtained final sample. As for gender and age, which are the items used for quota stratifications, the sample obtained in the present study and the population of internet users is very similar. However, certain differences are observed in the other two characteristics. More specifically, the percentage of university graduates in the sample is bigger than those in the population of internet users, while the percentage of employed participants in the sample is lower than those in the population of internet users.

<i>Variable</i>	<i>Population (%)</i>	<i>Sample (%)</i>
<i>Gender</i>		
Male	58.5	57.4
Female	41.5	42.6
<i>Age</i>		
18-24	27.4	26.5
25-34	32.6	31.4
35-44	21.7	22.3
45-54	12.7	13.9
55+	5.4	5.9
<i>Education Level</i>		
Primary	19.3	21.6
Secondary	22.2	28.2
College/University	58.5	50.0
<i>Occupation</i>		
Employed	60.6	68.4
Unemployed	39.4	31.6

*Table 1: Sample and population profile*

## Data Analysis and Results

The method of Partial Least Squares (PLS) analysis (Gefen *et al.*, 2000), an implementation of Structural Equation Modeling (SEM), was applied to test the measurement model, to determine the internal consistency, reliability and construct validity of the multiple-item scales used to operationalize the study variables. PLS is a multivariate technique that helps in constructs' testing of the psychometric properties of the scales used to estimate the parameters of the structural model (Fornell, 1987).

The sample size of 931 respondents considered to be adequate for PLS implementation. In general, the most complex regression in PLS implementation will involve either the indicators of the most complex formative construct or the largest number of antecedent constructs leading to an endogenous construct. Based on Barclay *et al.* (1995), sample size requirements should be at least ten times the number of predictors from either of the above rules, whichever is greater. In our case, since there are no formative constructs, the larger number of antecedent constructs leading to an endogenous construct is five and the minimum sample size based on the above rule is forty cases.

The data analysis employed a two-phase approach suggested by Anderson and Gerbing (1988) in order to assess the reliability and validity of the measures before using them in the research model. The first phase includes the analysis of the measurement model, while the second phase examines the structural relationships among latent constructs.

### Validation of the measurement scale

The test of the measurement model involves the estimation of internal consistency, reliability, as well as the convergent and discriminant validity of the study constructs, which indicates the strength measures used to test the proposed model (Fornell, 1987). As shown in Table 2, all reliability measures are well above the recommended level of 0.70 as an indicator for adequate internal consistency (Gefen *et al.*, 2000).

The latent constructs also show adequate convergent and discriminate validity. Based on Fornell and Larcker (1981), convergent validity is adequate when constructs present an average variance extracted (AVE) which is greater or equal to 0.5. Convergent validity can also be verified when items loading on their associated factors are well above 0.5, which is true in our case (Gefen *et al.*, 2000).

<i>Factors</i>	<i>Items</i>	<i>Mean</i>	<i>Std. dev.</i>	<i>Loading</i>	<i>CR</i>	<i>Reliability</i>	<i>Cronbach's Alpha</i>	<i>AVE</i>
<i>PU</i>	<i>PU1</i>	5.328	1.323	0.868	94.614	0.896	0.845	0.683
	<i>PU2</i>	5.618	1.308	0.795	48.415			
	<i>PU3</i>	5.403	1.451	0.796	49.759			
	<i>PU4</i>	5.040	1.393	0.844	73.514			
<i>PEOU</i>	<i>PEOU1</i>	6.062	1.182	0.833	51.451	0.858	0.779	0.599
	<i>PEOU2</i>	5.856	1.298	0.867	87.120			
	<i>PEOU3</i>	5.332	1.394	0.651	21.416			
	<i>PEOU4</i>	5.475	1.240	0.727	27.249			
<i>COMP</i>	<i>COMP1</i>	4.303	1.650	0.863	88.072	0.919	0.882	0.739
	<i>COMP2</i>	4.566	1.577	0.876	92.812			
	<i>COMP3</i>	5.091	1.428	0.842	73.802			
	<i>COMP4</i>	4.896	1.645	0.858	89.366			
<i>RISK</i>	<i>PRISK1</i>	3.102	1.798	0.892	96.568	0.907	0.846	0.765
	<i>PRISK2</i>	3.352	1.864	0.914	126.531			
	<i>PRISK3</i>	3.991	1.875	0.814	51.996			
<i>ATT</i>	<i>ATT1</i>	5.248	1.532	0.891	123.055	0.939	0.913	0.792
	<i>ATT2</i>	5.794	1.302	0.885	71.555			
	<i>ATT3</i>	5.656	1.359	0.915	108.920			
	<i>ATT4</i>	5.604	1.427	0.870	61.033			
<i>BI</i>	<i>BI1</i>	5.709	1.595	0.939	137.091	0.968	0.955	0.882
	<i>BI2</i>	5.736	1.609	0.930	124.391			
	<i>BI4</i>	5.485	1.725	0.942	164.603			
	<i>BI5</i>	5.535	1.672	0.945	171.735			

*Table 2: Psychometric Properties of the Constructs*

In order to test for discriminate validity, a matrix of loadings and cross-loadings was constructed (see Table 3). By using this matrix, the loadings of an item with its associated factor (or construct) to its cross-loadings were compared. All items had higher loadings with their corresponding factors in comparison to their cross-loadings. Therefore, it was concluded that there is enough confidence in the discriminate validity of the measures and their corresponding constructs (Chin, 1998).

Table 4 illustrates the discriminant validity of the constructs, with correlation among constructs and the square root of AVE on the diagonal. All values on the diagonal were greater than those in corresponding rows meaning that all measurement variables load more highly on their own constructs than on the other constructs (Fornell and Larcker, 1981).

Thus, it was concluded that online shopping adoption is explained sufficiently by the revealed latent variables' structure (convergent validity), and this structure includes all unique manifest variables (discriminant validity).

<i>Items</i>	<i>RISK</i>	<i>PU</i>	<i>PEOU</i>	<i>BI</i>	<i>COMP</i>	<i>ATT</i>
<i>PU1</i>	-0.387	0.868	0.408	0.458	0.553	0.549
<i>PU2</i>	-0.319	0.795	0.349	0.407	0.465	0.464
<i>PU3</i>	-0.318	0.796	0.306	0.435	0.427	0.458
<i>PU4</i>	-0.347	0.844	0.384	0.497	0.537	0.496
<i>PEOU1</i>	-0.329	0.358	0.833	0.346	0.398	0.384
<i>PEOU2</i>	-0.430	0.446	0.867	0.481	0.499	0.500
<i>PEOU3</i>	-0.219	0.246	0.651	0.241	0.312	0.292
<i>PEOU4</i>	-0.189	0.264	0.727	0.228	0.339	0.314
<i>COMP1</i>	-0.422	0.513	0.439	0.465	0.863	0.521
<i>COMP2</i>	-0.432	0.517	0.453	0.449	0.876	0.511
<i>COMP3</i>	-0.413	0.517	0.454	0.493	0.842	0.538
<i>COMP4</i>	-0.429	0.527	0.416	0.522	0.858	0.581
<i>PRISK1</i>	0.892	-0.405	-0.352	-0.490	-0.456	-0.458
<i>PRISK2</i>	0.914	-0.369	-0.382	-0.512	-0.452	-0.454
<i>PRISK3</i>	0.814	-0.312	-0.304	-0.392	-0.379	-0.362
<i>ATT1</i>	-0.533	0.578	0.482	0.671	0.634	0.891
<i>ATT2</i>	-0.375	0.517	0.383	0.539	0.487	0.885
<i>ATT3</i>	-0.428	0.519	0.449	0.597	0.545	0.915
<i>ATT4</i>	-0.386	0.505	0.444	0.607	0.548	0.870
<i>BI1</i>	-0.502	0.502	0.410	0.939	0.505	0.618
<i>BI2</i>	-0.495	0.504	0.412	0.930	0.500	0.627
<i>BI4</i>	-0.494	0.507	0.413	0.942	0.538	0.661
<i>BI5</i>	-0.519	0.534	0.421	0.945	0.566	0.656

**Table 3:** Matrix of Loadings and Cross-loadings

	<i>RISK</i>	<i>PEOU</i>	<i>COMP</i>	<i>PU</i>	<i>ATT</i>	<i>BI</i>
<i>RISK</i>	0.875					
<i>PEOU</i>	-0.398	0.774				
<i>COMP</i>	-0.493	0.512	0.860			
<i>PU</i>	-0.417	0.440	0.603	0.826		
<i>ATT</i>	-0.489	0.497	0.627	0.597	0.890	
<i>BI</i>	-0.535	0.441	0.562	0.545	0.682	0.939

**Table 4:** Discriminant Validity Assessment



### Results of hypotheses testing

The PLS method was also used to confirm the hypothesized relations between constructs in the proposed model. The significance of the paths included into the proposed model was tested using a bootstrap resample procedure (MacKinnon *et al.*, 2004). Smart-PLS software was used to conduct the PLS-PM analysis (Ringle *et al.*, 2005). Table 5 shows the model's standardized path coefficients and their statistical significance which is used for the hypothesized relations' validation.

<i>Effects</i>	<i>Std. Coefficient</i>	<i>Standard Error</i>	<i>t-value</i>	<i>Hypotheses Validation</i>
<i>COMP → PU</i>	0.462	0.032	14.500	<i>H7 Supported</i>
<i>PEOU → PU</i>	0.153	0.030	5.063	<i>H3 Supported</i>
<i>RISK → PU</i>	-0.128	0.030	-4.299	<i>H10 Supported</i>
<i>COMP → ATT</i>	0.296	0.032	9.294	<i>H6 Supported</i>
<i>PU → ATT</i>	0.281	0.030	9.490	<i>H2 Supported</i>
<i>RISK → ATT</i>	-0.164	0.027	-6.031	<i>H8 Supported</i>
<i>PEOU → ATT</i>	0.156	0.028	5.646	<i>H1 Supported</i>
<i>ATT → BI</i>	0.466	0.030	15.775	<i>H4 Supported</i>
<i>RISK → BI</i>	-0.237	0.026	-9.109	<i>H9 Supported</i>
<i>PU → BI</i>	0.168	0.028	5.925	<i>H5 Supported</i>

*Table 5: Assessment of the Structural Equation Model*

The results presented in Table 5 show support for hypotheses H1, H2, H6 and H8 as compatibility (COMP), perceived usefulness (PU), perceived risk (RISK), and perceived ease of use (PEOU), emerged as significant predictors of attitude (ATT). Further, attitude (ATT), perceived risk (RISK), and perceived usefulness (PU) proved to significantly affect customers' intentions to buy online (BI) supporting hypotheses H4, H5, and H9. Finally, perceived usefulness (PU) is affected by compatibility (COMP), perceived risk (RISK), and perceived ease of use (PEOU) supporting hypotheses H3, H7, and H10.

The proposed model accounted for 40.2% of the variance in perceived usefulness, 51.1% of the variance in attitude, and 53.6% of the variance in intentions. The relatively high values of coefficients of determination ( $R^2$ ) indicate that sizeable portions of the variances in the dependent variables were explained by the chosen independent variables. By combining TAM with IDT and perceived risk, our study has shown the relevance of two other salient beliefs with customers' attitude and intentions formulation.

### Discussion and Conclusions

The aim of this study is to advance our understanding in what is need to be done in order to increase penetration of online shopping in Greece. The major contribution of this study is that empirically investigates the applicability of Technology Acceptance Model's extension with Innovation Diffusion Theory

and the Theory of Perceived Risk in the online shopping context. A comprehensive research framework was developed and PLS-PM analysis was conducted to empirically validate the proposed model. The results show that there are significant relationships between research variables. Consumers' intentions to use online shopping are positively affected by attitude toward that behavior and are negatively affected by perceived risk associated with the system. The proposed framework also provides insights on the determinants of consumers' attitude formation about e-commerce. More specifically, compatibility was found to play the central role in the proposed model, since it directly affects customers' attitude, while at the same time raises customers' perceptions about the benefits of the new technology. Other significant determinants of attitude formation are the two salient beliefs of TAM, perceived usefulness and perceived ease of use, and the beliefs about risk as well.

Online shopping is considered as one of the emerging shopping channels. According to findings of this study, the priorities for online providers of product or services for better acceptance of e-commerce in Greece are to improve consumers' attitude toward online shopping by influencing consumer's beliefs formulation about the new transaction channel, and, at the same time, to reduce their perception about the risks of such behavior. As noted in previous research, compatibility, perceived usefulness and perceived ease of use lead to favorable attitude toward e-commerce (Gefen and Straub, 2004; Vijayasarathy, 2004). Virtual stores need to adjust their website contexts to match the preference of their major customer groups. For example, online vendors can provide a simple and easy-to-use interface or a rich and useful interface to enhance the shopping intention of consumers. Although attitude is an important issue in online shopping, the results of this study showed that perceived risk plays an important role as inhibitor of online shopping acceptance. This finding implies that online vendors should rely not only on the operational characteristics of websites, their perceived usefulness and perceived ease of use, but also on perceived risk of consumers toward these websites and online product and services they deliver. Practitioners need to take perceived risk into account in their website planning efforts. To diminish perceived risk, online vendors can improve the content of their websites. They also need to make special efforts to improve defects and problems that could influence consumers' perception of online shopping (Li and Huang, 2009). Other measures include: a. a money back warranty; b. a clear policy about the security and privacy of the transactions and the establishment of international standards concerning these two critical issues; c. information availability by the vendor about the online company d. a clear legal framework (Grabner-Kraeuter, 2002; Corbitt *et al.*, 2003). Online vendors need to be devoted to understand the factors that influence the formation of consumer's behavioral intention toward online shopping and develop appropriate strategies in order to influence their formation.

There are some limitations in this study. First, a non-probabilistic sampling strategy was followed for data collection, which does not allow for the full generalization of the results. The proposed model can be used for further research in close cooperation with the online vendors operating in Greece, using a random sampling approach and resulting to a more representative sample which will allow the extraction of results that represent the Greek population in total. Secondly, this study has not included some characteristics of

products/services marketed online, which may influence the choice of online shopping. Future research may identify some additional applicable factors such as product/service characteristics or individual differences so as to better understand the online shopping behavioral intentions. Finally, the findings and the implications of this research were obtained using a cross-sectional study. This reduces the ability of the study to reflect the temporal changes in the research constructs. A longitudinal study on the subject is necessary in order to determine and clarify the effects of temporal changes.

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**ENVIRONMENTAL CONCERN AND CONSUMER RECYCLING BEHAVIOR IN CYPRUS****Hadjimanolis, Athanasios<sup>1</sup>**<sup>1</sup>Professor, Business School, European University Cyprus**Abstract**

The paper refers to the empirical exploration of factors influencing the recycling behavior of consumers in Cyprus.

Environmental concern is considered as a major determinant of recycling, together with knowledge on environmental issues, socio-demographic variables, and especially policy controllable institutional factors. The theoretical model that is used as framework for the research draws on both environmental psychological approaches, as well as, sociological and economic theories. A random sample of 300 consumers has been surveyed with questions on the above determinants of recycling and the actual recycling behavior of consumers. The collected data have been analyzed by SPSS software with multiple regression and other multivariate methods.

Recycling rates among Cypriot consumers were found to be higher for women and older people. Education, environmental knowledge, and environmental concern have all a positive impact on recycling, while a high level of perceived barriers has a negative association with the recycling effort. Recycling rates were not found to vary significantly among employment or income groups.

The empirical exploration of recycling factors is a very important issue for both policy makers and product designers and an under-researched area in Cyprus, a country at a relatively early recycling stage.

Policy makers can improve recycling policies with research results based on the actual behavior of Cypriot citizens.

**Keywords:** consumers, planned behavior, barriers, recycling behavior.

**Introduction**

Conservation of the scarce natural resources and protection of the environment are increasingly being seen as major societal issues. Recycling can be considered as a significant part of conservation behavior (Castro et al, 2009). It requires consumers to choose between alternatives for disposal of a product (or its packaging), i.e. discarded as garbage or sorted and saved separately for eventual recovery of its material through special processing (Ebreo et al, 1999). Positive recycling behavior affects indirectly the purchasing of products with preference given to the selection of recyclable versus non-recyclable products and packaging (Davis et al, 2002).

Public policy has a significant role to play in the stimulation of recycling behavior through a number of intervention strategies (Steg and Vlek, 2009). These intervention strategies are briefly discussed in the next section. For the successful operation of recycling schemes consumers have to be persuaded about the importance of source separation of the different materials (Ying et al, 2007).

While most studies concentrate on advanced countries with proper infrastructure for recycling, there is a relative deficiency of studies in peripheral countries at early stages of recycling. Some recent exceptions, i.e. studies focusing on developing countries at early stages of recycling, include Schoot Uiterkamp et al, 2011 and Scheinberg et al, 2011. Cyprus is a country at an early stage of recycling and as an EU member has to deal with the problem of solid waste disposal, which is particularly acute in a small island country with limited space and inadequate sanitary landfills. Proper attention to recycling alleviates the problem of waste disposal, reduces pollution, and contributes to the protection of valuable non-renewable resources. The infrastructure for recycling has been developed in the last three to four years and is still severely limited and not well organized. Despite these infrastructural shortcomings the diffusion of recycling behavior, as a desirable social practice, is acknowledged as of paramount importance within a broad government environmental policy.

The special conditions of recycling behavior in Cyprus can be briefly summarized into the following:

- Special efforts are required for recycling on behalf of consumers due to the inadequate infrastructure. Recycling is mainly of the drop-off type rather than the curbside recycling. People seem relatively reluctant to sort waste. Only 64% of Cypriots (third lowest percentage in European Union – EU 25) agree “to sort waste so that it can be recycled” against 72% of EU 25 (Special Eurobarometer 217, 2005).
- Knowledge about recycling is relatively scarce.
- Awareness of environmental consequences of the recycling behavior is not yet high. Cypriots are less concerned about “growing waste” than other EU citizens (15% one of the lowest percentages in EU 25) (Special Eurobarometer 217, 2005).
- There is a relatively low influence of pressure groups (environmentalists).
- There is limited landfill space in an island country.

The purpose of the study is to examine the recycling behavior of Cypriots and their participation in recycling schemes. The sociological theory of context related (situational and institutional factors) is combined with the theory of planned behavior as a framework for the study. The paper tests the relationship of factors considered by these theories with recycling behavior. More specifically it investigates the impact of personal (socio-demographic and psychological characteristics) of consumers and country-specific institutional factors on the recycling behavior and explores the implications of the findings for public environmental policy and the actions of producers and marketers of consumer goods. The unique

contribution of the paper is the combination of personal and contextual factors as recycling determinants in the context of a country at an early recycling stage. There is relatively little research on drop-off recycling programs in comparison to research on curbside recycling in the literature (Sidique et al, 2010). Studies on contextual factors are also relatively scarce in the recycling literature (Steg and Vlek, 2009). Furthermore contextual factors, as extrinsic and potentially controllable variables, are more open to government policy intervention (Do Valle et al, 2005).

Section 2 below presents a literature review of the recycling behavior and its determinants, while section 3 provides an overview of the methodology followed. Section 4 gives a summary of the main research results and section 5 a discussion of the results. Finally the last section 6 presents the conclusions and a number of recommendations for public policy makers.

### **Recycling Behavior: A Literature Review**

Many research studies have investigated the recycling behavior and have tried to determine its antecedents (Hornic et al, 1995). The two main research traditions are those of environmental psychology with emphasis on personal factors and that of environmental sociology and economics with emphasis on contextual (situational and institutional) factors viewed as barriers and facilitators for the recycling behavior (Davis et al, 2002).

Due to the early stage of recycling in Cyprus the main emphasis in this paper is on contextual factors and social norms. The main theories of recycling factors are briefly considered and the literature on contextual factors is analyzed in more detail. The theories of recycling are broadly classified as psychological (or socio-psychological to be more precise) and sociological. Psychological theories include the theory of planned behavior and the theory of altruistic behavior. The sociological theories include the theory of social pressure and the related balance theory of adapting own attitudes to those held by others, the theory of self-identity (social representation), and the social dilemma approach.

The theory of planned behavior (TPB) is one of the major framework theories in research on environmental behavior in general and recycling in particular (Ajzen and Fishbein, 1980, Tonglet et al, 2004, Knussen and Yule, 2008). In TPB models behavior is predicted by intention, while intention itself is predicted by attitudes towards behavior, subjective norms, and perceived behavioral control (Ajzen, 1991). The latter refers to the extent that a person believes that his/her actions can have an impact on a particular situation, in this case whether individual recycling activities affect the environment (Do Valle et al, 2005).

The main criticism against TPB is that it assumes that the target behavior is based on the individual's volitional control, i.e. individual will. Therefore emotions, past behavior, and habits have been measured to extend the TPB model in some studies (Carrus et al, 2008).

The theory of altruistic behavior of Schwarz has been used to explain environmental behavior (Schwarz, 1977, Bratt, 1999). It describes how people develop personal and social norms regarding moral behavior.



Participation in recycling and through it in conservation of resources and reduction of environmental pollution is considered as an activity involving both personal morality and social responsibility (Tonglet et al, 2004). The theory considers the concepts of awareness of consequences and responsibility denial in order to explain why sometimes personal norms of altruistic behavior do not lead to corresponding behavior, e.g. recycling (Bratt, 1999). The theory of Schwarz has been extended by Stern and colleagues to the value –belief –norm theory, which maintains that pro-environmental behaviors are based on personal values and beliefs that issues relevant to these values are under threat, while the individual can take action to restore the values (Stern, 1999, Oreg and Katz-Gerro, 2006).

Theories considering variables related to individual decision making are certainly important in recycling activities, a more complete, however, approach would take into account the social structure within which the individual acts and which impacts its values, attitudes, and behavior (Oreg and Katz-Gerro, 2006).

The theory of social pressure and expectations of others suggests that humans have frequently the desire to integrate into a local community therefore the social pressure by valued others like family members, neighbours, and friends has a significant impact on a durable recycling behavior (Shackelford, 2006). Research suggests a positive relationship between an individual's beliefs about the recycling efforts of others and own recycling efforts (Hage et al, 2009).

The theory of self-identity refers to the person's conception of self and its effect on behavior (Sparks and Guthrie, 1998). The individual's self-concept includes both personal and social identities. The latter derive from membership of social groups. People tend to align with the norms and behavior of such groups. For environmental group members recycling may then be part of environmental activism. For those who are not involved in environmental groups individual concerns (like favorable attitudes or perceived behavioral control) may be more relevant as decision making guides (Terry et al, 1999). Similarity between personal identity and identity of the 'typical recycler' would lead people to involvement in recycling activities (Mannetti et al, 2004).

The social dilemma approach to recycling considers the costs and benefits of this activity for a particular individual (Shinoki and Kimura, 2007). Recycling activities lead to the production of a public good, i.e. improved environmental quality and preservation of resources. This causes a "social dilemma" situation where the payoff or benefit to the recycling participant is lower than that obtained by the non-participant, who obtains the benefit without suffering any inconvenience or cost (Hage et al, 2009).

Human behavior, including recycling, depends on many other factors besides the personal and motivational ones considered in the above psychological and social theories. Contextual or situational factors like the availability of recycling facilities, conditions of the logistic system of waste collection (physical proximity of containers or kerbside collection) and generally the technical infrastructure may promote or constrain recycling at the household level (Boldero, 1995, Steg and Vlek, 2009). People involved in recycling frequently face internal or individual and external or institutional barriers (Smallbone, 2005).

Hornic et al (1995) in their meta-analysis of 67 empirical recycling studies have identified two major types of variables involved, i.e. incentives and barriers or facilitators. Space, cost, and the effort needed to recycle, are some of the relevant factors since they determine the opportunity cost of recycling (Hage et al, 2009). People are more likely to recycle if they have the appropriate opportunities, facilities, and knowledge to recycle, while they are not obstructed by physical barriers like inconvenience, lack of time, and space (Tonglet et al, 2004). The model of needs, opportunities, and abilities takes the objective situational constraints directly into account in contrast to the theories and models mentioned above (Olander and Thorgensen, 1995). The low-cost hypothesis suggests that high behavioral costs due to high barriers lead to a lower impact of environmental concern on environmental behavior (Diekmann and Preisendoerfer, 2003).

The above set of barriers and facilitators are directly influenced by the government recycling policy. Governments can influence consumer recycling behavior, for example through legislation and economic incentives (Smallbone, 2005). Trust in the recycling authorities and the perceived effectiveness of government recycling policy may also have an impact on people's decision to recycle (Hansman et al, 2006, Omran et al, 2009). Local authorities play a significant role through the supply of infrastructure (recycling bins, etc.) thus increasing the convenience of recycling. The design of an appropriate recycling policy has to take into account the attitudes of people toward recycling and their perception of barriers to recycling (Tonglet et al, 2004). Such a policy could include persuasive instruments like exhortation and public information campaigns, but also specific incentives like price incentives.

Based on the above described theories and especially the TPB theory many empirical studies have considered various sets of variables as antecedents of recycling participation. They are briefly summarized under four categories socio-demographic, environmental attitudes and concern, environmental knowledge, and situational variables.

Some socio-demographic variables, like income, have been found as good predictors of recycling (Schultz, et al, 1995). Other researchers consider the effect of income as ambiguous pointing out that opportunity cost of time increases with income (Hage et al, 2009). Employment status is expected to affect recycling due to its correlation with income and especially time availability. Gender may have an influence on recycling effort and females are expected to be more active in recycling (Meneses and Palacio, 2005). Recycling efforts increase with age (Hage et al, 2009). Education has been found to be positively correlated with recycling (Schultz et al, 1995, Vicente and Reis, 2008). Others have, however, found a negative correlation relationship (Hage and Soederholm, 2008). Based on socio-demographic variables the following hypotheses have been formulated:

- H1.** Recycling rate is higher for women
- H2.** Recycling rate is higher for higher income groups
- H3.** Recycling rate is higher among older people

**H4.** Recycling rate is higher for more educated people

**H5.** Recycling rate is lower among full time employees

High awareness of and positive attitudes to ecological issues (i.e. high environmental concern), and knowledge of related issues (biodegradability, recyclability, reusable versus one-way packaging, etc.), indicate that consumers are conscious of the importance and benefits of recycling for reduction of pollution and preservation of non-renewable resources. There have been many studies supporting a positive relationship between high environmental concern and ecologically responsible behavior such as recycling (Hornic et al, 1995, Diekman, and Preisendoerfer, 2003). There is also empirical support for the relationship between environmental knowledge and environmental behavior in general and recycling in particular (Hansman et al, 2006). Other studies, however, have shown that awareness and knowledge do not necessarily lead to positive recycling behavior (Bratt, 1999, Ebreo et al, 1999, DoValle et al, 2005).

**H6.** Recycling rate is higher for those having higher environmental concern

**H7.** Recycling rate is higher for those having higher environmental knowledge

Social and institutional factors are important because they have a direct impact on recycling behavior as barriers or facilitators, while at the same time they may shape attitudes and values (Guagnano et al, 1995). Some other factors that have been considered in the literature, but are not further examined in the current study include past and habitual behavior as a powerful predictor of recycling behavior (Knussen and Yule, 2008).

**H8.** Recycling rate is higher for those perceiving lower barriers to recycle

The above short review of the literature indicates the importance of several categories of factors affecting recycling behavior. A parsimonious model based on a combination of the most important variables will be used. The proposed research model uses actual recycling behavior as the dependent variable of interest and four categories of independent variables as briefly described below.

1. Socio-demographic variables (gender, age, education, income, etc.)
2. Attitude related variables (Degree of environmental concern)
3. Level of knowledge about environmental recycling issues
4. Institutional and situational factors (Barriers and other variables affecting the opportunity cost).

## **Methodology**

A telephone survey of the general public was used with computer assisted telephone interviewing. A random sample of 300 consumers from the Nicosia district has been used mainly from the urban areas, which have recycling facilities. The survey took place in October 2009. The questionnaire was designed for telephone interviews, which lasted around 5-6 minutes in order to secure the desired consumer

participation. It has been pre-tested with 10-20 consumers to spot any problems or weaknesses. Information collected refers to demographic data (age group, gender, education level, income etc.) and attitudes, perceptions, and recycling behavior as detailed in the literature section. Table 1 below describes the main characteristics of the sample.

Items from standard scales are used whenever possible in order to make the comparison with published results in other countries easier, adapted if necessary for Cyprus conditions. Apart from frequency analysis and cross-tabulation, sophisticated bivariate and multivariate statistical techniques have been used in the analysis of data with the SPSS software package. Independent t-tests, analysis of variance (ANOVA) and multiple regression represent examples of such techniques.

The dependent variable is a measure of the actual recycling behavior. It measures the recycling rate for three categories of material/packaging through three five point scales (1= never to 5 = always). It measures how frequently respondents recycled paper products, PMD (plastics, metals and composites) and glass. The summated scale of the three items: "Sumrecyclrate" has a good reliability, Cronbach's  $\alpha = 0.83$ .

The main independent variables were socio-demographic: gender, age, education, annual family income, and work status. Regarding attitudinal variables "Environmental concern" was measured with five statements of five points each (1= completely disagree to 5= completely agree) each related to recycling. Examples of such statements are: "Recycling is a serious issue" and "Recycling deserves time and effort". The summation scale of the five items has a good reliability  $\alpha = 0.84$ . A summation indicator was constructed for environmental knowledge (sumenvknowl) based on three statements (1= Right 2= Wrong 3= Don't know - reconverted to 0 for further analysis). Similarly a summation scale was constructed for barriers to recycling (sumbarriers) based on four statements as reasons for not recycling (1= Not important, 5= Very important). Examples of the latter include 'lack of time' and 'distance of recycling bins'.

Table 1 Sample characteristics

Gender	Men	Women				
	49.2 %	50.8%				
Age	18-30	31-50	51+			
	20.6%	41.2%	38.2%			
Education	Primary School	Gymnasium	Lyceum	College	University Undergrad	Univ. Grad.
	9.6%	10.6%	26.9%	12.3%	31.2%	9.0%
Employment status	Unemployed	Full-time employed	Part-time employed	Pensioner		
	10.3%	63.1%	2.7%	23.6%		
Income	Less-than euro 20.000	20.0000-39.999	40000-59999	+ 60000		
	33.9%	38.9%	10.6%	4.3%		

## Results

### Descriptive results

The recycling rate is average (3.31 on a scale of 1-5) for paper, slightly higher than average for metal/plastics and relatively low for glass as indicated in Table 2 below. People in Cyprus recycle therefore most often metal/plastics and paper products and to a smaller extent glass. The distance of recycling bins from their homes, followed by lack of storage space, appear to be the main barriers to recycling in Cyprus as indicated in Table 3 below. The acknowledgement of the personal obligation to recycle, the belief that recycling is a serious and urgent issue and the opinion that recycling deserves time and effort are the three attitudes that have the highest level of agreement of the respondents as indicated in Table 4 below. Recycling knowledge was found to be at relatively high levels. A very high percentage (96%) of the respondents know that recycling reduces environmental pollution, while 85% know that plastics are not biodegradable, while a lower percentage (55%) know that paper is biodegradable as indicated in Table 5.

Table 2 Recycling rate

Recycling rate	Mean	STD
Paper	3.31	1.556
Metal/Plastics	3.47	1.662
Glass	2.69	1.695

Note: STD = standard deviation

Table 3 Recycling Barriers

Recycling Barriers	Mean	STD
Lack of time	1.89	1.13
Lack of storage space	2.23	1.16
Distance of recycling bins	2.56	1.26
Knowledge of sorting materials	1.71	1.00

Note: STD = standard deviation

Table 4 Recycling attitudes

Recycling attitudes	Mean	STD
Waste as threat to environment	4.27	0.58
Recycling as serious and urgent issue	4.37	0.57
Personal obligation to recycle	4.41	0.53
Recycling deserves time and effort	4.30	0.58
People not recycling harm the environment	4.26	0.66

Note: STD = standard deviation

Table 5 Recycling knowledge

<i>Recycling knowledge</i>	<i>Frequency of right answer</i>
<i>Biodegradability of paper packaging</i>	55.1%
<i>(Non)Biodegradability of plastic packaging</i>	84.7%
<i>Recycling reduces environmental pollution</i>	96.3%

### Data analysis

Gender is a statistically significant independent variable in the multiple regression model of recycling rate presented below in Table 8. (In order to indicate which gender shows higher recycling rate an independent t-test was conducted confirming that the recycling rate “sumrecyclrate” is significantly higher for women (Table 6). Hypothesis 1 is confirmed the recycling rate is higher for women.

Table 6 T-test of equality of recycling rate means for gender

	<i>Mean</i>	<i>STD</i>	<i>STD Error</i>
<i>Men</i>	8.76	4.234	0.348
<i>Women</i>	10.16	4.048	0.327
<i>Sumrecyclrate</i>	<i>Sig (two</i>	<i>Mean difference</i>	<i>STD error</i>
	<i>-tailed)</i>		<i>difference</i>
<i>Equal variances</i>	0.004	-1.3999	0.4776
<i>assumed</i>			
<i>Equal variances(not</i>	0.004	-1.3999	0.4779
<i>assumed)</i>			

*Note: STD = standard deviation, STD Error = standard error*

One-way analysis of variance (ANOVA) has shown that differences of the recycling rate across the four income groups are not significant. Hypothesis 2 is therefore rejected. Recycling rate is similar across income groups.

One-way analysis of variance (ANOVA) has shown significant differences across age groups (Table 7). Therefore Hypothesis 3 is confirmed. Recycling rate is higher among older people. (Scheffe test: Mean difference of the group: 18-30 and the group: (51+) is 1.95428 significant at 0.05 level).

TABLE 7 Recycling rate by age group /One -way ANOVA

Group	Age Group	N	Mean	Standard deviation	S. Error
1.00	18-30	62	8.19	4.20	0.53
2.00	31-50	124	9.49	4.05	0.36
3.00	51+	115	10.15	4.22	0.39
Total		301	9.47	4.19	0.24
<i>Test of homogeneity of variance</i>					
<i>Levene statistic</i>					
0.422	DF1		DF2	Sig.	
	2		298	0.656	
ANOVA	Sum of squares	df	Mean Square	F	Sig.
Between groups	153.907	2	76.953	4.476	0.012
Within groups	5123.156	298	17.192		
Total	5277.063	300			

Note: S. Error = Standard Error

Source: Data analysis

Recycling rate and education level are positively correlated, although the correlation coefficient is rather low. Spearman's correlation coefficient  $\rho = 0.115$  Sig. (two-tailed) = 0.05. Hypothesis 4 is therefore confirmed. Recycling rate is higher among people with higher education.

One-way analysis of variance (ANOVA) has shown that differences of the recycling rate across the employment groups are not significant. Hypothesis 5 is therefore rejected. Recycling rate is similar across employment groups.

Recycling rate is positively correlated with environmental concern: Pearson's correlation coefficient  $r = 0.275$ , Sig. (two-tailed) = 0.000. Hypothesis 6 is therefore confirmed. Recycling rate is higher among people with higher environmental concern.

Recycling rate is also positively correlated with environmental knowledge. Pearson's correlation coefficient  $r = 0.122$ , Sig. (two-tailed) = 0.034. Hypothesis 7 is therefore confirmed. Recycling rate is higher among people with higher environmental knowledge.

Recycling rate is negatively correlated with barriers to recycling. Pearson's correlation coefficient  $r = -0.426$  sig. (two-tailed) = 0.000. Hypothesis 8 is therefore confirmed. Recycling rate is higher among people with lower levels of perceived barriers.

Multiple regression results are summarized here and indicated in Table 8 below:

Dependent variable: Recycling rate (Sumrecyclrate)

Independent variables: gender, education, age, recycling knowledge (sumrecknowl), recycling barriers (sumbarriers), and environmental concern (sumenvconc). The percentage of variance explained is around 28%.

Model 2:  $R = 0.526$   $R^2 = 0.277$  Adjusted  $R^2 = 0.262$

$\text{Sumrecyclrate} = 0.688 \text{ (constant)} + 1.521 \text{ gender} + 0.454 \text{ education} + 0.660 \text{ age} - 0.501 \text{ sumbarriers} + 0.294 \text{ sumenvconc}$ .

The best statistically significant predictors of recycling rate are the independent variables: gender, age, and the indicator of the level of barriers (sumbarriers) as indicated in the equation above and Table 8. The assumptions of multiple regression are met as confirmed by the collinearity diagnostics and the plots of the regression standardized residual.

Table 8 Multiple Regression - Recycling Rate

Independent Variable	Unstandardized Standard		Standardized		
	coefficients	Error	coefficients		
	B		Beta	t	Sig. t
Constant	0.688	2.570		0.268	0.789
Gender	1.521	0.419	0.182	3.632	0.000
Education	0.454	0.154	0.161	2.954	0.003
Age	0.660	0.318	0.118	2.075	0.039
Sumrecknowl	0.326	0.314	0.053	1.038	0.300
Sumbarriers	-0.501	0.071	-0.371	-7.024	0.000
Sumenvconc	0.294	0.095	0.160	3.101	0.002

Note 1: (Dependent Variable: Recycling rate: Sumrecyclrate)

Note 2: (Sumrecknowl: Recycling knowledge, Sumbarriers: Recycling Barriers, Sumenvconc: Environmental Concern).

## Discussion

It was found that recycling rate is higher for women and older people. This could be due to the higher environmental concern of women versus men and older versus younger people. An independent t-test has not found statistically significant differences between males and females regarding environmental concern. A one-way ANOVA test has, however, shown a statistically significant difference of environmental concern at the 0.05 significance level between age groups, especially the group 18-30 and the group 51+. An alternative explanation is that these groups (women and older people) have more time at their disposal in order to separate materials and put them in the recycling bins. The finding that the recycling rate does not differ significantly among employment groups, which include unemployed and pensioners, indicates that the alternative explanation is rather weak. In contrast to this finding Ebreo et al, (1999) have found a statistically significant relationship between employment status and recycling behavior. Hage et al, 2009, have found a clear impact of increasing age on recycling in contrast to the poor explanatory effect of other socio-economic variables in their study.



Higher levels of education have a positive impact on recycling rates. Similarly higher levels of environmental concern are associated with higher recycling. Recycling is also higher among people with higher levels of environmental knowledge. Our findings agree with those of Diekmann, and Preisendoerfer (2003). Similarly Omran et al, 2009 have found that the level of awareness and understanding of recycling increases participation in recycling schemes. Other studies, however, have shown that awareness and knowledge do not necessarily lead to positive recycling behavior (Ebreo et al, 1999, DoValle et al, 2005).

Attitudes (environmental concern) were found positively associated with the recycling behaviour. Tonglet et al, 2004 report similar findings. High levels of perceived barriers to recycling have a negative impact on recycling rates. Our findings agree with those of the literature. Hage et al, 2009, for example, have found that convenience regarding collection of materials, indicating no or low barriers, has an important positive impact on recycling behavior. Access to recycling and good recycling facilities are also cited by Bratt, 1999, as essential for recycling behavior.

## **Conclusions and Recommendations**

Recycling rates among Cypriot consumers were found to be higher for women and older people. Education, environmental knowledge, and environmental concern have all a positive impact on recycling, while a high level of perceived barriers has a negative association with the recycling effort. Recycling rates were not found to vary significantly among employment or income groups. The most important predictors of recycling were found to be gender, education, environmental knowledge, barriers, and environmental concern.

The results show that certain groups of consumers are more likely to recycle than others, while environmental concern and knowledge, including awareness of recycling facilities, as well as recycling convenience are important factors in recycling behavior.

Limitations of the reported research include the fact that self-reported behavior for a socially desirable activity introduces bias because people tend to claim higher participation rates than their actual ones.

The design of an appropriate recycling policy with realistic recycling objectives and specific target groups has to take into account the attitudes of people toward recycling and their perceptions of barriers to recycling (Tonglet et al, 2004). Our recommendations are based on two major types of strategies, i.e. structural and informational strategies (Steg and Vlek, 2009). Structural strategies should aim to improve the existing recycling facilities and eliminate barriers to recycling, especially that of distance of recycling containers. Other related active recycling policies could use taxation and regulation. Policy instruments should be tailored to local needs.

Informational strategies aim toward better marketing of recycling by identifying target segments and using for example demographic variables for segmentation of people, e.g. age, gender or education. The basic issue

in information strategies is how to translate the awareness of recycling importance among people into an intention to act and eventually try recycling and establish a long term recycling behavior. The information campaign should also try to dispel misconceptions of inconvenience and address reservations about storage in households of containers for separate materials, the physical handling of them, and the time and effort required.

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## A PROPOSED INTEGRATIVE FRAMEWORK OF CORPORATE BRAND IDENTITY

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### Abstract

The purpose of the paper is to provide an integrated conceptual framework showing how corporate brand equity is generated. It builds upon a number of previous studies which have focused upon specific aspects of brand equity and integrates these within a more comprehensive model. It is based upon a review of the corporate branding, consumer psychology and strategy literature. The result is the construction of a number of sub-models and an overall proposed framework which integrates internal and external determinants of consumer-based corporate brand equity and combines these within a comprehensive framework. The model encompasses internal, company-determined, variables, a Stimulus-Organism-Response model, the stakeholder cognitive perception process, a number of mediating variables such as corporate performance, industry sector and internationality, and the resulting impact upon corporate reputation and brand equity. As a conceptual paper, further work will be required for empirical validation, although it does have management implications by means of its integrative nature. The originality of the work is that it is both comprehensive and it puts forward an integrative model which goes beyond previous work which has focused upon specific aspects of corporate brand value. It also analyses the links between the different constructs and the directions of causality and influence.

**Keywords:** Corporate brand equity; corporate brand models; corporate branding; brand conceptual framework; brand management

### Introduction

Brands are increasingly recognised as a key asset accounting for over 60% of corporate value. Increasing attention has been focused upon the corporate brand and a number of studies have considered different aspects of how corporate brand equity is created. Some research has treated the internal, company-driven elements, others have focused upon the consumer perception process and others have considered external mediating factors. In this article we propose an integrated model to analyse how corporate brand equity is generated. The major contribution is to provide a conceptual framework which is both comprehensive and which integrates existing work within a coherent model.

## **Brand and Corporate Brand Definitions**

The American Marketing Association defines a brand as “a name, term, sign, symbol, or design, or a combination of them, intended to identify the goods or services of one seller or group of sellers and to differentiate them from those of competitors” and there are countless other such definitions. Unfortunately, there is no accepted definition of ‘brand value’ – for some this is equated with financial value, for others consumer metrics, and for others a combination of the two. Other terms are used such as brand equity (again for some a consumer measure for others financial), brand knowledge, brand association, brand contribution, etc. For the purposes of this paper we will use the term ‘brand value’ in its widest sense to accommodate all such possible measures, and the term “brand equity” to refer to consumer perceived equity.

Although the bulk of the branding literature focuses upon product branding, more recently there has been greater attention given to corporate branding, (Balmer, 2001a&b, Balmer and Greyser, 2003, Kapferer, 2009, de Chernatony and McDonald, 2003, Aaker, 2004). A corporate brand should give a clear picture and should personify the values of the company (de Chernatony and McDonald, 2003). Organisational characteristics such as values, culture, people and skills form a source of competitive advantage, which is difficult to copy, (Aaker, 2004, de Chernatony and McDonald, 2003). Kapferer (2009) argues that companies use the corporate brand as a tool to create and defend their reputation, to advocate a socially responsible position, and to target the labour market, especially in financial markets or business-to-business markets. The corporate brand can be used to build recognition and credibility, which in turn, can encourage relationship building (de Chernatony and McDonald, 2003), and is an important factor for international brands ( de Chernatony, Halliburton & Bernath, 1995). Corporate brands focus upon multiple stakeholders, which makes their management more complex (Stuart and Jones, 2004, Baker and Balmer, 1997, Melewar and Jenkins, 2002, Kapferer, 2009, Esch et al, 2006). Corporate branding is now increasingly manifested through digital channels (Halliburton and Ziegfeld, 2009). Thus, a number of authors have concluded that corporate branding is of higher strategic importance relative to product branding, (Ind and Riondino, 2001). Various models or frameworks have been proposed for corporate brand identity, (Melewar and Jenkins, 2002, Melewar and Saunders, 1998, Gregory and Wiechmann, 2001, Staudte and Schmidt, 2004).

## **Methodology**

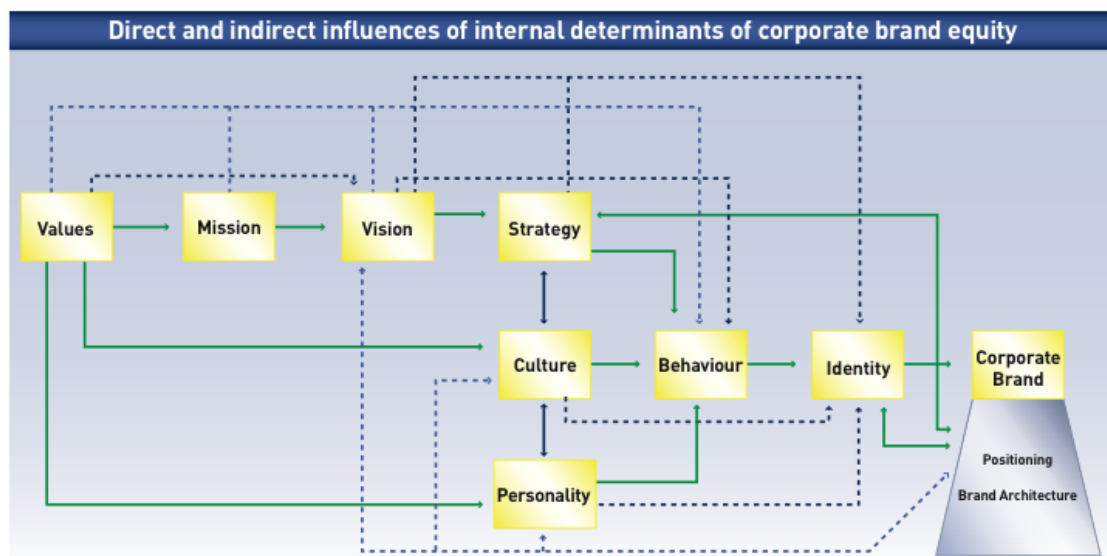
We first of all conducted a review of the corporate branding, consumer psychology and the strategy literatures. We then constructed frameworks to analyse the internal and external determinants of consumer-based corporate brand equity and combined these within a proposed integrative comprehensive framework.

## **A Proposed Framework of Corporate and Brand Equity**

We propose a framework which incorporates internal (company) factors, external (consumer) factors and mediating factors. This distinction allows us to incorporate the company’s desired positioning and brand architecture with the consumer and stakeholder perception process as well as with mediating variables.

### Internal determinants

*The core element here is the corporate values that play an important role in formulating the corporate mission, vision and hence corporate strategy. Corporate values also influence the corporate culture and the corporate brand personality and manifest themselves in corporate behaviour, which in turn impacts upon the corporate identity. See Figure 1. Figure 1 – Internal Determinants of Corporate Brand equity*



*Figure 1 – Internal Determinants of Corporate Brand equity*

Firstly, corporate values contribute intrinsically to brand equity, they help to harmonise actions, (de Chernatony, 2002), and they play an important role in formulating the corporate mission, which demonstrates the purpose and focus of a company's objectives and provides the basis for establishing the corporate vision. Corporate vision is the future-oriented guideline by which the organisation sets the goals and objectives it wants to achieve in the future (Grant, 2005). The corporate strategy is then selected in order to deliver the corporate vision within the particular market and competitive environment in order to achieve a sustained competitive advantage (Lechner and Muller-Stewens, 2005). The interaction between the corporate strategy and the prior elements of values, mission and vision determines the unique philosophy of the business. These determinants can either be formulated by the top hierarchy within the company or on a more collective or consensus basis across the organisation, depending upon the corporate or national culture (Simoes et al, 2005).

Secondly both corporate values and corporate mission influence the corporate culture to a significant degree (de Chernatony, 1999). Corporate culture can be seen as shared values, norms, attitudes, beliefs, ideals and organisational work habits, which not only characterise the behaviour and self-conception of the staff but also the company as a whole. The corporate culture can thus be understood as a social control mechanism that plays an important role for communication and motivation and hence influences the staff's behaviour. In order to avoid inconsistent behaviour that might be negatively perceived by stakeholders, corporate values and corporate culture should be strongly aligned (de Chernatony, 2001; Dowling, 1994).

Thirdly, corporate values affect the corporate brand personality. This is a key element that relates to the beliefs and attitudes within the organisation (Balmer, 2001). Consequently corporate identity can be seen as a subset of specific value-constellations that shows what a company represents and describes the human characteristics that are related to the firm (Davies et al, 2003). In more explicit cases the corporate personality can be characterised by the company founder's personality, (e.g. Richard Branson and Virgin or Steve Jobs and Apple), (Balmer and Greyser, 2002).

As already indicated, corporate strategy, culture and personality are the key drivers of corporate behaviour, (Herrmann, 2005). This can be especially significant when dealing with problems as well as with the perceived consistency of service. In order to maintain such consistency again it is essential that corporate behaviour is aligned with the values, mission and vision (Diller, 2001; Bruhn and Homburg, 2004).

Lastly, corporate behaviour has a direct impact upon the corporate identity, which can cover a broad and complex area across disciplines. The marketing discipline (corporate identity) and the organisational discipline (organisational identity) share a related interest. While corporate identity essentially responds to the question "what the company represents" and therefore deals with the internal and external communication of the company's unique character, organisational identity addresses the issue of "who is the company" and thus pays greater attention to internal perception and values (Balmer, 2001; Brockdorff, 2003). A company is therefore characterised by its corporate identity, by bundling specific attributes and embodying them within the staff's minds (Aaker and Joachimsthaler, 2009). However external representations such as the name, logo and visuals also contribute to the corporate identity (Dowling, 1994). Thus there is a balance to be achieved between internal and external stakeholders. For internal stakeholders, corporate identity supports identification and commitment to the company and for external stakeholders' identification of the company's uniqueness (Bruhn and Homburg, 2004). Corporate identity also plays an important role in the choice of brand architecture determining whether a product brand or a corporate brand architecture is selected (Herrmann, 2005). Brand architecture refers to the brand portfolio, either a 'House of Brand' strategy (such as P&G), a 'Branded House' (such as Unilever), or a fully corporate brand (such as Virgin or Sony). Branding decisions may be made at different levels of the hierarchy – with product brands typically assigned to middle management, whereas the corporate brand strategy is determined by top management. Hence leadership is critical in establishing a strong corporate identity, which should be

embodied in staff attitudes and behaviour, especially in the case of service brands (Balmer, 2001a and 2004). Accordingly, the corporate brand strategy should be in the line with the overall corporate strategy.

### External determinants – SOR model

Corporate communications, employees as stimulus carriers and third party communication are the three major '**stimulus**' components within the proposed framework. Balmer and Gray (2000) refer to this as "total corporate communications", comprising primary, secondary and tertiary communication from the communications function itself, from the organisation and its employees, and from third parties via word of mouth. The perceptual process has received extensive attention from marketers and psychologists. This includes activation and involvement and the cognitive information processing dimensions and the affective processes of association and attitude formation. These processes are summarised within the framework under the '**organism**' element of the SOR model. The responses to these processes are strong corporate brand awareness and positive brand associations across the stakeholder group. Strong corporate brands enjoy high top-of-mind awareness, important for brand choice (Keller, 2007). They also embody positive brand associations or image. In contrast to the corporate identity (company determined within the framework), the corporate image is the short-term stakeholder-specific perceptions (Fombrun, 2001, Brockdorff, 2003). The long-term corporate reputation therefore comprises the sum of the short-term stakeholder-specific corporate images. These all comprise the '**response**' element within the SOR model. See Figure 2.

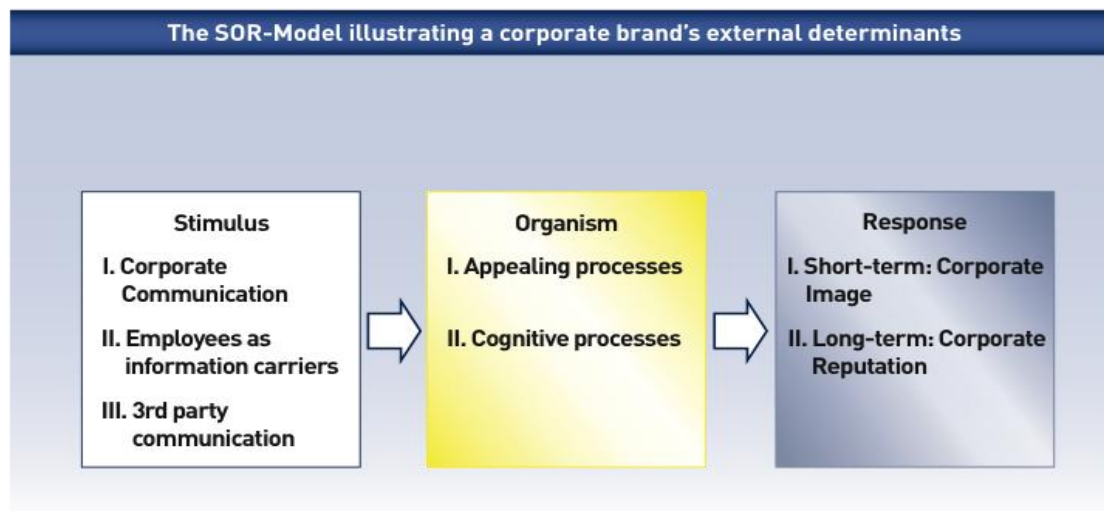


Figure 2 – External Determinants - S-O-R Model



**External determinants – SOR model – ‘Stimulus’**

The stimulus component of the SOR model comprises corporate communications, employees as stimulus carriers and third party communications. As a word of caution, some authors have highlighted a potential area of conflict for corporate brand management if these three are not in alignment and well managed (De Chernatony, 2001; Stuart and Kerr, 1999). However, if well aligned this can result in a positive perception of corporate identity such as quality, competence, trustworthiness, attractiveness, reliability, credibility and responsibility (Blackston, 2000).

**Corporate communications**

Corporate communications plays a key role in the many different areas of contact with multiple stakeholders, a role of coordination and integration. The objective is to create an integrated approach and a coherent brand architecture for the corporate brand and to ensure a consistent presentation of the organisation (Stuart and Kerr, 1999; Bruhn and Homburg, 2004).

The corporate identity is transmitted by corporate communications, corporate design and corporate behaviour. As a consequence, the relationship between the corporate identity, brand architecture and corporate brand positioning are communicated to both internal and external stakeholders via traditional communication tools such as advertising, PR and sponsorship and by newer digital methods. As regards external stakeholders, the key concerns include reliability for customers, credibility for suppliers and investors and responsibility for the general public, whereas internal stakeholders pay particular attention to trustworthiness (Fombrun, 1996).

**Management and staff as information carriers or advocates**

Although their importance can be underestimated, employees are valuable representatives of the corporate identity and thus information carriers and even advocates of the brand, especially for those with direct contact with external stakeholders, (Simoës et al, 2005). In order to communicate the corporate brand to the external environment in a consistent way, internal communication plays an important role (Tomczak and Kernstock, 2004). Burmann and Zeplin (2006) point to “organisational citizenship behaviour” which can be transferred to the corporate brand. The driving factor is the appreciation of and commitment to the corporate identity and, by implication, an employee’s psychological engagement to the corporate brand. This can involve active participation and internalisation of corporate identity but may also have a positive effect on employee motivation, attitudes and behaviour (Burmann and Zeplin, 2006). Hence corporate brand communication is embodied by the staff. This may be achieved by internal communication, by in-house role models, or by carefully selecting staff who share corporate values and culture (Burmann and Zeplin, 2006; Aaker, 2004; Kitchen and Laurence, 2003).

In addition, managers, especially senior managers or founders, are important communicators as they transmit the corporate values, culture, and corporate identity to internal and external stakeholders such as investors, media, analysts and the general public (Aaker, 2004; Kitchen and Laurence, 2003). Managers can

therefore embody the corporate identity leading to a relevant, long-term, differentiated and consistent positioning (Aaker and Joachimstaler, 2009) - famous examples are Bill Gates, Microsoft or Jack Welch, General Electric.

### **Third party communications**

In addition to the company's own staff, a wide range of third parties can also contribute to brand communications. Customers are perhaps the most obvious group, where referrals, or indeed advocacy can be amongst the most persuasive communications, as evidenced in the 'net promoter' concept. A recent study by Forrester Research found that 'email from people you know' showed the highest level of trust followed by consumer product ratings or reviews (Forrester Research, 2008). Clearly the increase in social networking and consumer communities or tribes has encouraged this. Other third parties may also contribute to the total communications effort – these include suppliers, independent reviewers, influencers, trade associations, journalists, and indeed many others, Public Relations can be seen as the effort to influence some of this third party communications.

### **External determinants – SOR model – 'Organism'**

#### **Corporate brand perception process**

Having described the stimulus, we now outline the cognitive perception process. In this context, the corporate brand embodies compacted information 'chunks' which can help to reduce the overall information-overload (Meffert et al, 2005; Baumgarth, 2004). See Figure 3.

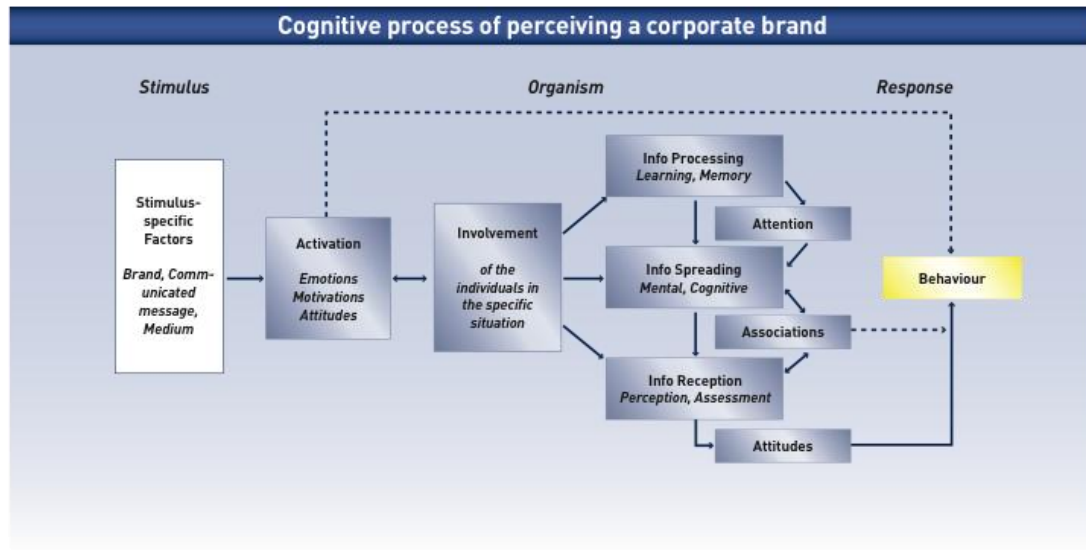


Figure 3 – Cognitive Perception Process

This framework requires that perception of external stimuli are activated via human drive forces such as emotions, motivations and attitudes that result in awareness raising and attention by the different stakeholders and which then trigger specific behaviours (Baumgarth, 2004; Meffert et al, 2005). Corporate communication can play an important role as a perception-screener or filter to influence stakeholder behaviour (Keller, and Lehmann, 2003). As emotions and hence motivations and attitudes strongly depend upon a specific culture, cultural conditions have to be taken into account when defining and transmitting stakeholder-specific stimuli, especially by globally operating companies (Meffert et al, 2005; Krober-Riel and Weinberg, 2003).

This also depends upon the level of stakeholder involvement in the product category and is determined by influencing factors specific to the person, the context and the stimulus (Trommsdorff, 2004). This activation and involvement have a significant effect on the cognitive processes, the mental, rational process of absorbing (selective perception and evaluation), handling (thinking and knowledge) and saving (learning and memory) information. Cognition therefore can be understood as the processes by which an individual conceives his/her environment and controls behaviour accordingly (Trommsdorff, 2004; Krober-Riel and Weinberg, 2003).

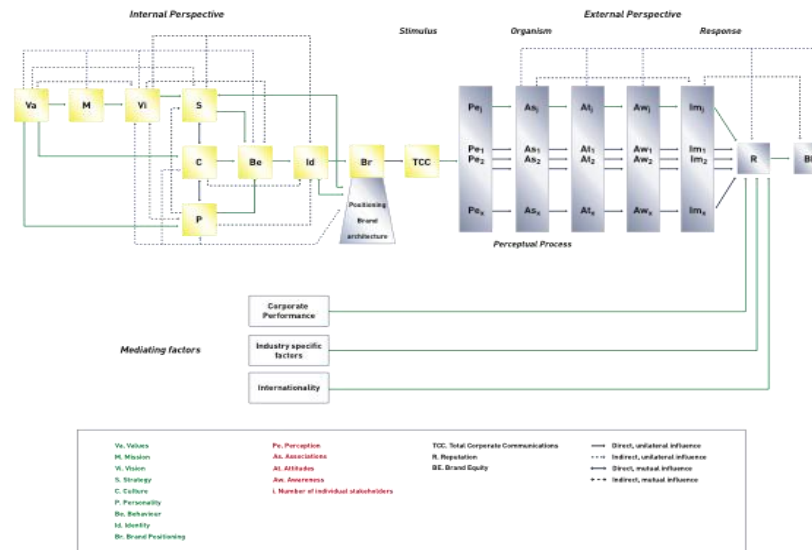
When absorbing information, specific stimuli will be selected, organised and interpreted and result in selective perception of the information. As information is digested the perceived stimuli reach the sensory memory for a split second, to be transmitted to the short-time memory subsequently. Making use of different stimuli patterns, brand management is able to trigger higher attention levels, to overcome the sensory memory and reach the short-term memory. This represents the stakeholder's active memory which decrypts, enhances, interprets and translates the stimuli into organised information leading to specific knowledge of the situation. By this means, the different stakeholders relate the transmitted information to their existing knowledge which evokes a stakeholder-specific association (Brockdorff, 2003; Krober-Riel and Weinberg, 2003). For this reason it is crucial for the perception of a corporate brand to communicate clear, stakeholder-specific messages. The previously organised information finally reaches the long-term memory. As a consequence the levels of knowledge and preferences will change, which can then cause a change in behaviour (Foscht and Swoboda, 2005; Krober-Riel and Weinberg, 2003).

So the objective of brand management is the long-term retention of positive knowledge and associations towards the corporate brand in the minds of stakeholders, given their perception process. Moreover, relevant and differentiated corporate brand associations have to be evoked in order to satisfy the stakeholder's needs. This can be supported by effective corporate communication and stakeholder contact points. In addition corporate brand associations can have a distinctive value for different stakeholders (Aaker, 1992; Dacin and Brown, 2002). Therefore, associations have an impact upon stakeholder attitudes as well as on the corporate image, reputation and corporate brand equity as outlined below. Figure 10

#### **External determinants – SOR model – 'Response'**

##### **Corporate reputation and corporate brand equity**

The outcome of the perception process is stakeholder response in terms of awareness and image and their consequent effect upon corporate reputation and hence brand equity. See Figure 4.



Va Values	Pe Perception	TCC Total Corporate Communications
M Mission	As Associations	R Reputation
Vi Vision	At Attitudes	BE Corporate Brand Equity
S Strategy	Aw Awareness	
C Culture	Im Image	
P Personality	i stakeholders	
Be Behaviour		
Id Identity		
Br Brand Positioning		

Figure 4 – Integrative Model of Corporate Brand equity

Awareness of the corporate brand can be defined as the stakeholder's ability to identify the corporate brand, to bring it to mind and to allocate it to a specific business category (Brockdorff, 2003). Awareness may either be passive (aided) or active (unaided) awareness, (Homburg and Krohmer, 2006). The highest level of awareness is reached if a corporate brand is selected first within its category. Such corporate brands enjoy so-called top-of-mind awareness which is especially relevant for brand choice (Keller, 1997). Corporate brand management therefore has to establish strong brand awareness as a marketing objective as well as the choice of brand architecture since this is a necessary condition for the development of a strong image and reputation, the foundation of a corporate brand value. Corporate communication therefore enables the

stakeholder to perceive the corporate identity, which is the basis of both corporate image and reputation (Aaker, 1992; Balmer and Gray, 2000).

As already indicated the image of a corporate brand is influenced by the stakeholder's specific associations and depends on tangible characteristics such as the brand name, logo, visuals, etc., (Tomczak and Kernstock, 2004). Corporate image is based upon the communication of the corporate identity as determined by the company - it is a mental picture that a stakeholder holds individually at a certain point of time. In contrast to the corporate identity (company self-perception), the corporate image describes the short-term stakeholder-specific perceptions (Fombrun, 1996; Brockdorff, 2003). Ideally these two images should be the same however this may often not be the case and so one goal of strategic brand management is to minimise this gap.

The overall long-term corporate reputation is the accumulation of the short-term stakeholder-specific images. This reputation can be seen as the collective (emotional and rational) perceptions and evaluations by all the stakeholders (Fombrun, 1996). A positive corporate reputation may be evidenced for example by the corporate brand being appreciated as responsible, reliable, credible or trustworthy; by the staff's commitment to the company; by positive tertiary communication; as well as by the satisfaction and loyalty of the staff and consumers (Aaker, 2004). The reputation is the result of a process where stakeholders evaluate all services of a company and it determines the long-term corporate brand equity generated by the organisation, (Brockdorff, 2003).

### **Mediating factors**

In addition to these endogenous factors, three mediating variables are postulated – corporate performance; industry specific factors and internationality (Fombrun, 1996).

### **Influence of corporate performance**

Previous studies suggest a number of qualitative and quantitative performance factors which affect corporate reputation positively or negatively. Positive qualitative factors include leadership, talent management, investment strengths, marketing intensity and CSR initiatives. Negative, or uncertain, qualitative factors include unrelated diversification (which may be perceived as unfocused or risky, (Grant, 2005)) and media presence (which may indicate operations in turbulent markets, for example the BP Mexican Gulf issue). Positive quantitative factors include market capitalisation, market share, rising share prices, equity use, return on assets and sustainability. Negative quantitative factors include volatility, risk assumptions and shareholder concentration (possibility of interference). In summary, reputation supports sustainable competitive advantage and is correlated to corporate performance mostly in a positive direction, (Carmeli and Tishler, 2005; Davies et al, 2003).

**Influence of industry sector**

Prior work suggests that industry sector can have an impact on corporate reputation, hence corporate brand equity (Schwalbach, 2001). To operate in a specific industry can positively influence the company's reputation due to the fact that some industrial sectors are held in higher esteem (e.g. automotive industry in Germany), whereas others have a lower reputation (e.g. energy supply companies in Germany). The industry classification can have a consequent impact for companies clearly associated with specific industries (Schwalbach, 2001).

**Influence of internationality**

Internationality can also have an effect if a specific industry has a high rating in a specific country. This might reflect national competitive advantages but could also relate to cognitive processes, attitudes to internationality or to specific national perceptions and country of origin effects, including explicit references such as "made in..." or "made by...", e.g. 'made in Germany' for automotive or engineering sectors, French luxury products or Italian design, (Schwalbach, 2001). Some financial brand valuations explicitly include internationality, including Interbrand for example. There is some counter evidence that in certain sectors, local brands may be preferred over global, (for example the European food sector – (Schuiling & Kapferer, 2004).

Figure 4 therefore proposes an integrative framework for the creation of corporate brand value. It integrates the internal (company) and external (consumer) variables, the perceptual process, the S-O-R-model and the mediating factors. It also attempts to show the nature of the interactions between the different variables. The previous sections outlined the different determinants of corporate brand equity and their impact on the corporate brand value. By integrating work from a number of existing sources we have tried to systematise the different heterogeneous conceptions and relate them to each other within a structured framework.

**Conclusions**

Our review of the branding and other literature has enabled us to propose an integrative corporate brand value creation framework. We argue for the inclusion of internal (company) as well as external (consumer) variables as well as mediating factors.

The management implications are that there is still a need therefore to reconcile academic and practitioner models and to seek greater universality. This does implies the use of a comprehensive framework which incorporates company-determined constructs as well as consumer, and other stakeholder, measures.

**Limitations and Future Research**

The principal contribution of this paper is to provide a comprehensive theoretical framework for the generation of consumer brand equity. The next steps will require validation of the model and empirical testing with practitioners.

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## EFFECT OF EXTENSION CONTACT ON RICE PRODUCTIVITY IN GAZIPUR DISTRICT OF BANGLADESH

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### Abstract

The impact of extension contact is examined with a view to evaluate the agriculture extension in Bangladesh. It is found that the impact of extension contact is stronger for the comparatively nearer villages to upazila headquarters. This effect is weaker for those villages which are comparatively away from upazila headquarters. Evident shows that the influence of extension contact is strongly positive and significant in the upazila where peoples are mostly involved in agricultural works. The results show that the impact of extension contact which is one of the basic tenet of agricultural extension, as found in the yield of rice in the whole survey area, is strongly positive and significant. Some determinants of extension contact are also examined. Findings revealed that education of farmers, size of farm families, number of earners of farm families, irrigation and villages which are nearer to the upazila headquarters are key determinants for a household participation in extension contact.

**Keywords:** Extension contact, farmer, rice yield

### Introduction

In order to raise farmers' income and production in developing countries, governments and international organizations have been aggressively promoting agricultural extension services in those countries. According to a review of tens of researches by Birkhaeuser and Evenson (1991), on the whole the extension services have contributed to some extent to raising the amount of information and thus the productivity levels of farmers. In the late 70s, an extension system involving 12000 workers was initiated under the denomination of "Training and Visit System" hereinafter referred to as T&V system in Bangladesh (Illah *et al.* 1996; Reynar *et al.* 1996). Yet, whether or not that program actually contributed among the farmers' productivity in terms of income or physical production and if yes, whether the benefits of the system are homogeneously distributed among the farmers have not been clarified enough. The Gazipur district is one among many average rice productivity areas of Bangladesh. It is necessary to increase the rice productivity of the Gazipur district. It will support to reach the self sufficiency of the rice productivity in Bangladesh. Haq *et al.* (2003) found that the extension contact has positive impact on the income of farmers of the Gazipur district. It is also depicted that large farmers, higher income of farmers, young farmers are some key factors to adopt extension contact. The study is recognized but unclear due to smaller samples and fewer study sites respectively. To remedy this situation serious studies on the extension services and its determinants are necessary. Thus the current paper, based on farmers in the central area of Bangladesh, has two major

objectives: 1) to assess the benefits of agricultural extension services on the productivity of rice and 2) to determine the type of farmers who benefited from the extension services.

## Methodology

### Sampling Design

The research area was Gazipur district which is an average agricultural productivity area. The selection of the study sites and sample respondents were done purposively. There were some salient features in the selection procedure. First one, the selected district includes some important infrastructures such as BARI, BIRRI and BSMRAU etc. Second one, total numbers of selected villages were ten by taking two villages from five upazilas (subdistricts). Of the two villages in each upazila, one village is selected comparatively nearer to the upazila headquarters and the other one is selected comparatively away from the upazila headquarters. The selected comparatively nearer villages were namely, Samantapur (Sadar), Bagnahati (Sreepur), Dushya Narayanpur (Kapasias), Katalia (Kaliakoir) and Poinlanpur (Kaliganj). The selected villages which were comparatively away from the upazila headquarters, namely, Bara Bhabanipur (Sadar), Saitalia (Sreepur), Noyanagar (Kapasias), Poshim Chandpur (Kaliakoir) and Bhatgati (Kaliganj). Third one, the total households were more than one hundred in the selected villages (BBS, 1993). It was then decided to collect<sup>2</sup> one hundred samples from each village. The total numbers of investigated farmers were one thousand (2 villages x 5 upazilas x 100 farmers) and multistage random sampling technique was followed. Primary data was collected using survey method and personal interviews were conducted through pre-tested questionnaires with a view to collect data. The survey was administered with the help of staffs of the BARI in 2002. Fourth one, each upazila has some characteristics: Sadar upazila is completely urban type; Sreepur, Kapasias and Kaliganj upazilas are rural type and headquarters of these upazilas are the only urban areas while Kaliakoir upazila headquarter is the only urban area and Safipur is the other urban area of this upazila (BBS, 1993). This study can be comprehensive compared to many research works due to the above salient features which will explore the actual situation of agriculture extension either in Bangladesh or else where from the grassroots levels.

### Conceptual Framework

Many of the previous researches used the productivity index representing the amount of production per unit of farm land, that is, the value added of production, which is found by deducting production costs from gross income. By using that index, it is possible to convert the specific quantities of products into given amounts of money to be added up; therefore it represents a considerable

<sup>2</sup>Data was collected from the author's Ph.D program.

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analytical benefit. The method of settling the type of variables from which the index is determined, expected to be discussed.

As is commonly used in analyzing production function, chemical fertilizer, farm buildings, irrigation facilities, family and hired labours should be considered as important investment functions (Evenson *et al.*, 2001; Owens *et al.* 2003). Haq *et al.* (2003) considered crop income per unit of land as dependent variable and chemical fertilizer cost per unit of land, irrigation cost per unit of land, experience of farmers, farm area, number of times extension contact as independent variables. Therefore, it summarized the model,  $\ln \text{crop income} = f(\ln \text{ chemical fertilizer}, \ln \text{ irrigation}, \ln \text{ experience}, \ln \text{ farm area}, \ln \text{ labour}, \text{ extension contact dummy}_1, \text{ extension contact dummy}_2)$ . Haq *et al.* (2004) interpreted total income as dependent variable, while age of farmers, years of schooling of farmers, family size, number of educated family members, number of earners of a farm family, rural institutions dummy, number of times extension contact, proportionate effect of flood to crop land, distance between crop land to market, homestead area, size of farm, irrigation cost, village dummy were taken as independent variables. The income function was solved by applying ordinary least squares. The above concepts provide to run an empirical model which is found in the ensuing section.

### Empirical Model

The model applied here is the input-output model. The heart of the input-output model is the concept of the production function  $[Y=f(\text{Capital}, \text{Labour})]$  which helps us in understanding the role of important variables like capital and labour in determining the crop productivity. But only two factors have no reflection on the productivity of a major crop like rice. Therefore, based on related past studies and logical analysis some important explanatory variables which are considered in this study namely age of the farm household head (Ag), number of family earners in the household (Fea), number of times extension contact received by the farmer for the sample crop season (Et), proportionate effect (%) of flood to crop land (Fec), distance from farm land to market in miles (Mr), actual size of cultivated land in acre (Fs), per acre total cost of chemical fertilizer (Chem), per acre total labour cost (Lab), per acre total money spent for irrigation (Irr), village dummy (Vdummy) = 1 if near village; otherwise = 0 and upazila dummy (Udummy) i.e. Sadar upazila = 1, otherwise = 0.

The yield of rice (maund/acre; 1 maund=37.3 kg) is the dependent variable in the present paper as it is the major food crop in the country. It includes boro rice because it is hardly affected by the natural disaster compared to other rice crops and it was cultivated by all sample farms.

In the objective of this research, the most important variable is that of the activities of the agricultural extension services. In Bangladesh T&V system, farmlands are divided into blocks and the T&V workers target the representative farmers of the different blocks, who are referred to as “contact farmers” (Haq *et al.*, 2003). Although the T&V workers can directly get in touch with ordinary farmers, they mainly train the contact farmers, who afterwards transmit the training results to the other farmers, in a progressive system (ibid). Considering this situation in Bangladesh, the current paper used the frequency of contacts on the basis of actual number of times contacted between ordinary farmers and T&V workers or contact farmers. Note that the combination of T&V workers and contact farmers is hereinafter referred to as “extension agents”

(ibid). Most of the farmers of Bangladesh are either illiterate or unskilled. Thus with the knowledge derived from extension services through extension contact, farm operators may increase their production (Haq *et al*, 2003; Owens *et al*, 2003). Relevant importance of other selected variables can be found in related literatures (Haq *et al*, 2004; Evenson *et al*, 2001; Begum *et al*, 1998). Except for the variables of contact frequency, proportional effect of flood to crop land, village dummy and upazila dummy, all the variables have been evaluated with a logarithmic converter to avoid disparities of the figures (Haq *et al*, 2003; Owens *et al*, 2003). Data have been analyzed by correlation and regression analyses. The productivity expressed in terms of physical quantity is as follows for village level analysis:  $\text{Ln Rice yield} = f(\text{LnAg, Ln Fea, LnFs, Et, Fec, LnMr, Ln Lab, LnIrr, LnChem, Vdummy})$ . For the upazila level analysis the above function is,  $\text{Ln Rice yield} = f(\text{LnAg, Ln Fea, LnFs, Et, Fec, LnMr, Ln Lab, LnIrr, LnChem, Vdummy, Udummy})$ .

## Results and Discussion

### Correlation Analysis

It is argued by some researchers that a correlation analysis is necessary to identify the degree of association between the dependent and selected independent variables in order to determine their expected signs prior to multivariate analysis (Evenson *et al*, 2001). A bivariate analysis is done and Table -1 demonstrates the possible signs of selected numerous factors which can affect on the yield of rice.

### Regression Results

The estimated values of coefficients and related statistics of the multiple regression coefficients of villages and upazilas are presented in Table-2 and Table-3. The adjusted R<sup>2</sup> values agree with similar studies which are understandable because of the numerous factors affecting the yield of rice. The F-values are significant at 1% level of significance which implies that the specifications of the models were reasonably accurate (Begum *et al*, 1998). The results of the functional analysis suggest that except for few variables, all the variables had a positive effect on rice yield in the sample farms.

Table- 1 Correlation analysis

Variables	Rice	Ag	Fm	Fea	Et	Fs	Fec	Mr	Chem	Irr	Lab	Vdummy	Udummy
Rice	1	-.06**	-.01	.03	.08***	-.37***	-.05**	-.09***	.50***	.45***	.21***	-.18***	-.07**
Ag	-.06**	1											
Fm	-.01		1										
Fea	.03			1									
Et	.08***				1								
Fs	-.37***					1							
Fec	-.05**						1						
Mr	-.09***							1					
Chem	.50***								1				
Irr	.45***									1			
Lab	.21***										1		
Vdummy	-.18***											1	
Udummy	-.07**												1

\*\*\*, \*\* &amp; \* indicate 1%, 5% &amp; 10% level of significance.

Table – 2 Regression Results by village levels

<i>Variables</i>	<i>Samantapur</i>	<i>Bagnahati</i>	<i>Dushya Narayanpur</i>	<i>Katalia</i>	<i>Poilanpur</i>	<i>All Near Villages</i>	<i>Bara Bhabanipur</i>	<i>Saitalia</i>	<i>Noyanagar</i>	<i>Poshim Chandpur</i>	<i>Bhatgati</i>	<i>All Far Villages</i>	<i>All Villages</i>		
<i>Constant</i>	*** 4.761	.353	** 2.598	*** 4.080	* 1.127	*** 6.090	** 2.450	.725	7.418	.514	1.222	10.788	12.296		
<i>LnAg</i>	.039 .383	-.003 -.043	-.222** -2.919	-.164** -2.194	-.100* -1.717	-.053* -1.601	-.025 -.341	.032 .579	-.055 -.740	.072* 1.054	.024 .233	-.053* -1.540	-.058** -2.416		
<i>LnFea</i>	.123* 1.243	.055 .930	.128* 1.588	.150** 2.103	.200*** 3.505	.134*** 4.042	.146** 2.085	.111** 1.996	.274*** 3.795	.033 .497	.169* 1.668	.105*** 3.028	.127*** 5.312		
<i>LnFs</i>	-.414** -2.956	-.445** -4.235	-.331** -2.863	-.532*** -5.627	-.461*** -4.817	-.460*** -10.152	-.325*** -3.316	-.378*** -5.844	-.694*** -9.349	-.499*** -5.660	-.197* -1.396	-.531*** -12.313	-.481*** -15.737		
<i>Et</i>	.184** 2.002	-.003 -.0445	.142* 1.869	.170** 2.302	.067* 1.221	.116*** 3.466	-.019 -.268	-.055 -.616	-.037 -.301	-.094* -1.584	.163** 1.961	.064** 1.842	.095*** 3.944		
<i>Fec</i>	-.206** -2.239	.209** 2.358	-.337*** -3.800	-.267*** -3.193	-.042 -.779	-.072** -2.128	-.302*** -4.091	.221** 2.176	-.074 -.567	-.198** -2.987	-.246** -2.495	-.063** -1.761	-.073** -2.981		
<i>LnMr</i>	-.325** -3.251	.122* 1.723	-.099* -1.183	-.075 -.991	-.080* -1.408	-.119*** -3.464	.063 .877	-.098* -1.460	-.202** -2.227	.158** 2.817	.297** 2.577	.127*** 3.808	-.022 -.900		
<i>LnLab</i>	-.146* -1.069	.022 .213	.242* 1.908	.004 .036	-.058 -.716	-.026 -.558	.316*** 3.041	-.448*** -7.743	-.404*** -5.060	-.176** -2.328	.167* 1.045	-.252*** -6.443	-.137*** -4.680		
<i>LnIrr</i>	-.095 -.967	.079* 1.265	.073 .933	.179* 1.675	.265*** 4.714	.302*** 8.100	.048 .597	.055* 1.038	.115* 1.595	.121* 1.811	.158* 1.127	.016 .427	.265*** 10.246		
<i>LnChem</i>	-.048 -.397	.395*** 5.114	.051 .515	.177* 1.564	.422*** 5.413	.221*** 5.492	.184** 2.056	.619*** 8.866	-.035 -.493	.444*** 5.184	.104 .744	.361*** 8.562	.247*** 8.702		

<i>Vdummy</i>	---	--	---	---	--	---	----	---	----	----	-----	-----	-.149***		
<i>AR<sup>2</sup></i>	.239***	.690***	.499***	.569***	.735***	.514***	.560***	.753***	.538***	.710***	.569***	.512***	-.6.068		
<i>F</i>	4.449	25.519	11.955	15.227	31.266	59.179	14.996	34.500	13.818	27.090	10.393	54.834	100.233		
<i>N</i>	99	99	99	97	98	492	99	99	99	96	64	457	949		

*The figures are standardized coefficients (Beta) Italics denotes computed t-values; \*\*\*,\*\* &\* indicate 1%,5% &10% level of significance.*



Table- 3 Regression Results by Upazila levels

Variables	Sadar upazila	Sreepur upazila	Kapasias upazila	Kaliakoir upazila	Kaliganj upazila	All upazilas
Constant	*** 6.218	** 2.824	*** 5.863	*** 5.515	* 1.474	*** 12.504
LnAg	.042 .853	-.001 -.035	-.102** -2.040	-.080* -1.526	-.102** -2.092	-.060** -2.576
LnFea	.101** 2.087	.095** 2.408	.198*** 3.894	.111** 2.125	.201*** 4.008	.149*** 6.376
LnFs	-.315*** -4.745	-.435*** -8.617	-.489*** -8.125	-.591*** -9.157	-.303*** -4.042	-.473*** -16.476
Et	.027 .575	.012 .234	.112** 2.107	.039 .763	.076* 1.595	.068** 2.833
Fec	-.155*** -3.208	.198*** 3.460	-.112** -1.910	-.248*** -4.532	-.053* -1.100	-.068** -2.777
LnMr	.013 .200	.057* 1.008	-.095* -1.702	.003 .052	.015 .317	-.086*** -3.517
LnLab	.005 .071	-.235*** -5.052	-.307*** -4.853	-.141** -2.094	-.016 -.217	-.155*** -5.593
LnIrr	.055 .762	.075** 1.879	.092** 1.828	.125** 1.930	.274*** 5.486	.235*** 8.340
LnChem	.086* 1.419	.475*** 9.717	.354*** 5.967	.281*** 3.941	.448*** 7.091	.269*** 9.821
Vdummy	-.670*** -8.223	-.272*** -5.161	.031 .520	-.016 -.322	-.215*** -4.274	-.164*** -6.687
Udummy	----	-----	-----	-----	----	-.007 -.288
AR <sup>2</sup>	.589***	.725***	.583***	.576***	.664***	.535***
F	29.334	53.560	26.383	27.384	33.196	101.102
N	198	198	198	193	162	949

The figures are standardized coefficients (Beta). Italics denotes computed t-values.

\*\*\*, \*\* & \* indicate 1%, 5% & 10% level of significance.

The coefficient for contact comparatively nearer villages is particularly great (0.116), compared to the villages away from the upazila headquarters (0.064). The contact coefficient is stronger in Kapasia upazila (0.112) which is followed by Kaliganj upazila (0.076) and other upazilas. According to Owens *et al*, (2003) a frequency of one and two operations per year between extension agents and farmers generates a high contribution to yield. However, a frequency of three or more than three times per year showed no clear effects in his study. Compared with the results of Owens *et al*, (2003) the results of Haq *et al*, (2003) suggests that in Bangladesh, the higher number of contacts (3 contacts or more per year) between extension agents and farmers seem more effective. Haq *et al*, (2003) found that the coefficient for 3 contacts or more per year was 0.353, while the coefficient for 1-2 contacts per year was 0.234. The present analysis suggests that in Bangladesh, the higher number of contacts between extension agents and farmers seem more effective than in the case of comparatively nearer villages with minor exception. Conversely, no such clear effects are found in the comparatively far villages since their coefficients are not significant. Jan *et al*. (2008) also observed that the coefficient for contact is stronger in the well situated villages. Analysis by upazila levels imply that higher number of contacts is more effective in the case of rural type upazila where more than eighty percent peoples are also engaged in agricultural works. Kapasia is a rural type upazila where the involvement of peoples in agricultural works is 80.15 percent (BBS, 1993) and the effect of contact is stronger in Kapasia upazila. Despite some similarities of other upazilas with Kapasia upazila, no clear effects of extension contacts in other upazilas are found as their coefficients are either significant or insignificant. The more higher number of contacts are plausible because the farmers who have more than three contacts could get case – by – case suitable guidance encouraging the application of fertilizers or prevention of insects and diseases etc. (Haq *et al*, 2003). Accordingly, it is possible to ascertain in the context of all villages as well upazilas that the contacts with extension agents contributed to improve agricultural production per unit of farmland.

#### **Relationship of the Selected Characteristics of the Farmers with their Extension Contact**

Since the average number of times extension contact in the investigated areas was not higher, it is necessary to examine what type of farmers is provided extension contact.

Table – 4 shows that extension contact is associated with the young age farmers, small size of farms, higher number of earners of a family, higher number of family members, little distance between farm land and nearest market, irrigation expenditures and comparatively nearer villages from upazila headquarters. The Vdummy is not important for extension contact. The relationship of Chem is insignificantly negative and hence, it keeps importance for extension contact. The insignificantly positive Ed implies that extension has importance for literate and illiterate farmers. According to Huffman (1974) extension activities help farmers who did not acquire enough school education to improve their ability to adjust. Similarly, the literate farmers may not

be excluded from extension contact unless the quality of education is life oriented and this situation prevails in Bangladesh and other developing countries. The difference in the educational background of the farmers keeps influence the effectiveness of extension services and thus magnify the economic gap between farmers in a vicious cycle (Haq *et al*, 2003). Therefore, extension contact is necessary to provide among all farmers regarding out their educational background since extension is a type of education for all.

Table- 4 Relationship of the selected characteristics of the farmers with their extension contact

Dependent variable	Characteristics of farmers	Correlation coefficient	Calculated values	Tabulated values*	Significance level
Et	Ag	-0.012	0.704	0.254	0.01
	Ed <sup>3</sup>	0.047	0.142	0.164	ns
	Fs	-0.125	0.000	0.254	0.01
	Fea	0.025	0.445	0.254	0.05
	Fm <sup>4</sup>	0.029	0.372	0.254	0.05
	Mr	-0.038	0.242	0.195	0.05
	Chem	-0.047	0.142	0.164	ns
	Irr	0.133	0.000	0.254	0.01
	Vdummy	0.104	0.001	0.254	0.01
	Udummy	-0.088	0.006	0.254	0.01

\* Bio Statistics: B K Mahajan, 6<sup>th</sup> ed. Jaypee Brothers, India.

Note: <sup>3</sup>Ed- Schooling years of the farm household head (Mean value is 5.77 years);

<sup>4</sup>Fm- Number of family members of a household (Mean value is 5.34);

Explanations of Et, Ag, Fs, Fea, Mr, Chem, Irr, Vdummy and Udummy variables are same as previous sections.

## Conclusion

This paper was aimed at clarifying the effects of agricultural extension on improving the productivity of farmers with the example of one district of Bangladesh, emphasizing the relevance of number of times extension contacts between farmers and extension agents. The results of the study can be summarized as follows:

First, from the estimated production function, it is clarified that the more the extension contacts between extension agents and farmers, the higher the productivity is. This clarifies that the extension contact has positive and significant effects in improving farm productivity. The effect of extension contact is stronger in those villages which are comparatively nearer to upazila headquarters. The effect of extension contact is weaker in those villages which are comparatively away from upazila headquarters. The effect of extension contact is stronger in those upazilas where the involvement of peoples in agricultural works is about eighty percent.

Second, by examining the factors determining the contacts between extension agents and farmers, a positive correlation was found with the level of education, size of farm families, number of earners of farm families, irrigation and villages which are comparatively nearer to the upazila headquarters. On the other hand, the size of farm, age of the farm household head, chemical fertilizer, distance between farm land to nearest market and upazila dummy variables have no direct relationship with the extension agents.

Considering the overall estimation, it has been possible to ascertain that agricultural extension positively contribute to increasing the rice productivity of farmers to some extent but there is a necessity to develop the system toward more efficiency for all farmers in Gazipur district of Bangladesh. It is anticipated that the findings of the study will help the planners and policymakers of Bangladesh to offer a better agriculture extension in future.

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**MEASURING CUSTOMER SATISFACTION OF ELECTRONIC DEVICE BY USING  
SERVQUAL APPROACH -A CASE STUDY OF UDDIPON DIGITAL SYSTEM IN  
DHAKA, BANGLADESH-**

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**Astract**

Servqual factor is necessary in order to gain a high level of customer satisfaction. In a competitive marketplace where businesses compete for customers, customer satisfaction is seen as a key differentiator and increasingly has become a key element of businesses strategy. This study explores overall customer satisfaction as well. The major objectives of the study were as follows: customer perception towards different service quality factors and determining the customer satisfaction of overall service quality in Uddipon Digital System which is working in the IT Product Market of Bangladesh since 2003 and served more than 250 companies. Both primary and secondary data have been used. Primary data was collected through questionnaire. Analysis technique was descriptive. Many weaknesses of service quality were found. The study also thinks that many clients are possible to manage in order to accelerate the business activities of Uddipon Digital System in Bangladesh.

**Keywords:** Customer satisfaction, Servqual, Bangladesh

**Introduction**

**Background of the study**

In the recent world business has become more competitave where customer satisfaction plays an important role to servive in the market. To gain a higher level of customer satisfaction servqual factor is must. Customer satisfaction, a business term, is a measure of how products and services supplied by a company meet or surpass customer expectation. It is seen as a key performance indicator within business and is part of the four of a Balanced Scorecard. In a competitive marketplace where businesses compete for customers, customer satisfaction is seen as a key differentiator and increasingly has become a key element of business strategy. This study explores overall customer satisfaction as well by considering the major objectives which are as follows:

- Consumer perception towards different service quality factor.
- Determining the customer satisfaction of overall service quality in Uddipon Digital System.

**Significance of the study**

There is almost no study found on customer satisfaction of IT products of Bangladesh and in this respect this study will be able to find out the satisfaction level that would help IT product firm like Uddipon Digital System for their service development through service quality where needed on the basis of the findings of the study.

If any company wants to go or introduce in the market they can study this report. This report might help them to aware the current customer demand and such other factors. After studying this they can easily maintain firm their shrines easily & solve or ignore the major problem to serve the best to the clients.

The use of information and communication technology has been playing a vital role in the 21st century due to globalization and the government is encouraged to adapting with the coming future. The government of Bangladesh has target to establish a resourceful and modern country by 2021 through effective use of information and communication technology- a "Digital Bangladesh".

"Digital Bangladesh" does not only mean the broad use of computers, perhaps it means the modern philosophy of effective and useful use of technology in terms of implementing the promises in education, health, job placement, poverty reduction etc. Therefore, the government underscores a changing attitude, positive thinking and innovative ideas for the success of "Digital Bangladesh"(www.digitalbangladesh.gov.bd).

The philosophy of "Digital Bangladesh" comprises ensuring people's democracy and rights, transparency, accountability, establishing justice and ensuring delivery of government services in each door through maximum use of technology-with the ultimate goal to improve the daily lifestyle of general people. Government's "Digital Bangladesh" includes all classes of people and does not discriminate people in terms of technology. Hence, government has emphasized on the four elements of "Digital Bangladesh Vision" which are human resource development, people involvement, civil services and use of information technology in business. This paper will also aid to learn the factors regarding the titled issue by doing this, which factor may affect the company what they to do for the performance.

**Literature Review****Customer Satisfaction Research**

Both public and private sectors have given much attention to the concept of customer satisfaction in the past couple of decades. Naturally, administrators have requested their staff to do customer satisfaction studies for their own organizations. In this section, the researcher elaborates on the importance of the customer that is the access control user and its perception

towards the service provided by the access control service provider and their satisfaction on the service received. Consumer satisfaction provides the basis for the marketing concept and has been shown to be a good predictor of future purchase behavior. As a reflection of its importance, consumer satisfaction is a popular topic in the marketing literature. Most models of consumer satisfaction—and service quality—maintain that discrepancies between ex ante expectations of a good or service and the product's ex post performance are the best predictors of the satisfaction or quality perceived by the customer (e.g., Oliver 1977, 1980; Parasuraman, Zeithaml, and Berry 1985, 1988).

### **Customer Satisfaction**

The concept of customer satisfaction has drawn the interest of academics and practitioners for more than three decades in the light of fact that customers are the primary source of firm's revenue without the emergence of the consensual definition of concept. Churchill and Suprenant (1992) define customer satisfaction as an outcome of purchase and use resulting from buyers' comparison of the rewards and costs of the purchase in relation to the anticipated consequences. It also has been viewed as an emotional state that occurs in response to the evaluation of a service (Westbrook, 1981). The former conceptualization recognizes that satisfaction is determined by a cognitive process of comparing what customers receive (rewards) against what they give up to acquire the service (costs), whereas the latter view satisfaction as an emotional feeling resulting from evaluation process. Consistent with this view, customer satisfaction is defined as an emotional response, which results from a cognitive process of evaluating the service received against the cost obtaining the service (Woodruff et al., 1991; Rust et al., 1994). Satisfaction is an emotional or feeling reaction. Moormann (2000) defines satisfaction as a positive feeling about a particular entity. Rust et al (1996) define satisfaction as how customer perceives service and how they feel about it. This is because customer decisions take place in the customers' mind. Oliver (1991) defines consumer satisfaction as the overall attitude towards goods or services after they have acquired and used it. It is post choice evaluative judgment resulting from a specific purchase selection and the experience of using/consuming it.

Customer satisfaction measure is useful for assessing the effectiveness of efforts to redesign elements of the service delivery system (Chase et al., 1991)

### **Service Quality Research**

Delivering high quality services has been recognized as the most effective means by which a service company's can create a competitive edge from the competitors (Parasuraman et al, 1991). Studies have also demonstrated the strategic advantage of delivering superior quality to market share as well as profits (Gronross, 1988). Research on services has grown correspondingly. In particular, academics and practitioners alike have exhibited considerable interest in the issues

that surround the measurement of service quality. Service quality is one of the major issues facing operations managers (Gupta et al., 1995) but it is an area characterized by debate concerning the need for assessing customer expectations and service quality assessment (Parasuraman et al., 1994). Service marketing literature in general and service quality in particular is still evolving and not achieves the maturity stage yet, thus this study is aimed at exploring the service quality in the UDS management services which is still lacking behind and need further explored.

### **Relationship between Satisfaction and Service Quality**

Satisfaction is defined as a customer's perception of a single service experience, whereas quality is the accumulation of the satisfaction for many customers over many service experiences. Such post-evaluation experiences perhaps lead over time to a more general attitude. Moreover, service is equal to the perception of a single service as received and measured against the expected service received. The difference in the degree, direction and discrepancy between perceptions and expectations of a customer result in a level of satisfaction or dissatisfaction (Hill, 1992).

The relationship between customer satisfaction and quality can be explored by using Gronroos (1984) quality dimensions. In his work, Gronroos determines the technical quality of the service process that the customer is left with when the service production process and its buyer-seller interactions are over. Customers can often measure this dimension relatively objectively because of its technical nature. The service dimension is another quality dimension, which has been used in literature as a functional or process quality of the process. The customer is also influenced by how he receives the service and how he experiences the simultaneous production and consumption process.

However, in the literature three theoretical conclusions can be found regarding the relation between satisfaction and (service) quality. First, (service) quality is understood as an antecedent of customer satisfaction (Peyrot et al, 1993; Woodside et al, 1989). According to this interpretation, (service) quality is equated with the customer's appraisal of a concrete product or service experience (Gotlieb et al., 1994). Consequently, it does not include expectation aspects, whereas satisfaction is based on the (dis-) confirmation of expectations associated with the service or product experience.

Second, both constructs are treated as one and the same. According to this approach no significant theoretical difference between satisfaction and (service) quality exists (Gummesson, 1987; Spreng and Singh, 1993). As with the first interpretation, the aforementioned divergences concerning the higher stability of quality perception and the emotional dominance of satisfaction are ignored by this approach.

The third approach is where customer satisfaction is modeled as an antecedent of quality. Following this interpretation, the product and/or service related quality perception is as seen as



the higher order and more stable variable, which is built mainly on previous experiences of (dis-) satisfaction related to discrete transactional episodes (Bitner, 1990; Bitner and Hubber, 1994; Bolton and Drew, 1991, 1994). Thus, satisfaction is regarded as a short term emotional state that results from an intrapersonal comparison of the customer's expectations with the evaluation of a single product or service encounter. This emotional state of satisfaction leads to an overall, global attitude about (service) quality (Dabholkar, 1993) which is only implicitly based on some kind of internal expectation standard. Because quality is a dynamic construct, additional consumption experiences influence and modify the existing quality perception and cause changes in this perception (Thompson and Getty, 1994). In other words, multiple satisfaction evaluations contribute to an overall quality evaluation.

In this research, it follows what Rust et al (1996) has clearly illustrated in the relationship between perceived quality and satisfaction. It has pointed out in two different situations. As illustrated in Figure 2.1, the perceived quality is higher than expected. This situation will usually result in satisfaction. Oppositely perceived quality is not as good as expected. In this situation will result in dissatisfaction. This disconfirmation (gaps) forms the conceptual basis for the SERVQUAL model for the service quality and satisfaction.

### **Conceptual Framework**

The framework will provide the researcher with a guide on how to develop the service quality instrument to be implemented in this study. The development of framework has to start from an initial idea and concept. In this case of implementing service quality, one can start by trying to analyze the range of options available such as development of service quality dimensions as well as the existing models of service quality. The researcher will discussed at the service quality dimensions from various studies. Service quality is multidimensional (Parasuraman et al, 1985) and a very complex phenomenon (Gronroos, 1998). Thus this section is to identify the most suitable construct and dimensions for highway management services. The framework is illustrated as Figure 2.1 below.

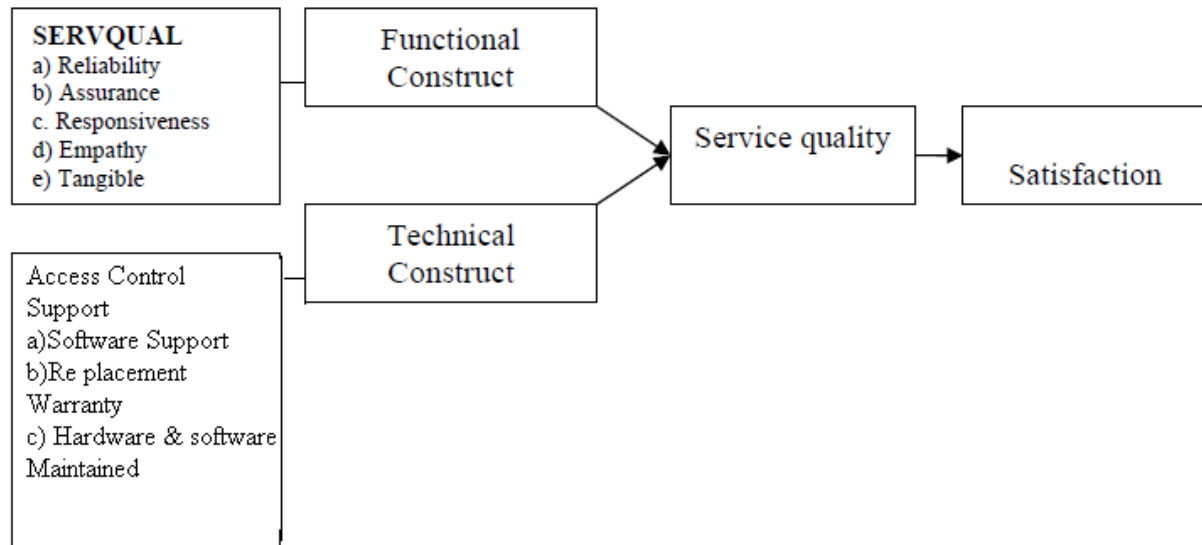


Figure 2.1: Proposed Conceptual Framework

The model proposes that the service quality consist of technical and functional dimensions. The model also proposes that there are direct relationships between service quality perception and the technical construct and the quality dimensions, in addition to the indirect effects of technical and functional quality on service quality perception. The model also suggests that the service quality leads to customer satisfactions. There is theoretical support for a multi dimensional, multi level model of service quality (Dabholkar et al, 1996), but little effort has been taken to conceptualized and empirically tests such structure.

SERVQUAL was modified in the present study to reflect the nature of UDS management services. Parasuraman et al (1988), indicated that such modifications were appropriate and do not represent difficulties related to the reliability and validity of the instruments.

### The SERVQUAL Model

Given the growth of services in the last decades, many researchers have recognized the need to develop measures of service quality. One of the most often used measures is the SERVQUAL based on extensive research in generic determinants of perceived service quality (Parasuraman, Berry et al. 1985; Parasuraman, Berry et al. 1988; Zeithaml, Parasuraman et al. 1990; Parasuraman, Berry et al. 1991; Parasuraman, Berry et al. 1993; Parasuraman, Berry et al. 1994). The model measures the difference between customers' expectations about general quality of a certain group of service providers and their perceptions about the actual performance of a service provider from that group. It uses a set of service quality determinants measured by a 22- item scale. The model defines customer satisfaction as perceived service quality, which is the gap between expected service and perception of service actually received. Many studies in different service

industries use the model as a basis for developing surveys to evaluate customer satisfaction, which was the ambition of the authors.

### **Dimension in SERVQUAL Model**

Boulding et al. (1993) perceived the dimensions of service quality as a function of a customer's prior expectations of what should transpired during a service encounters, as well as the customer's most recent contact with the service quality delivery system. These perceptions of quality dimensions form the basis for a person's intended behavior. Their findings suggest that the two different types of expectations have opposing effects on perceptions of service quality and that the service quality perceptions positively affect the intended behavior.

Starting with the ten dimensions, Parasuraman et al (1988) conducted studies in several sectors to developed and refined SERVQUAL, and using factor analysis reduced the ten dimensions to five. These five new dimensions were defined as below and summarized in Table 2.3.

#### Tangibles

According to Kotler (1999), Bitner and Zeithaml, (2003), the appearance of physical facilities, equipment, personnel and communication materials of an organization is the tangibles. Churchill and Peter (1999) added that customer look for quantity in the equipment, facilities and communication used to provide the service.

#### Reliability

According to Kotler (1999), Bitner and Zeithaml (2003) the ability to perform the promised service dependably and accurately is the reliability. Churchill and Peter (1999) added that customers want performance to be consistent and dependable.

#### Responsiveness

According to Kotler (1999), Bitner and Zeithaml (2003) responsiveness is the willingness to help customers and provide prompt service. Churchill and Peter (1999) added that customer must see service provider as ready and willing to perform.

#### Assurance

According to Kotler (1999), Bitner and Zeithaml (2003) assurance means the knowledge and courtesy of employees and their ability to convey trust and confidence.

#### Empathy

According to Kotler (1999), Bitner and Zeithaml (2003), empathy means the provision of caring, individualised attention to the customer. Key dimensions used in this study can be summarised as Table 2.3 below:

<b>Tangible</b>	Appearance of physical facilities, equipments, personnel, and communication materials
<b>Reliability</b>	Ability to perform the promised service dependably and accurately
<b>Responsiveness</b>	Willingness to help customers and prompt service.
<b>Assurance</b>	Knowledge and courtesy of employees.
<b>Empathy</b>	The firm provides care and individualised attention to its customers.

*Table 2.3: Dimensions in SERVQUAL Model*

While being widely applied, the SERVQUAL model has also received criticism for not including prices in the assessment or for the inclusion of expectations as a variable in measuring service quality (Boulding, Kalra et al. 1993). Perhaps the most often heard criticism pertains to the lack of a clear link between satisfaction and perceived service quality identified by some research (Duffy and Ketchard 1998). An alternative model (SERVPERF) was later developed for these reasons, based on the findings that service quality does not depend on expectations and can be directly measured by simple performance based measures of service quality (Cronin and Taylor 1994).

### **Service Quality Model**

According to Grönroos (1982), the quality of a service perceived by customers will differ depends on what strategy the company chooses to deliver and promote that service. The service quality model by Grönroos holds that the quality of a service, as it is perceived by the customer, can be divided into technical quality and functional quality dimensions. The former denotes what the customer receives as the output of a service production process and the latter how the technical quality is produced and transferred to the customer during buyer-seller interactions

Grönroos (1988) posits that the technical quality is the “basic condition for a positively perceived total quality, but the functional quality is the one that adds competitive edge” (Gummesson and Grönroos, 1987). Furthermore, in the relationship marketing, the growth of the importance of functional quality in comparison to technical quality becomes a strategic one

(Grönroos, 1993). The distinction is also made in the model between perceived and expected service quality and it is suggested that the quality is perceived subjectively. Grönroos, (1988) further develops the model by positing that in the case of a company, which extends product offer with services, it is more appropriate to talk about total perceived quality. According to him, a high perceived quality is obtained when the experienced quality meets customer expectations, i.e. the expected quality. However, if the expectations are unrealistic, the total perceived quality will be low, even if high quality was experienced (Grönroos, 1988). Grönroos urged that the total perceived quality is not only defined by the level of technical and functional dimensions, but also by the gap between the expected and the experienced quality.

### Discussion on the Proposed Researched Model

Based on the Parasuraman et al (1988) gaps model, this research will focus on the gaps 5, where it measures the perceived service against the expected service provided by the highway service provider to measure their service quality. According to Parasuraman et al (1988) the smaller the gap between adequate service and perceive service, the higher the perceived adequacy of the service. The gap 5 is simplifies as Figure 2.2 below.

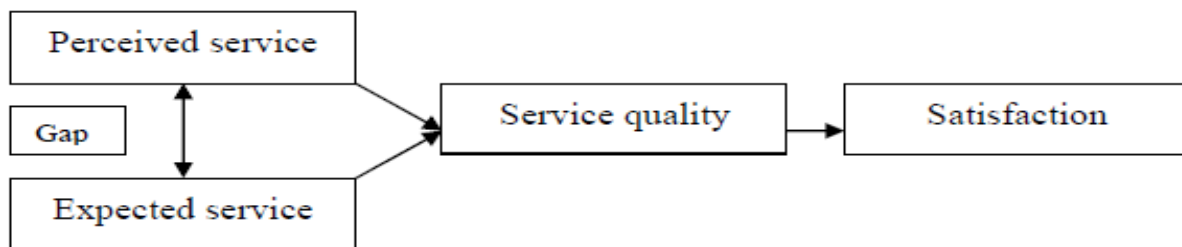


Figure 2.2: Service Quality FRAME WORK 1

According to Gronroos (1988), in order to make a list of determinant or factors of good quality useful for managerial purposes, it has to be short enough, but still provide a comprehensive list of aspects of good quality. Therefore, for the purpose of this study the researcher has chosen Parasuraman et al (1988), ie the five service quality dimensions as the most relevant study because it fit with the suggestion made by Gronroos (1988) the quality dimensions has been developed specifically for services, and the dimensions are derived from empirical studies and statistical analysis. Zarita (2006) demonstrates that these five dimensions will be one aspect of service quality construct that is the *functional/process construct*. Thus the suggestion of the conceptual model based on the above discussion is illustrated as figure 2.3 below

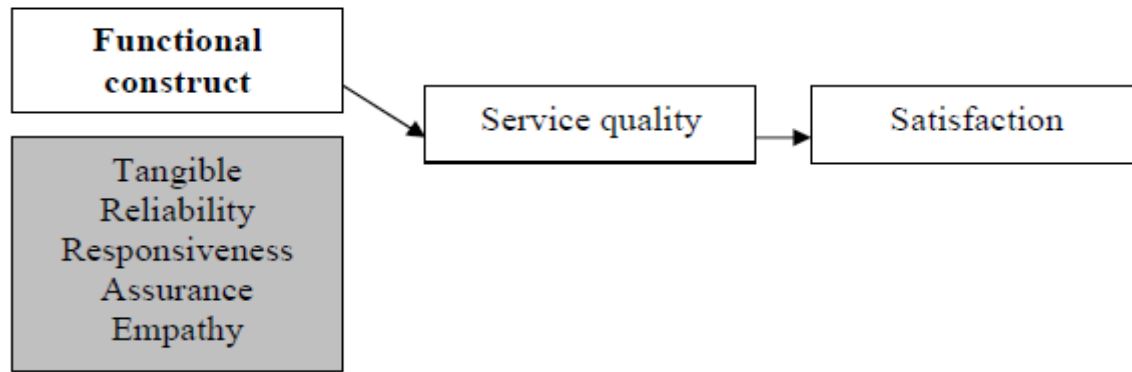


Figure 2.3: Service Quality FRAMEWORK 2

As Parasuraman et al. (1988), suggest that the five (5) dimensions above are generic dimensions which are appropriate to apply in measuring Service Quality for all service sector. However, Taylor and Baker (1994), urged that the relationship of service quality is different from industry to another industry of services as mentioned by Carmen (1990). New factors should be added and taken into account based on generic and appropriateness of the services sectors.

Gronroos (1988) urged that the quality of a service, as it is perceived by the customer, can be divided into technical quality and functional quality dimensions. The technical quality is the basic condition for a positively perceived total quality. In the UDS management and services, the UDS and the facilities used by the access control users represent the *technical/outcome quality* dimensions. On the other hand the highway service provider/concessionaires who provide the management and maintenance of the services and facilities represent the functional or process dimensions. Operational highway management and services consist of two main task (1) the management and (2) maintenance. The management involves all the coordination of work, toll collections, supervision and other management task, whereas maintenance involves the outcome of the physical aspect which is the road and its facilities. Figure 2.3 below illustrate the framework and conceptual model based on the conclusion made.

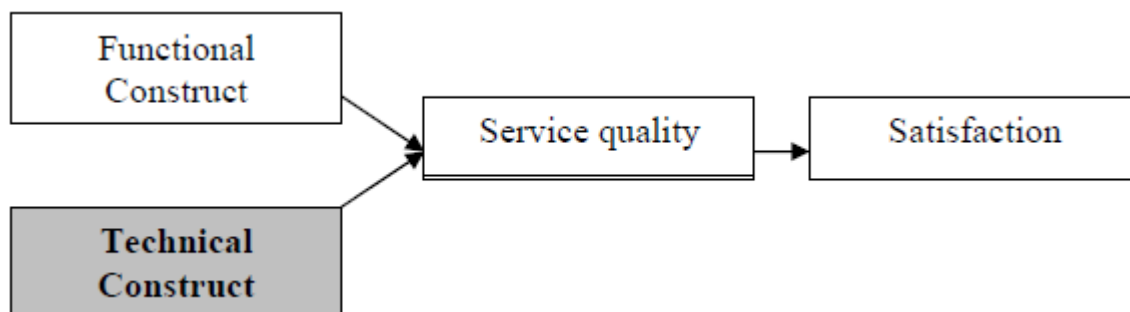


Figure 2.3: Service quality FRAMEWORK 3

The technical or Outcome quality of the physical aspects is the second part of the framework which is the maintenance of the access control and facilities. However, in the marketing terms, it is known as the physical evidence. Zeithaml and Bitner (2003), customers often rely on tangible cues, or physical evidence, to evaluate the service before its purchase and to assess their satisfaction with the service during and after consumption.

### **Service Quality Foundations**

There are many factors regarding a products or services which have a direct impact on customer satisfaction, service quality is one of them. If the quality of service is not good, the customer will not be satisfied. So as a consequence it will be very difficult for that product or services to survive in the market any longer. So it has been chosen service quality as an important factor to assess customer satisfaction on access control of uddipon digital system.

Besides, access control is also a services oriented product. So to know the customers satisfaction level on access control service quality is must. Otherwise the study would not satisfy the objective taken in this report.

## **Methodology**

### **Overview of Uddipon Digital System:**

The organization is a group of young and experienced energetic professionals working as the driving force behind this Company Uddipon Digital system since its inception in the year 2003 in Bangladesh. In this short span of time it has already earned a good reputation by its' own sincere effort and hard work.

The organization initially started with Sales and Service of Computer Hardware and Supply of Networking Products and Accessories in the Bangladesh market.

The organization gradually developed the Company in the line of business of Import, Wholesale Distribution and Retail Sales of IT products like Computer Hardware, Networking products and various kinds of Electrical and Electronic equipments and Accessories including Electronic Security systems, among others.

Uddipon digital system has our Registered Office to take care of our Corporate Affairs and a Showroom-cum-Shop for marketing and sales purposes.

Uddipon Digital system gradually developed the Company in the line of business of office automation products Time Attendance Solution, Access Control & High Security ID card Printing, Automated Security (including access control and CCTV) and Biometric related technology. Product line of it includes the latest Barcode & Biometric Printing, Scanning and Reading technologies and all the solutions for POS. We offer a variety of portable stationary

devices including Portable Data Collection Terminals (PDTs) and state-of-the-art forward compatible spread spectrum Radio Frequency (RF) technology for real time data collection with wireless networks.

During the past few years of successful consolidation and dominance as one of the automated company in Bangladesh which concentrates in local market through the business partners.

The corporate policy of Uddipon Digital system is to take prompt business decisions; regular and careful work supervision and monitoring, professional skill development through appropriate training and human resource development. A panel of highly skilled Technical & Management Consultants is always at hand to tackle critical issues to help facilitate smooth business transactions both at home and abroad.

### **Data collection**

For organization of the paper, it has been used the knowledge and experience from various department of Uddipon Digital system. An effort has been tried to focuses the service quality system in Uddipon Digital system. To complete the paper it is used some official documents provided by the authorized person of the company. To add more valuable information, researcher has searched the company profile and website. Some other books writing on service quality also helped to finish the paper successfully. Primary data has been collected through personal interview with the investment officer to make the concept clear.

- Target population: Corporate clients are considered to collect relevant data of the study.
- Sample size and sampling technique: 15 corporate clients have been selected through convenience sampling techniques due to the time and cost constraints. Self-administered questionnaire is the research instrument. The questionnaire was close-ended where 5 points liker scale is used from I= strongly disagree to V = strongly agree. Face to face or personal interview was the data collection techniques since the rate of refusal is usually low under these methods (Sherlaker, 1990).

### **Analytical Technique**

Analytical Technique: Descriptive analysis has been conducted. Mean analysis has been applied in order to fine respondents perception towards Tangible, Reliability, responsiveness, assurance, empathy and service quality.

### **Findings**

Here it has been tried to find out the satisfaction level by calculating mean value of customer response on SERVQUAL Factors.



I - Strongly Disagree

II - Disagree

III – Neutral

IV - Agree

V - Strongly Agree

## Part - 1

Section	Question	Mean
Tangibility	1. The physical facilities at Uddipon digital system are visually appealing.	3.3
	2. Materials associated with the service are visually likable at Uddipon digital system.	3.6
Reliability	3. The products/services provided were represented accurately by the company.	3.5
	4. The product is delivered on the promised time by the company.	4.3
Responsiveness	5. Employees of Uddipon Digital system give prompt service to customers.	3.1
	6. The company shows a sincere interest in solving the problem.	3.1
	7. Employees of Uddipon Digital system always willing to help customers.	3.1
Assurance	8. Service time provided by the company is enough for the product.	3.5
	9. Replacement service that assured is given properly in warranty time.	4.5
Empathy	10. The employees of Uddipon Digital system Understand the specific needs of their customers.	3.0
Service Quality	11. Access to overall services is satisfactory.	3.5
	12. Communication style and information provision is at satisfactory level.	2.9
	13. Security of your care is satisfied with Access control solution.	3.4
	14. Competence in overall service delivery is satisfactory level.	3.3
	15. Customers are satisfied with the up-to-date range of physical facilities of access control.	3.4

In part 1, the analyzed data on perception has been described on the basis of organization's Tangibility, reliability, responsiveness, assurance, empathy; service quality. Here is the explanation of the collected data one by one.

## Tangibility

We had asked our valued clients about the organization physical facility. But it is seen that most of the clients were less than agree in the case of organization Physical facility. Out of 15 sample sizes, 2 were strongly agree, 5 were agree, 5 were Neutral, 2 were disagree and rest 1 were strongly disagree about the Physical Facility. The mean is 3.3 that stand in natural position.

On the other hand, we also asked about the material associated. Our question was " Materials associated with the service are visually likable at Uddipon digital system " In this case Out of 15 sample sizes, 1 were strongly agree, 9 were agree, 3 were Neutral and 2 were disagree. But nobody claimed strongly disagree about this option. So it can conclude that

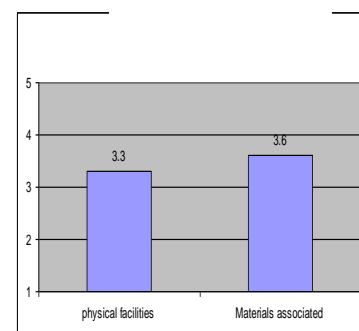


Fig.-4.1

*most of the clients are agree on the respective factors.*

#### *Reliability*

*We asked to the clients that the company represent all the products / services accurately or not. In this case Out of 15 sample sizes, 2 was strongly agree, 6 were agree, 5 were Neutral, 2 were disagree and 0 were strongly disagree that the products/services that came were represented accurately by the company. It is seen that on average the clients are between neutral and agree position.*

*When we asked about the delivery process which the customer ordered, the clients agree that they got the products what they ordered. In this case Out of 15 sample sizes, 6 were strongly agree, 3 were agree, 3 were Neutral, 3 was disagree. But nobody claimed strongly disagree about this option. So it is seen that on average the clients are in agree position about they got the product what they ordered.*

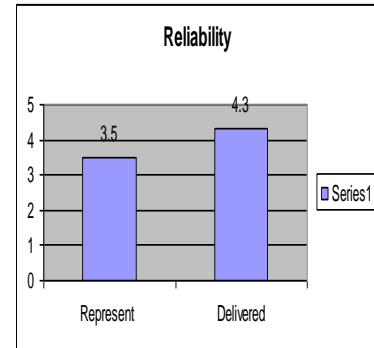


Fig.- 4.2

#### *Responsibility*

*We have tried to find out the employee prompt service to customer. Out of 15 sample sizes, 2 were strongly agreed, 4 were agreed, 4 were Neutral, 3 were disagree and 2 were strongly disagreed about employee prompt service to customer. In the conclusion it is seen that the ratio is neutral position.*

*One of our questions was about the sincere interest in solving the problem.*

*Out of 15 sample sizes, 3 were strongly agreed, 3 were agreed and 1 was Neutral, 8 disagree. Nobody strongly disagree it. In the conclusion it is seen that the ratio is neutral position.*

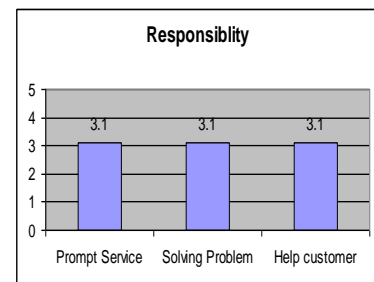


Fig.- 4.3

*When we asked the clients about the willingness to help customer Out of 15 sample sizes, 2 were strongly agreed, 2 were agreed, 7 were Neutral, 3 were disagreed and 1 strongly disagree it. In the conclusion it is seen that the ratio is neutral position.*

#### *Assurance*

*When we asked the clients about the time period give by the company for the product. After completing the analysis that it is seen that Out of 15 sample sizes, 2 were strongly agreed, 6 were agreed, 4 were Neutral and 5 were disagreed and 1 was strongly disagreed. Nobody strongly disagree it. But In the conclusion it is seen that the ratio is between neutral and agree.*

*We asked to the clients that "Replacement service that assured is given properly in warranty time". Out of 15 sample sizes, 7 were strongly agreed and 8 were agreed. Nobody Neutral, disagreed, strongly disagree it. In the*

conclusion it is seen that the ratio is between agree and strongly agree. So it is seen that most of the clients were satisfaction in this stage. And they had no claim against the question. It is also good point to get more potential clients.

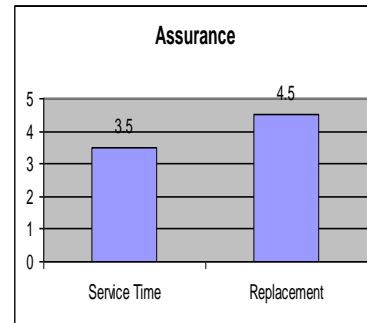


Fig.- 4.4

#### Empathy

We are trying to find out The employees of Uddipon Digital system Understand the specific needs of their customers. Depending on this issue, out of 15 sample sizes, 2 were strongly agreed, 5 were agreed, 1 were Neutral, 5 were disagreed and 1 was strongly disagreed. In the conclusion it is seen that the ratio is neutral. So it is quite alright and it may play bad impact on looking the potential customer.

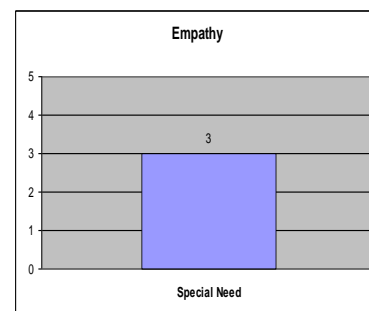


Fig.- 4.5

#### Service Quality

To find out the Service quality level we asked clients against Access control. The question was ". Access to overall services is satisfactory." Out of 15 sample sizes, 3 were strongly agreed, 5 were agreed, 5 were Neutral, 1 was disagreed and 1 were strongly disagreed. In the conclusion it is seen that the ratio is between Neutral and agree. So it is also alright and does not play any bad impact on service quality.

We also asked the customers that are they getting everything from Uddipon digital system what they need. Out of 15 sample sizes, 6.67% was strongly agreed, 26.67% were agreed, 26.67% were Neutral, 33.33% were disagreed and 6.65% was strongly disagreed. In the conclusion it is seen that the ratio is neutral. So this factor may play bad impact on customer service quality.

On the survey it is seen that Out of 15 sample sizes, 20% were strongly agreed, 33% were agreed, 20% were Neutral, 20% was disagreed and 7% was strongly disagreed against the argument "Security of your care is satisfied with Access control solution. So the mean value is 3.4. In the conclusion it is seen that the ratio is between neutral and agree.

When we asked a question on Competence in overall service delivery is satisfactory level, out of 15 sample sizes, 1 was strongly agreed, 7 were agreed, 3 were Neutral and 4 were disagreed .Nobody strongly disagreed with the statement. In the conclusion it is seen that the ratio is neutral position. So this factor may play bad impact on service quality.

*And finally when it went to know about the customers are satisfied with the up-to-date range of physical facilities of access control, out of 15 sample sizes, 4 were strongly agreed, 5 were agreed, 0 were Neutral, 5 were disagreed and 1 were strongly disagreed about their quality of services. In the conclusion it is seen that the ratio is between neutral and agree. So this factor does not play any bad impact on service quality.*

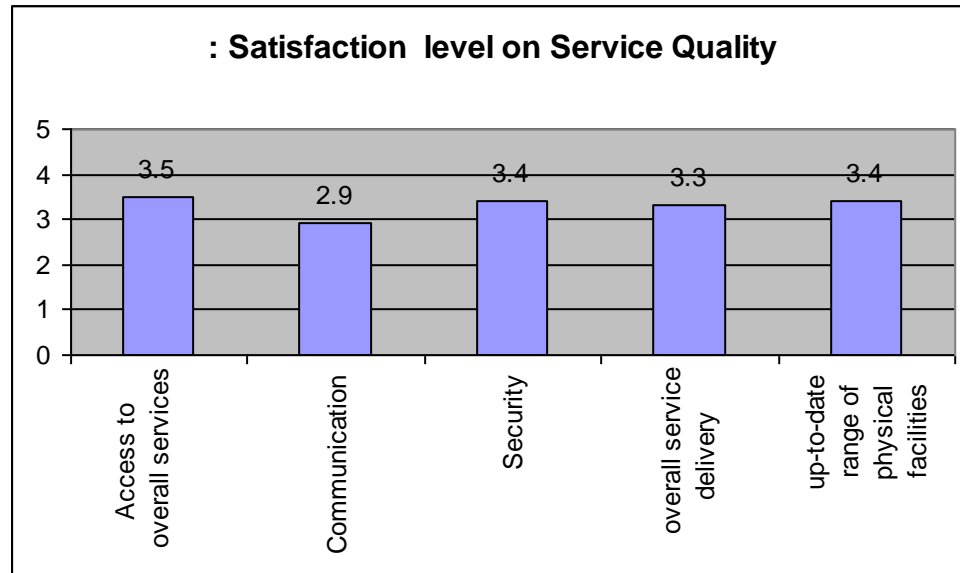


Fig.- 4.6

## Conclusion

After analyzing the data, it has been found that some factors may play bad impact on service quality which may reason to decline clients. Although most of the clients did not make any comment regarding the issues, it may reply that they may leave the company at any time.

From the finding of the report and the discussion of the objectives, I can present some suggestion. Such as-

- From the findings as it has seen that the responsiveness is not enough strong because of the employees are not willing help and they are not sincere solving the problem. So they should increase the responsiveness.
- Most of the clients complained that they are not responded when they get a problem from a client. If they have not enough human resource, they may hire some more engineers.

- In case of the service, most of the clients were not pleased. They should develop their service quality.
- One bigger thing is the promise which the company may breaks as per the clients view. So the company should keep their promise. Otherwise they will fail to satisfy their customers.
- Uddipon digital system communication style is not good. So they should develop the communica

### **Managerial Implication**

Most of the case it is seen that the clients were unhappy because of the product and employee in Uddipon digital system. Not only that but also customers are not well satisfied regarding the after sales services. So the managing director should take special action on behalf of this issue. For ever organization service quality is like a vehicle. Without the best service quality the company may fall down and lost from the competitions market. There are lots of competitors in the market. The managing director should survey to other competitors to find out their service quality or working procedure which will add extra benefits for the organization. The MD always should be dated about the information of the competitors. An organization should be ready to provide the latest customer service.

A customer always wants quick service. So, in this case the organization should keep more service provider because they solve the problem within short period of time. If the company fails to response any query within very short time, the customer will be dissatisfied. Moreover the organization should guarantee to the customer to keep the information confidential.

From the above discussion it has to provide some curative key for the development of the company. After evaluating the objectives, it is seem that most of the clients are dissatisfied with the products, service and finally the customer services. They should sincere about the above three items to increase their sales and brand value.

Uddipon Digital System is one of the most potential Access control product supplies in Bangladesh. The employees of this firm are very much expert and they have the knowledge how to capture the market and provide the necessary support. But the firm needs more employees for its substantial growth. It would rather feel like producing researcher's personal opinion about practices in the head office. It has been found that they have many multinational & leading companies in Bangladesh. So they need to provide necessary support to the clients more strongly rather than now.

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**THE CASE OF FINANCING AN INDUSTRIAL ENTREPRENEUR BY BASIC BANK  
LTD, GULSHAN BRANCH, DHAKA, BANGLADESH**

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**Abstract**

This study has been conducted on “The case of Financing an Industrial Entrepreneur by BASIC Bank Ltd.” Gulshan Branch, Dhaka in order to achieve the aspiring objective of:

- To know the genesis and present Status of BASIC Bank Ltd. Gulshan Branch.
- To analyze case history of an entrepreneur financed by the branch.
- To suggest policy implications arising out of the study.

It has been found that in the development of Future Entrepreneur BASIC Bank Ltd. played a good role. Their deposit growth is more than 5.4% where as the providing loans growth is 1.88%. That result shows that the efficiency of loans was provided & deposit collected.

In the other objective by studying the case it was found that the entrepreneur didn't face a lot of problem to have the loan if the documents are provide on the right way & almost the coordination of the employee is very much heartfelt. Basically in the case study the entrepreneur had faces a lot of problem in doing business but the characteristics of the leadership is much in him.

By considering the case it is a successful story where very few recommendations needed to given:

- Diversify the managerial power
- Increasing Investment.

**Keywords:** Entrepreneur, BASIC Bank

**Introduction**

**Background Of The Study**

Industrial Entrepreneur play an important role in the value addition of the economy and there they helps in the economic development of the county. They provides employment of million of men and women, sources of technological innovations and new product make an easy entry as well as exist of industrial enterprises. They also create value addition to local price and can



establishing forward and backward linkages. Besides, they can produce exportable surplus and thereby helps to earn foreign exchange.

Bangladesh is mainly an agro-based country and her economy has undergone rapid structural transformation towards manufacturing and services. Industrial entrepreneurs specially medium and small have considered as the principal driving force of Bangladesh economy. Industrial enterprises in Bangladesh, along with stimulating private ownership and entrepreneurial skills are flexible and can adopt quickly to changing market demand supply, generate employment, helps diversify economic activities and make significant contribution to the exports and trade of the declined from 50% in 1973-99 to around 20% in 2009-10 (ERB, 2010). So now, boosting the industrial sector should be an imperative and along with the growth of this sector which includes large, medium and small, the financial market have played significant roles in both urban and rural areas.

In the industrial sector, Industrial policy has been prepared, taking into consideration the govt's determination to achieve the MDGs by 2015, and have the number of the unemployed and hunger and poverty stricken people by 2017. To alleviate poverty by creating additional employment opportunities, the policy aims to create job for at least one man per family. The policy envisages rapid industrialization through short, medium, and long term measures, aiming to raise the rate of GDP growth to 8% by 2013 and 10% in 2017 and thereafter. The proposed policy puts emphasis a private sector industrialization efforts but at the same time vows to reform the public sector enterprises to make them profitable. The proposed industrial policy envisages an increase in the industry sectors share in GDP to 40% by 2021 from the 28% and this proportion of the employed work force to 25% by that period from 16% more. The main features of Bangladesh's industrial sector with opportunities for establishing import substituting industries alongside expansion & improvements of export oriented ones. These policy issues have a positive role in the development of industrial entrepreneurs in Bangladesh.

In considering the above context, the issue of financing in industrial enterprises as well as entrepreneurs, is getting importance by The Bangladesh Bank, The Central Bank of the country. The Bank of Small Industries & Commerce Bank Ltd. (BASIC) registered under the Company Act 1913 on the 2<sup>nd</sup> August, 1988, started its operation from 21<sup>st</sup> January, 1989. The main mandate of BASIC Bank is to provide financial services to the Small enterprises spreaded throughout the country. The proposed study on "Financing an Industrial Entrepreneur by BASIC Bank Ltd.- Gulshan Branch, Dhaka" is a modest attempt by the researcher as a requirement of the entrepreneurship program. It is hoped that the study will help bank management to handle industrial entrepreneurs more efficiently. The future researcher in this line will find a new way of their thinking specially The Financial aspects & add knowledge in the existing researcher. The

entrepreneurs will also be benefitted by having a good knowledge and understanding of the practical business as well as taking right decision in right time.

### **Objective of the Study**

The broad objective of the study was to analyze the financial aspect of an industrial entrepreneur of BASIC Bank Ltd. Gulshan Branch.

The specific objectives of the study are as follows:

- To know the genesis and present Status of BASIC Bank Ltd, Gulshan Branch.
- To analyze case history of an industrial entrepreneur financed by the branch.
- To suggest policy implications arising out of the study.

### **Scope**

The entire study was based on a case study of an Industrial loan holder. As this is an intensive study, the scope was confined to the entrepreneur only.

### **Methods of investigation**

Data sources:

Data were collected basically from two sources:

- Secondary Sources.
- Primary Sources.

Secondary sources:

Data collected from secondary sources were based on the following aspects:

- Operational materials of the Bank;
- Annual Report of BASIC Bank Ltd;
- Periodicals published by Bangladesh Bank;
- Gulshan Branch, BASIC Bank, documents on enterprise financing.
- Website information.

Primary Sources:

The study was based on case study method and the stages of investigation employed in this study are given bellow:

Study area:

BASIC Bank Ltd. Gulshan Branch (112 Gulshan Avenue, Gulshan, Dhaka-1212) was the study area of this research.

#### Study Sample:

As a case study, a single unit was selected for the study.

#### Sampling Unit:

Mars Knitting Ltd. was selected as a sampling unit for the case study because the entrepreneur is one of the loan holders provided by BASIC Bank, Gulshan Branch.

#### Sample Size:

The size of the sample was limited to only one unit. In spite of that much concentration was given to make it as objective as possible. It is hoped that this effort fulfill the requirement or efficiencies, reliability and flexibility.

#### Methods of Data Collections:

Questionnaire, Personal Interview etc was employed to collect data for the case study.

### **Limitations of the Study**

The study suffers from the following limitations:

- As the case is based on a particular individual unit, the personal experience of other Industrial clients of BASIC Bank Ltd was not considered.
- All the information is not gathered from the main Industrial loan holder Retd. Lt. Col. Monirul Islam Khan. As he was reluctant to give some of the important information, researcher had to rely on his staff.
- It was not possible to do numerical assessment of Retd. Lt. Col. Monirul Islam Khan's business because of his non-co-operation regarding profits and other personal matters. In spite of the limitations, it is hoped that the study would be able to fulfill the objectives.

### **Genesis of BASIC Bank Ltd. Gulshan Branch**

#### **Introduction to BASIC Bank Ltd.**

The BASIC Bank Ltd. was established as a banking company under The Companies Act 1913 and licensed its operation in 1989. At the outset the bank started as a joint venture enterprise of the BCC Foundation with 70% share and Government of Bangladesh with the 30% share. The BCC Foundation being nonfunctional following the closure of the BCCI, the Government of Bangladesh took over 100% ownership of the bank on the 4<sup>th</sup> June, 1992. The bank was

established as the policy makers of the country felt the urgency for a bank in the private sector for financing Small Scale though it is not nationalized.

Adjudged as one of the soundest bank in Bangladesh, The BASIC Bank is unique in its objectives. It is a blend of development and commercial banking functions. Fifty percent of its loan able funds revenue to be invested in Small and Cottage Industries.

### **Approach of BASIC Bank Ltd.**

The bank attaches special emphasis to technical and advisory support to small scale industries in order to enable them to sum their enterprises successfully. Micro credit to the urban poor through linkage with NGO's with a view to facilitating their access to the formal financial market for the mobilization of resources is another diversification of services offered by the bank.

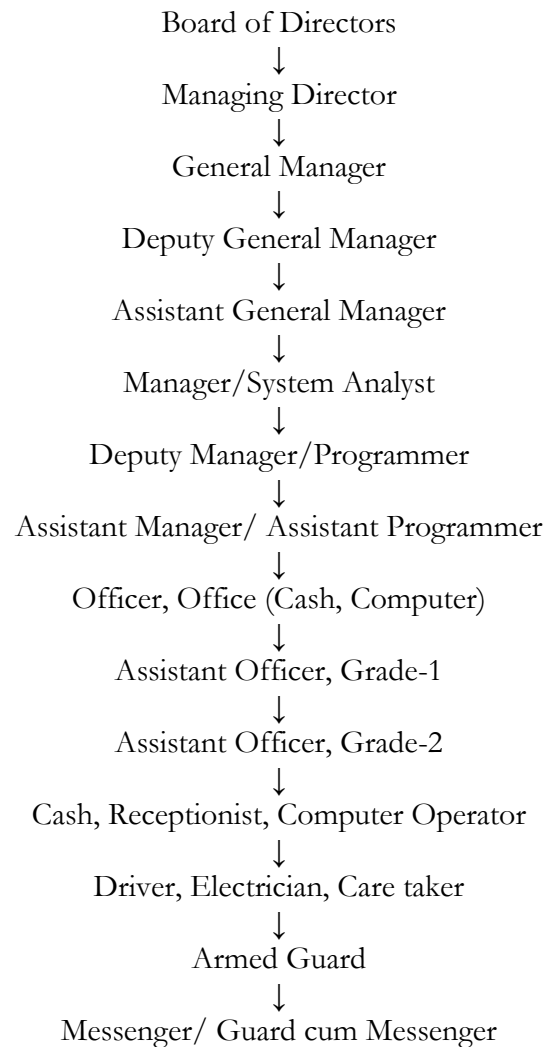
The bank provides an environment in which its staff members feel they can exercise their initiative and judgment within a clearly established frame work. The bank is the leader in offering excellent career opportunity in transparent and participative management culture. Coping with the competitive and rapidly changing financial market, BASIC bank maintains close contraction with its clients. The regulatory authorities, the share holders (GOB), other banks & financial institution.

### **Organizational Goal of BASIC Bank Ltd.**

- To employ funds for profitable purposes in various fields with special emphasis on Small-Scale Industries.
- To undertake project promotion to identify profitable area of investment.
- To search for newer entrepreneurs for investment & development products to such needs.

### **Organizational Structure, Head Office, Dhaka**

To alliance its organizational goals, the banks conduct its operations in accordance with the major policy guidelines laid down by the board of directors, the highest policy making body of the bank. The organizational hierarchy of the bank is given bellow:



### **BASIC Bank Ltd, Gulshan Branch**

Now the bank has 35 Branches all over Bangladesh & in Dhaka there are 11 Branch. One of them is Gulshan Branch, which is also one of the leading branch compare to others. The main tasks of the bank are providing loans, foreign trade & some of other services like remittance, underwriting, guarantee public offering shares etc. BASIC Bank provides three types of loan generally. They are:

- Industrial Credit
- Commercial Credit
- Micro Credit

## **Lending Criteria**

### **Entrepreneur**

Entrepreneur / promoter have to be creditworthy and competent enough to run the proposed industry.

### **Viability of the project**

The project should be viable from organizational, technical, commercial, financial and economic points of view.

### **Technical Viability**

- The project should be technically sound and environment-friendly.
- Technology transfer in case of borrowed know-how ought to be ensured.
- Building should be well planned and well constructed.

### **Commercial Viability**

- Market prospect and potential for the product has to be fully assured at competitive prices.
- Marketing channel for the product should be accessible to the entrepreneur.

### **Financial Viability**

- There should be reasonable debt equity ratio as determined by the Bank on individual case basis.
- Debt service coverage ratio should be at least 2.5 times at the optimum level of production.
- IRR should preferably be not less than 20 percent.

### **Economic Viability**

The project should ensure benefit to the national economy and create sufficient employment opportunity and be environment friendly.

### **Certificates are needed for an Industrial Loan**

- Credit Application of the borrower with signature.
- Clean & updated (not over 60 days from the date of approval by the competent authority) CIB report.
- Borrowing authority of the customer.
- Latest form-XII certified by RJSC regarding list of Directors for Limited Company.
- Head Office Sanction Advice.
- Duplicate Branch Sanction Letter.

- Deed of Partnership.
- Memorandum & Article of Association with Certificate of Incorporation.
- Certificate of Commencement.
- Certificate of Registration.
- Letter of Disbursement.
- Letter of Agreement.
- Letter of Guarantee.
- Letter of Undertaking.
- Letter of Installment.
- Letter of Continuity.
- Letter of Revival (Form I & II).
- Certificates from Chief Inspector of factories.
- Export License.
- IRC renewed.
- Bonded Ware House License, if applicable.
- No custom demand, if applicable.
- Tax Holiday Approval from NBR, if applicable.
- BKMEA/BGMEA/others relevant Membership Certificate.
- Fire protection License from Civil Defense Authority.
- EPB Registration Certificate, if applicable.
- Renewed Trade License.

**Various Products Related to the Industrial Loan.**

- Industrial Fixed Asset- Long & Medium.
- Capitalized Expenditure (Long, Medium & Short).
- Converted Loan (Long & Mid Term).
- Short Term Loan (Import).
- Short Term Loan (Procurement & Merchandising).

- Short Term Loan (Purchase of office supplies/ office renovation).
- Short Term Loan (Financial obligation).
- Cash Credit (CC), Hypothetical
- CC Pledge.
- Export C.C (Hypothetical).
- Export C.C (Pledge).
- SOD (Industrial).

### **Geographical Financial Area of BASIC Bank Ltd, Gulshan Branch**

Though the geographical area of BASIC Bank Ltd, Gulshan branch is surrounded in to Gulshan , Mohakhali, Rampura etc but it has huge client from Gazipur & Dhaka EPZ. The reason of it is that the service, the transaction capacity & almost the age of the Branch. Because at the time of establishing the branch Uttara Branch didn't setup & the existing customer are very much reliable to the branch for their transaction.

### **Approval Authority with their capacity of providing loan:**

- Cash Collateral
  - AGM- Up to 30 lac
  - DGM- Up to 50 lac (10% Margin)
  - GM- Unlimited
- Other
  - MD- 1.5 crore (cash)
  - MD- 6 crore (Contingent, L.C, Cash Liability)
- Board
  - Unlimited ( As per Circular of Bangladesh Bank)
  - SLR- 19% (Cash-6% & Other 13%)

### **Growth of deposit of the Branch:**

*Figure in crore Tk.*

<i>Branch Name</i>	<i>Achieved in Dec 2009</i>	<i>Achieved in Nov 2010</i>	<i>Percentage of growth</i>
<i>Gulshan</i>	<i>435.21</i>	<i>969.95</i>	<i>5.4%</i>

*Table: Growth of Deposit By Gulshan Branch*

*Source: Yearly Report, BASIC Bank Ltd, Gulshan Branch*



### Growth of advance of the Branch:

Figure in crore Tk.

Branch Name	Achieved in Dec 2009	Achieved in Nov 2010	Percentage of Loans
Gulshan	226.94	415.00	182%

Table: Growth of Advance By Gulshan Branch

Source: Yearly Report, BASIC Bank Ltd, Gulshan Branch

### Sector wise loan program of the Branch

The table below shows the amount of Loan and its Percentage given by Gulshan Branch of BASIC Bank Ltd against different nature of businesses. The total Small & Medium Industries Loan amount in this branch from January 2009 to January 2010 is Tk. 415.00 crore taka.

Figure in crore Tk.

Portfolios	Loan Amount	Percentage
Manufacturing Enterprises	157.7	38.00%
Trading Enterprises( Internal & Exports)	186.75	45.00%
Commercial & OD Against	58.1	14.00%
Professional Service Rendering Units.	12.45	3.00%
Total Loan Amount & Percentage	415.00	100%

Table: Loan Given Against Various Nature of Business By Gulshan Branch

Source: Yearly Report, BASIC Bank Ltd, Gulshan Branch & Conversation with the employee of the branch

### Entrepreneurship development program of the bank

The founders of this Bank envisioned to foster entrepreneurship from among the potential, new and small entrepreneurs and to generate employment through financing SMEs. In harmony with the dream dreamt by our forefathers, BASIC Bank never ran after the so called blue chips (the established and larger corporations) to maximize our profit. Rather, we always remained stick to the triple bottom line: People, Planet & Profit and focus attention to the Small and Medium Scale Enterprises (SMEs). In this way, a lot of entrepreneurs have grown with us through which employment opportunities have been created for a large number people.

The trend of Loans & Advance Of BASIC Bank Ltd. is one most thing by that easily the entrepreneurship development program can be understood.

From 2006 to 2010 the trend is almost upward where as the other financial institute are ran after the client to sell loan.

## Loans & Advance Trend of BASIC Bank Ltd

Figure in Million Taka

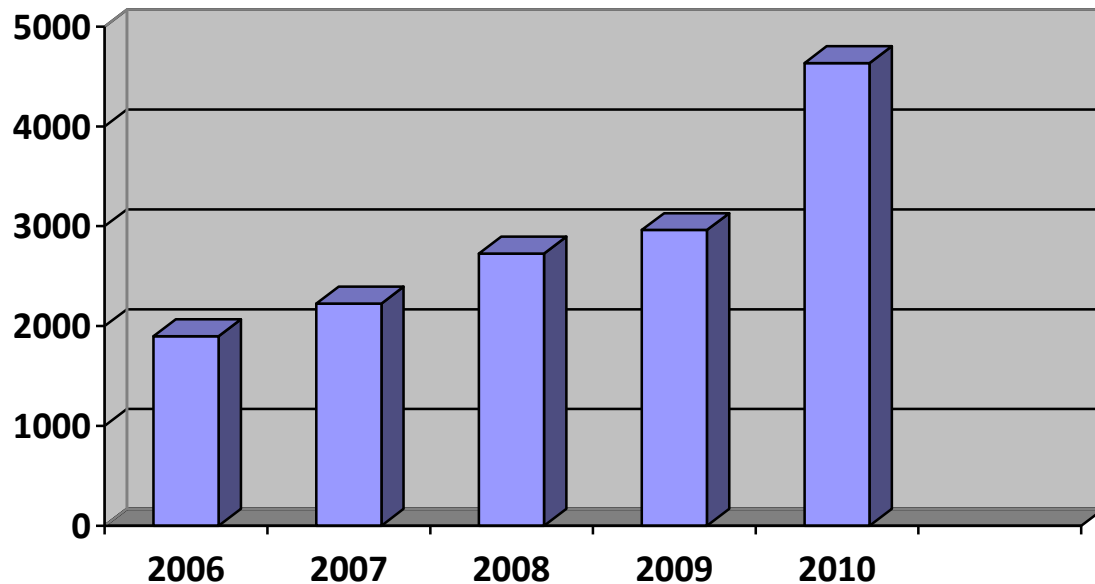


Table: Loan & Advance Trend of BASIC Bank Ltd.

Source: Yearly Report, BASIC Bank Ltd, Gulshan Branch

## Financing an Entrepreneur: A Case Study

### Profile of the Industrial Entrepreneur

Every client of BASIC Bank Ltd has to fulfill a certain criteria before getting the approval of enjoying their Industrial Loan facilities. Retd. Lt. Col. Monirul Islam Khan also had to fulfill those criteria before getting his loan. The following are a snapshot of his personal and professional profile:

Name	Retd. Lt. Col. Monirul Islam Khan
Father's Name	Late Ahsanul Khan
Present Address	2, Abbas Nir, Mohakhali DOHS, Dhaka
Family Composition	Mother, Wife, 1 Daughter, Son in Law
Name of Term Loan Product	Overdraft
Name of the Bank & Branch	BASIC Bank Ltd. (Gulshan Branch)
Tenor	36 Months (Renewable)
Interest Rate	13.00%
Security Provided	Flat what has owned for him.
Nature of Business	Manufacturing Fabric from Yarn.

Table: Profile of Ret. Lt. Col. Monirul Islam Khan

Source: Mr. Monirul Islam Khan

## **The Motivational Forces Behind The Success**

Mr. Monirul was brought up in a middle class family in the city of Kushtia where he got the chance of good schooling. He was the elder son of his family and had three younger brothers. Like all the other middle class families his parents somehow managed to provide him with secondary and higher secondary level education (SSC and HSC). His dream from childhood was to become a professor of the Dhaka University, but unfortunately his destiny had something which he never dreamt of. He didn't know that the dream which he has dreamt for his future is going to be shattered so viciously.

It was his father (Mr. Mijanul Islam Khan) who used to give him the motivation and inspiration to go ahead in life and fetch the dream. One day all of a sudden his father called him up and said that he should start packing his bags to go to Dhaka for his higher studies. He was totally surprised when he heard the news and was thinking how his father who was just a simple service holder managed such a big amount for his higher studies. On asking, his father replied that he sold one of his four piece of land and took some loan against their house from his neighbors Md. Hasanuzzaman, Mahbubur Rahman who also were very good friends. Mr. Monirul was deeply mesmerized by his father's sacrifice. He didn't know what to say when he heard all these from his dad and was totally speechless. He was both happy and worried about the fact that how his father was going to repay the debt. Finally, he thought that his dream was taking the shape of reality as he started his journey to pursue his higher medical studies in Dhaka. With his outstanding results in both the preliminary education (SSC & HSC) he got admitted in Army.

It seemed like a wind of change has finally blown the dark clouds of sorrow and was bringing a new hope of light into his life. It was a new beginning for him and with that happiness and new enthusiasm he was about to get started with his new life. The way of life becomes changing & he did excellent performance in that sector. He made himself as an intelligent & curious person that increased his thirst for knowledge. This thirstiness about knowledge made him different from others. The other main characteristics are sincere about doing jobs. He is also sincere about time. These three things made him successful in his life. By these reason he got the award of his career & at the time of resigning he was continuing the post of Colonel in the Army. After giving his best performance he got the honor that he dreamt of on his boyhood.

## **The Struggle Towards Success**

After resigning from the armed force he didn't want to waste his time by passing idle work. So for that he thought that he had to do something for him, his family & for the society. So for that he started a Fish Feeding Mill in Khulna because there are vast demands of the feed in the south side of the country. The major people of the Khulna division are attached with fish business. He

judged the demand & for that he goes to the business with a good investment. By this investment he cut a good return from the business.

To start the business he had to face many problems because he was an outsider of the city. He had to find it out the supplier, land, worker support etc. So for that he found Mr. Rajib Rahman who doing business since 1994 in the same sector with a few investments that is not sufficient to survive & gaining more return. Mr. Monirul Islam Khan offered him for joint business with a share of 70:30. Mr. Rajib Rahman accepted this offer & helped him in the business.

After resolving this problem the Fish Feeding Mill was running good & creating a face value towards the farmer. By earning a good face value Mr. Monirul Islam Khan thought that he had to increase the capacity of the mill. But on that time he had a heart attack in 1998 & it was major. So for that he was unable to work for 8 months, on that situation the mill going to be loosing because lack of proper care. In the same time Mr. Rajib Rahman betraying with Mr. Monirul Islam Khan & want to take over the 60% share of the mill. For that he showed that on the time of Mr. Monirul Islam Khan the mill losses 14 Lac taka in 3 months.

By his illness & betraying of Mr. Rajib Rahman, Mr. Monirul Islam Khan took decision that he doesn't run the business any more. After taking this decision he sold his share to Mr. Rajib Rahman & Abdul Bari. By selling his share he got 35 Lac taka as per ratio. Mr. Monirul Islam Khan then came back to Dhaka & took rest 6 months by doing nothing.

### **The Beginning of His Business**

In the time of rest he found that in Bangladesh the RMG (Ready Made Garments) is the most growing business & from this an entrepreneur can get a good profit by using time & tide ness with cheaper price. But he didn't have interest in main business because it needs a lot of money what is not possible to invest by Mr. Monirul Islam Khan at that time. He thought that he came to the supply chain on RMG because it needs not huge money whether by proving the quality Mr. Monirul Islam Khan can earn good profit from it. He find that yarn is the main raw material of RMG. So he made a factory named **Mars Knitting Ltd.** near the Gazipur Road what present capacity about 20 tons a day by the handling of 110 employees.

Mr. Monirul decided to use his previous experience in opening up his mew business. Mr. Monirul faced a lot of trouble running his new business. Though he had the knowledge experience to operate such an industry but he faced problem to get order from the buyers. So to collect the order he came as a leader to the entire employee. First he used his previous position to meet the buyers & then try to convince them where as the merchandiser also tried their best collect order. But Mr. Monirul didnt wait for them so that he also tried from his perspectives. That made him successive to operate his business. In that time the persons who had a good connection with Mr. Monirul by the way of his previous business were very much helpful to

running his business by giving suggestions, policy making, organizing & getting more work order.

By passing a tough time near about 2 years Mr. Monirul made his business running well. In that time he cut a good profit of 15 lac taka per year. The work order goes up & up because of the quality & time ness. But it wasn't possible to serve by Mr. Monirul Islam's industry because of poor investment. So for that he thought that he had to take a loan from the bank for developing his business. He made a plan to take the loan from such type of bank where small & medium investment enterprises are motivated. Then he contact with BASIC Bank- Gulshan Branch with the hope of getting a loan to spread his business as the demand grows up.

### **Introduction With BASIC Bank**

By the suggestion of the business partners & familiars Mr. Monirul goes to the BASIC Bank- Gulshan Branch & meted with the manager to have a loan. Then the branch manager insist him take loan for the development of his business. There he found the same proposal what he heard from the outsiders & almost fair support for him.

### **Particulars of proposed venture**

BASIC Bank explained him the whole procedure of what are the requirements needed to apply for an Industrial loan. They stated that there are two kinds of Industrial loan, and they are:

## Cash Credit:

<i>Eligibility</i>	<p><i>All Industrial businesses where the Key personnel have 5 years experience in the line of business.</i></p> <p><i>Satisfactory credit report</i></p>
<i>Method of Appraisal</i>	<i>The client's business experience, expertise, business volumes and monthly cash flow are used in the assessment process.</i>
<i>Margins (indicative)</i>	<i>The quality of receivables would be of importance in fixing margins up to which working capital is made available.</i>
<i>Tenor</i>	<i>Maximum 36 months (Renewable)</i>
<i>Pricing</i>	<i>Risk based pricing strategy, in line with the market rates.</i>
<i>Security</i>	<p><i>Primary:</i></p> <ul style="list-style-type: none"> <li>• <i>Charge on the inventory and receivables.</i></li> <li>• <i>Charge on other current assets</i></li> <li>• <i>Personal guarantee of proprietor/partners/ directors.</i></li> <li>• <i>Charge on fixed assets.</i></li> </ul> <p><i>Secondary:</i></p> <ul style="list-style-type: none"> <li>• <i>Collateral security on a case-to-case basis.</i></li> </ul>
<i>Interest</i>	<i>13% Fixed Rate, typically for 36 months.</i>
<i>Review</i>	<i>Facility terms &amp; pricing are both reviewed at least annually</i>
<i>Processing fee</i>	<p><i>Processing fee of 1% is generally charged on small loans.</i></p> <p><i>Actual fee charged is determined on a case-to-case basis.</i></p>

*Table : Details of SME Cash Credit Facility**Source: BASIC Bank Ltd Website, face to face conversation with officials of Gulshan Branch*

## Overdraft:

<i>Eligibility</i>	<i>All Industrial businesses where the Key personnel have 5 years experience in the line of business.</i>  <i>Satisfactory credit report</i>
<i>Method of Appraisal</i>	<i>The client's business experience, expertise, business volumes and monthly cash flow are used in the assessment process.</i>
<i>Margins (indicative)</i>	<i>The quality of receivables would be of importance in fixing margins up to which working capital is made available.</i>
<i>Tenor</i>	<i>36 months (Renewable)</i>
<i>Pricing</i>	<i>Risk based pricing strategy, in line with the market rates.</i>
<i>Security</i>	<i>Primary:</i> <ul style="list-style-type: none"> <li>• <i>Charge on the inventory and receivables.</i></li> <li>• <i>Charge on other current assets</i></li> <li>• <i>Personal guarantee of proprietor/partners/ directors.</i></li> <li>• <i>Charge on fixed assets.</i></li> </ul> <i>Secondary:</i> <ul style="list-style-type: none"> <li>• <i>Collateral security on a case-to-case basis.</i></li> </ul>
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*Table : Details of SME Overdraft Facility**Source: BASIC Bank Ltd Website, face to face conversation with officials of Gulshan Branch*

Mr. Monirul Islam Khan selected the Overdraft Loan as it matched his criteria. The requirements of taking an Overdraft Loan were also fulfilled by the client. Mr. Monirul Islam Khan then had to submit all his legal business documents as stated in requirement of Overdraft Loan. The steps of the whole procedure are given below.

Step - 1: Mr. Monirul filled up the loan application form and the charge documents which were provided by BASIC Bank.

Step - 2: BASIC Bank sent the necessary information to Bangladesh Bank for obtaining the CIB report of Mr. Monirul Islam Khan.

Step - 3: The Bank then sent some of their credit officers to verify the business stocks of Mr. Monirul Islam Khan and also had a brief observation of his family. These verifications are done without informing the Industrial loan holder.

Step - 4: Disbursement was made within 96 hours after receiving the clean CIB report from Bangladesh Bank.

After going through all the terms and conditions and the procedure he finally had his loan. The total procedure took around 15 days and Mr Monirul Islam Khan got the revolving Overdraft Industrial loan of Tk. 60 lac for 36 months on 15<sup>th</sup> June 2002.

The Industrial loan turned out to be a blessing for Mr. Monirul Islam Khan. It took his life to a happy trail from a murky, gloomy and dismal one. By this he brought some equipment of around 40 lacs for his factory & rest of the money were used for purchasing raw materials and as working capital. Gradually the production capacity goes up & the owner gets the competitive edge at that business.

### Present Status

<i>Company Name</i>	<i>Mars Knitting Ltd.</i>
<i>Asset Worth</i>	<i>Tk. 10 Core (approximately. 2010)</i>
<i>Business Place Rent</i>	<i>Tk. 2,00,000 per month</i>
<i>Business Type</i>	<i>Moderate Scale</i>
<i>Target market</i>	<i>Reputed RMG Manufacturing Company</i>
<i>Major Competitors</i>	<i>Various textile companies</i>

*Table: Present Business Status*

*Source: Mr. Monirul Islam Khan*

### Future Plan

Mr. Monirul Islam Khan has the plan not to expand his business in the textile sector but he want made his business more competitive by providing quality product. He had the plan to make his daughter & son in law efficient in this business on the time of his absence the business will run well. His upcoming target is to make a new factory where he can made large volume products. So for that he wants to buy a place where he would be able to make a factory of his own. For that he wants to submit a proposal to the BASIC Bank Ltd. for a Long Term Industrial Loan near about 15 core tk.

### Problem of the entrepreneur in Bank Loan

Although the loan holder didn't face a lot of problem to have the loan amount but for sanctioning the loan the borrower has to submit all the required documents where the employee of BASIC Bank by giving proper suggestions. For the approval of the loan the loan borrower has to mortgage his flat. By submitting all the require documents he got his loan at the earliest time.

### Objective Analyze of the entrepreneur's problem s

From the study the required objectives are fulfilled:



- From the first objective the researcher found that BASIC Bank Ltd.-Gulshan Branch has doing a good performance on deposit collection & providing loans to the clients.(Page-9- Growth of Deposit & Growth of Advance of BASIC Bank Ltd.)
- The entrepreneurial qualities are also finding out from the study, because on basis of the qualities the success comes to him.
- At the study the researcher tries to give some strong recommendations which are very much needed to imply in the industry of the loan borrower.

## **Findings From The Case Study**

### **Explanation of Is There Any characteristic of entrepreneur found in Mr. Monirul Islam Khan**

Mr. Monirul Islam Khan certainly possesses most of the characteristics of an entrepreneur within himself. The steps he had taken when he was 50 years old & prove that age is not a barrier for becoming an entrepreneur. But sometimes it has a good influence on running a business. He loose his business in Khulna at the age 52 with having poor health but his desire didn't stop to go forward.

### **Whether Mr. Monirul Islam Khan Comparable to a Successful entrepreneur**

Mr. Monirul Islam Khan is definitely comparable to a successful entrepreneur. He has all the qualities (risk taking capacity, new business policy, positive thinking, time consciousness etc) of an entrepreneur and is always optimistic to achieve good things. He is always looking forward to take up new challenges and is a good risk calculator. He assumes the future condition but he hadn't the aspiration to make his business too large.

One of the main reasons behind Mr. Monirul Islam Khan for Becoming a Successful Entrepreneur is not to waste time where as the other reasons are also work as same. He has the motto of using time as much you can.

### **Evaluation of The Accuracy of Making Decision of Mr. Monirul Islam Khan**

It has o be said that Mr. Monirul Islam Khan has always been absolutely clear about his decisions from the very young age. He made the right decision of joining ARMY in the young age & then after retirement the beginning business in Khulna. After loosing this business he also judged the importance of RMG sector. These two decisions proved him accurate decision maker.

### **The Influencing Lessons from Mr. Monirul Islam Khan To Be An Entrepreneur**

The influencing lesson from Mr. Monirul Islam Khan is that age & money is not a barrier to a man to be an entrepreneur. He proved that with utilizing time, hope & right decision a man can

be successful entrepreneur with having a little investment. Determination about the goal & right time right decision for the upcoming situation is the main lessons come from him.

### **Mr. Monirul Islam Khan - An Opportunity Seeker With Examples.**

Mr. Monirul Islam Khan is an opportunity seeker and has always grabbed the opportunity to go ahead in life. He initially grabbed the opportunity to start his business of fisheries because of its huge demand & then comes to the Textile. He can judge the upcoming situation very well.

### **Summary of findings, recommendations**

#### **Diversify the managerial power**

Mr. Monirul Islam Khan needs to diversify the managerial power to other. Because at that age he is not willing to take more risk to increase his business. Though the family members are not willing to take over the business but it is very much needed to make them ready to take the challenge. To diversify the managerial power Mr. Monirul Islam Khan can choose his daughter or son in law who are very much reliable. For that he has to motivate to attend the office at least two days within every week or after the lunch of three days in a week. First he has to him them power & share of his business & also give some job that did they make it successful. After some of the short term liability they may be motivate to take more responsibility and from that the Managerial Power can comes out.

#### **Increasing Investment**

Mr. Monirul Islam Khan has to be increase the investment because it will make him more competitive in the price decreasing. Mr. Monirul Islam Khan will be able to produce more products which will be cheaper than now & make him competitive. The price competitiveness has added extra advantage for his business. The present business asset of Mr. Monirul Islam Khan is 10 crore where as the other competitors are invested a huge amount but not based on that, the increasing investment is needed for capturing more order which will make his business in a good shape.

#### **Policy Implication**

In the part of policy implication the researcher suggest that the entrepreneur has to give emphasis on the recommendation i.e. diversifying managerial power, increasing investment & some internal change. The overall study is a successful one whether the entrepreneur had faces a lot of problem but with the help of BASIC Bank Ltd. & his internal capacity he came out from all the uncertainty. Here in this part the entrepreneur have to make a good relation with the BASIC Bank Ltd. which played an important role to become a successful entrepreneur. Where as the bank has not such type of marketing capacity to disclose/branding them(entrepreneur) to others.

The leadership capacity & also the help of BASIC Bank Ltd. is the main topic to gathering knowledge from the case which based on a practical one.

**Reference:**

- [1] Website: BASIC Bank Ltd.( <http://www.basicbanklimited.com/index.php?index=1>)
- [2] Yearly Report, BASIC Bank Ltd, Gulshan Branch
- [3] Face to face interview with Mr. Monirul Islam Khan
- [4] Interest rate of BASIC Bank Ltd. (<http://www.basicbanklimited.com/lending.pdf>)

## DETERMINING A MULTILEVEL MEDIATING ROLE OF WORK CHARACTERISTICS IN RELATIONSHIP BETWEEN MACRO-ORGANIZATIONAL VARIABLES AND WORK PERFORMANCE OUTCOMES

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### Abstract

The paper presents an in-depth research on the link between 4 macro-organizational and 15 micro-organizational variables from a multilevel perspective, using a HLM methodology. The research was primarily oriented towards understanding the nature of the influence which macro-organizational, organization design concepts have on their micro-organizational, work design counterparts. Multilevel analysis was conducted on a research sample of 51 organizations and 1285 work positions. The results showed that cognitive and social characteristics of organizations have significant influence on work characteristics. While the influence of cognitive characteristics is much stronger and more widespread, the influence of social characteristics also exists, although it was present only partially.

Furthermore, a lower-level mediation analysis was conducted in order to test a mediating role of work characteristics in relationship between macro-organizational variables and work performance outcomes. Research findings revealed a partial existence of mediating effects in almost 50% of all possible relationships. They were more represented in the case of contextual performance than in the case of task performance as an outcome variable, and with a more significant influence regarding cognitive characteristics (cross-functional training in particular) than social characteristics of organizations. Results led to the conclusion that some macro-organizational variables have a more or less direct influence on work performance, as well as to the insight that some work characteristics are more relevant than others, depending on particular organization design practice.

**Keywords:** organization design, work design, work characteristics, work performance, multilevel analysis, lower-level mediation

### Introduction

Current business trends are putting significant requirements on everyday working practice and are causing rapid changes. Due to globalization and information technology development, as well as due to influence of other relevant factors, organizations are forced more than ever before to internally align and optimize their systems, rewards, structures,

employees, jobs, and organizational processes – if they want to survive. Significant changes in the business environment over the past 20 years require a new practice of work and organizing that has outpaced underlying theories and methods (Child, 2005).

Work is not performed in a vacuum but is done in organizations. For that reason it is imperative that we understand how organizations, as social systems, influence the way work is designed and managed (Hackman and Oldham, 1980). Although issues on organization design and nature of organization's work exist for some time, they had been rarely put into the same research focus (e.g., Van de Ven and Ferry, 1980; Moorhead, 1981; Griffin, 1982; Daft and Steers, 1986), especially not as system-wide concepts. Although work design is tightly woven into the structure and function of organizations (Torraco, 2005), the evident link between organization design and work design has been neglected in both theory and practice (Gyan-Baggour, 1999). Furthermore, their relationship has not been related to work performance outcomes neither.

Until recently, this complex organizational issue was addressed only from a single level of analysis. However, existing research findings potentially may lead towards wrong conclusions and may provide an incomplete picture because they oversimplify complex relationships. Roberts *et al.* (1978), as well as Rousseau (1985) and Gersick (1991) were among the first who realized deficiencies of dominantly used single-level research methodology. Even more, they emphasized a need for development of multilevel perspective of organization science. In a short period, multilevel perspective became very popular and applicable because of its potential for integrating macro and micro aspects inside common theoretical framework (Mossholder and Bedeian, 1983). Today, a need for a different, multilevel approach has been acknowledged and broadly accepted (Klein *et al.*, 1994; Dansereau *et al.*, 1999; Klein *et al.*, 1999; Brass, 2000; Luke, 2004; Goldstein *et al.*, 2008).

Applying multilevel lenses leads to a better understanding and more precise insights regarding complex organizational issues (e.g., Behling, 1978; Moorhead, 1981; Rousseau, 1985; Liska, 1990; Cappelli and Sherer, 1991; Tosi, 1992; House *et al.*, 1995; Klein and Kozlowski, 2000), and therefore it is applied in this study as well. The research was conducted in order to address the existing gap in the literature and to apply a multilevel approach in thorough investigation of relationship between organization design practices and broad work design dimensions.

In accordance with mentioned, the main purpose of the paper is to put organization design and work design into the same multilevel context. An in-depth analysis is conducted in order to provide understanding of the multilevel relationship between broad aspects of organization design and work design, with the ultimate impact on work performance. In particular, at the organizational level, the focus is on cognitive and social variables, while at the individual level task, cognitive and social characteristics are investigated, jointly with two outcome variables measuring work performance.

The paper will try to provide the answer on the following research question: What is the nature of relationship between organizational characteristics, work characteristics and work performance outcomes? As such, the research aim represents a unique attempt in the literature. It offers interesting insights on a complex, mediating role of work characteristics in relationship between macro-organizational variables and work performance outcomes, from a multilevel viewpoint.

The paper consists of six parts. After the introduction, the next part reviews relevant literature on organization design and work design in general, and their relationship in particular. In the third part research goals and hypotheses are explained, while in the fourth methodological framework is presented. In the fifth part results of a data analysis and main research findings are provided. Finally, the last part concludes with a summary of the main findings, discusses them from theoretical and practical standpoint, and outlines directions for future research.

## Literature Review

Requirement for integrating macro- and micro-levels of analysis regarding several organizational issues has been recognized since 1980s (e.g., Van de Ven and Ferry, 1980; Moorhead, 1981; Griffin, 1982; Rousseau, 1985). It has been realized that designing organizations just to address environmental demands is not enough. We must also match design of the organization to its employees and their jobs.

Competitive trends of the global business environment are causing executives to rethink traditional design configurations and work design (Stebbins and Shani, 1995). Numerous empirical studies conducted during 1970s and 1980s often relied on too narrowly defined concepts of organization design and work design. While organization design has traditionally represented only structural aspects offering rather limited view of organizational reality, work design has dominantly been treated as a phenomenon focusing only on motivational or task characteristics, without considering other dimensions of work.

Many studies have investigated and confirmed the mediating role of task characteristics between organizational structure and outcome variables such as job satisfaction or motivation (Hall *et al.*, 1978; Rousseau, 1978; Pierce, 1979; Brass, 1981; Pierce *et al.*, 1984). Oldham and Hackman (1981) developed the *Job Modification Framework* that shows that significant relationships can be found between organizational structure and task characteristics, as well as between task characteristics and employee reactions.

However, in spite of numerous findings in work design literature, many authors have addressed a lack of systematic attention to context and other contextual factors (e.g., Kelly, 1992; Parker and Wall, 1998; Liden *et al.*, 2000; Parker *et al.*, 2001; Rousseau and Fried, 2001; Wall *et al.*, 2002; Torraco, 2005; Johns, 2006; Fried *et al.*, 2007; Morgeson and Humphrey, 2008; Morgeson *et al.*, 2010).

Their message was directed towards a broader approach and understanding of organization design and work design theory and practice. Nowadays, organization design can be broadly defined as a deliberate process of configuring structures, processes, reward systems, and people practices, to create an effective organization capable of achieving the business strategy (Kates and Galbraith, 2007). On the other side, the area of work design in the last 15 years has also flourished. It includes not only motivational work characteristics, but also many others as well (cognitive, social, contextual, etc.), applying them both at the individual and group level.

New and broader meaning and understanding of organization design and work design concepts puts a significant requirement for testing newly acknowledged and possibly interesting relationships between macro- and micro-organizational variables. It also calls for further investigation of the mediating role of various work characteristics, related to different organizational characteristics, as well as distinguishing work performance outcomes.

At the organizational level, particular interest should be put on cognitive and social dimensions of organizations. At the individual level, various work characteristics should be observed besides traditionally accepted task characteristics. Furthermore, the most appropriate work performance outcomes should be addressed as well.

Recent years have brought a continued increase in the scope and importance of knowledge in general, and knowledge work and knowledge management in particular. Consequently, a cognitive dimension of organizations has been recognized as an important one (e.g., Birkinshaw *et al.*, 2002). It describes people issues and represents the collective human resources (HR) practices that create organizational capability from the many individual abilities resident in the organization (Galbraith *et al.*, 2002). People issues also encompass knowledge management practice, KSAO's of employees, their career development and level of engagement.

Along with stronger focus on people, social dimension of an organization has become more important. It is related to organization's reward system that has a significant influence on employees, as well as their work design practice. Reward system represents means or instruments designed to encourage certain actions or behavior on the part of employees, or groups of employees (Burton *et al.*, 2006). It could provide individual, group or organizational incentives although we can agree with Mohrman *et al.* (2003) and distinguish between two main types: rewarding for individual performance and rewarding for organizational performance. While the former focuses employees on their own performance, the latter focuses them on how to contribute to their team and/or to the overall unit or company performance.

At the individual level, as the world of work is now quite different than it was 20 years ago, perhaps fundamentally so (Oldham and Hackman, 2010), numerous work characteristics have been recognized. Researchers have begun to devote greater attention to extension of the

JCM conceptually, to include a broader range of job characteristics, outcomes, mediators, moderators, and antecedents (e.g., Parker *et al.*, 2001; Morgeson and Humphrey, 2006; Morgeson and Humphrey, 2008; Vough and Parker, 2008).

An interdisciplinary perspective proposed by Campion and Thayer (1985) and Campion (1987) among the first emphasized the multidimensional nature of work design theory and practice. However, a recent effort at categorization by Morgeson and Humphrey (2006) represent currently the most thorough review of existing work characteristics. They identified no less than 21 distinct work characteristics (i.e. patterns) from task, knowledge, social, and contextual sources. For the purpose of this research, three categories of work characteristics will be investigated: (1) task characteristics, (2) social characteristics, (3) cognitive characteristics. The fourth, contextual characteristics were excluded because of potential ambiguity with some of macro-organizational variables.

Task characteristics are most commonly investigated motivational characteristics of work. They are primarily concerned with how work itself and the range and nature of tasks associated with a particular job are accomplished. Cognitive or knowledge characteristics reflect the kinds of knowledge, skill, and ability demands that are placed on an individual as a function of what is done on the job (Morgeson and Humphrey, 2006). Social characteristics have become especially important due to a wider application of teams and teamwork in organizations. It has been realized that people cannot handle tasks that are more complex by themselves and that social support and interaction is inevitable.

Finally, nowadays it is obvious that work performance as an outcome should be also addressed in a different way then traditionally accepted. It has been empirically confirmed that work performance has a multidimensional nature and that it is very important for determining organizational performance (Lawler III, 1996). Currently the mostly used concept of work performance includes task performance and contextual performance (Borman and Motowidlo, 1993; Motowidlo and Van Scotter, 1994; Motowidlo and Schmit, 1999).

Task performance can be defined as the effectiveness with which employees perform activities that contribute to the organization's technical core either directly by implementing a part of its technological process, such as producing products, selling merchandise, acquiring inventory, managing subordinates, or indirectly by providing it with needed materials or services (Borman and Motowidlo, 1993). Such kind of performance refers to activities that are formally part of a worker's job (Conway, 1996).

Contextual performance, on the other hand, represents behavior that does not necessarily support the organization's technical core as much as it supports the organization's climate and culture (Motowidlo and Van Scotter, 1994; Conway, 1996; Borman and Motowidlo, 1997; Motowidlo *et al.*, 1997). Contextual activities are important because they contribute to organizational effectiveness by shaping the organizational, social, and psychological context



and serving as a catalyst for task activities and processes. Such activities include volunteering, to carry out task activities that are not formally part of the job, and helping and cooperating with others in the organization to get tasks accomplished (Borman and Motowidlo, 1997).

Task and contextual performance reflect different aspects of overall work performance that are predicted differently by individual differences variables (Hattrup *et al.*, 1998). Both they were found to be important in determining work quality that is responsible for enhancing individual work performance (e.g., Motowidlo and Van Scotter, 1994). Task and contextual performance represent a strong starting point for determining overall contribution of an individual to a wider, organizational system.

## Research Goals and Hypotheses

Numerous models of interaction between macro- and micro-organizational variables exist in the literature. They represent a very useful background for studying the link between organization design and work design although they were traditionally focused only on structural aspects of organization design and narrowly defined job design approach. In the meantime, over the last 20 years, scholars have noted the importance of the work context for understanding organizational behavior (e.g., Cappelli and Sherer, 1991; Mowday and Sutton, 1993; Hattrup and Jackson, 1996; Rousseau and Fried, 2001). However, multilevel interactions have not been addressed appropriately.

Accordingly, it is necessary to develop and to test models that are more comprehensive. Improved models potentially will perceive not only newly updated macro- and micro-organizational variables and their single-level interaction, but they will also apply new or improved methodological approaches and statistical methods. Such practices could lead towards more relevant and more reliable conclusions. Therefore, the aim of the paper is to observe macro-organizational variables, which have not been previously widely studied, and take a broader perspective of work characteristics by applying various types of task, cognitive and social characteristics, from a multilevel perspective. By investigating their interplay and the nature of influence on work performance, useful insights could be provided.

The main goal of the research led to proposing four hypotheses. First two hypotheses were focused on determining the existence of multilevel influence of macro-organizational variables on their micro counterparts. Third and fourth hypothesis strived towards testing indirect, mediating effects of work characteristics between macro-organizational variables and work performance outcomes.

**H<sub>1</sub>: Cognitive dimension of organizations has a cross-level influence on work characteristics.**

The design of work is now inextricably bound up with the structures and processes of organizational systems more generally (Oldham and Hackman, 2010). However, the same

could relate to cognitive dimension of organizations. People are more often seen as a source of competitive advantage and large amount of resources have been invested in managing knowledge in organizations. Therefore, it should be clearly determined in what way the HRM practices are related, directly or indirectly, to work performance. As work design is one of the techniques in the armory of HRM practitioners, potentially it represents a mechanism for translating organizational policies into work practices that are much closer to employees.

**H<sub>2</sub>: Social dimension of organizations has a cross-level influence on work characteristics.**

In global competitive environment, complexity of doing business grows on a daily basis at a higher rate than ever before. The complexity of today's business world translated into complexity of the company's organizational design (Galbraith, 2002). The new world of organizing should logically be reflected in new ways of designing work. Raising complexity strongly addresses a need for social interaction between people and brings significant interdependence at work. Nowadays, not only individuals, but entire organizational units as well should collaborate more often and more intensively to handle complex business issues. Consequently, complexity of organization design could manifest itself through work design characteristics at the individual level.

**H<sub>3</sub>: Work characteristics mediate the relationship between cognitive variables of organizations and work performance outcomes.**

Numerous studies have investigated and confirmed the *Job-Modification Framework* and a mediating role of task characteristics in relationship between organizational structure and employee reactions (e.g., Rousseau, 1978; Pierce, 1979; Brass, 1981; Pierce *et al.*, 1984). Although those findings date from even 30 years ago, Morgeson *et al.* (2010) have recently argued that work designs mediate relationships between context and individual outcomes. As today, we have a much broader understanding of organizational context and work characteristics, their proposition should be tested accordingly but on different set of macro- and micro-organizational variables. In this research, firstly, a mediating role of various work characteristics (task, cognitive, and social) should be tested in relationship between cognitive variables (cross-functional training and employee know-how) and work performance outcomes (task performance and contextual performance), to find out if indirect or direct effects exist between HRM practices and people's knowledge and current work performance outcomes.

**H<sub>4</sub>: Work characteristics mediate the relationship between social variables of organizations and work performance outcomes.**

While many authors had been emphasizing influence of structural variables on work design dimensions, although by using single-level methods of analysis, the influence of social variables of organizations was very rarely addressed. However, Mohrman *et al.* (2003) recognized the existence of two distinguished types of rewards (pay for organizational

contribution and pay for individual contribution) that are by their nature very applicable for two-level analysis. Additionally, as the attitude that reward systems are shaping organizational behavior is widely accepted (e.g., Lawler III, 2000, Galbraith, 2002), it should be interesting to determine whether their influence is direct or indirect in nature.

## **Research Design and Methodology**

In order to test the proposed hypotheses, the research methodology and instrument have been developed. Because of a multilevel nature of a planned research, very rigorous methodological assumptions had to be satisfied, from hierarchically nested data and rigorous subsampling to clearly determining two levels of analysis – individual and organizational.

Although most of the earlier studies on work design were focused on same or very similar occupations, according to Morgeson and Campion (2003) more and more investigations are cross-occupational in nature so we decided for the latter. Such an approach was appropriate because it is the first research of a kind in Croatia, so findings that are more generalizable are more than welcomed.

For the purpose of chosen research design, two separate questionnaires were developed. *Questionnaire for assessing organizational characteristics* was created to collect data on organizations and their macro-organizational characteristics. This questionnaire was filled out by persons who have a holistic view of the organization, mostly by CEOs, HR managers and middle managers in charge of organization design issues. It consisted of 13 items on a 5-point Likert scale (1 - strongly disagree; 5 - strongly agree) measuring 4 macro-organizational variables. *Questionnaire for assessing work characteristics* focused on gathering employees' perceived characteristics of their work. It encountered 75 items on a 5-point Likert scale (1 - strongly disagree; 5 - strongly agree) measuring 15 micro-organizational variables and 2 outcome variables. The questionnaires were pre-tested and their reliability and validity had been checked causing smaller changes in their initial design.

Table 1 Research instrument overview and reliability

	CATEGORY	VARIABLE	# of items	Cronbach Alpha
ORGANIZATIONAL LEVEL	Cognitive variables	Employee know-how (KNOW)	4	.846
		Cross-functional training (TRAIN)	3	.749
	Social variables	Pay for organizational contribution (REWORG)	3	.813
		Pay for individual contribution (REWIND)	3	.735
INDIVIDUAL LEVEL	Task characteristics	Work autonomy (AUTON)	3	.765
		Task variety (VARIETY)	3	.776
		Task significance (SIGNIF)	4	.731
		Task identity (IDENTITY)	4	.847
		Nature of the task (NATURE)	3	.707
	Cognitive characteristics	Job complexity (JCOMPLEX)	3	.771
		Skill variety (SKILVAR)	2	.751
		Job specialization (JOBSPEC)	4	.893
		Problem solving (PROBSOLV)	4	.712
		Information processing (PROCINF)	4	.868
		Skill utilization (SKILUTIL)	5	.795
	Social characteristics	Initiated task interdependence (INITDEP)	3	.717
		Received task interdependence (RECDEP)	3	.818
		Dependence position (DEPPOS)	5	.712
		Interaction with others (INTERACT)	4	.771
OUTCOMES	Work performance	Task performance (TASKPERF)	6	.851
		Contextual performance (CONPERF)	11	.861

The empirical research was conducted through a field study of the largest Croatian organizations with more than 500 employees because it has been proved that those organizations have more complex organizational solutions with stronger requirements for alignment of various organizational issues. Targeted population consisted of 226 organizations listed by *Croatian Chamber of Economy*. The whole population was included in

the research process due to a very small amount of organizations that satisfied aforementioned size condition.

The questionnaires supplemented with a cover letter and a short brochure were distributed by postal mail to CEOs of targeted organizations. Data collection process began in November 2009 and lasted until February 2010. The research sample was cross-sectional in nature and consisted of 51 organizations with a response rate of 23.2%. The sample was mostly represented by manufacturing organizations (33.3%), along with transport and financial companies (each 11.8%).

Besides organizations, at the individual level, the sample was cross-occupational where 1285 employees were chosen to participate in the research. The snowball sampling strategy was used and respondents were surveyed regarding the nature of their work characteristics. Contact persons in each organization, chosen by their CEOs, had received guidelines for choosing the sample of employees, which represented various parts and levels of the organization.

Very rigorous multilevel sampling requirements were satisfied because more than 65% of organizations had returned 20 and more individual questionnaires for assessing work characteristics. However, 4 organizations were excluded from the sample because they had less than 5 individual answers which led to the final observed sample of 47 organizations. Collected data were analyzed by using software packages *SPSS 18.0* and *HLM 6.08* where, besides multi-level analysis and HLM methodology, several other quantitative methods were also applied (e.g. multiple regression analysis and correlation analysis).

### **Data Analysis and Research Findings**

After data had been collected and questionnaires had been tested for validity and reliability, explorative data analysis was conducted. Missing value analysis showed less than 10% of missing data so pair-wise deletion strategy was chosen. Data were linear and normally distributed (Shapiro-Wilk test showed a value above .88). Descriptive statistics for organizational and individual level is shown in the Table 2.

Table 2 Descriptive statistics

<i>Macro-organizational variables</i>	<i>N</i>	<i>Mean</i>	$\sigma$	$\sigma^2$	$\alpha_3$	$\alpha_4$
KNOW	50	3.680	.666	.444	-.831	1.484
TRAIN	50	3.567	.732	.536	-.130	-.259
REWORG	49	2.884	1.001	1.003	-.108	.340
REWIND	50	3.040	.796	.633	-.504	-.208
<i>Micro-organizational variables</i>	<i>N</i>	<i>Mean</i>	$\sigma$	$\sigma^2$	$\alpha_3$	$\alpha_4$
AUTON	1269	3.562	.809	.656	-.453	.192
VARIETY	1253	4.081	.735	.540	-.856	1.057
SIGNIF	1186	3.324	.813	.661	-.314	-.052
IDENTITY	1264	3.828	.769	.592	-.549	.335
NATURE	1216	3.749	.772	.596	-.658	.920
JCOMPLEX	1259	3.651	.798	.637	-.231	-.499
SKILVAR	1271	3.919	.797	.635	-.632	.532
JOBSPEC	1250	3.422	.892	.795	-.347	-.174
PROCINF	1269	4.158	.704	.496	-1.045	1.725
SKILUTIL	1252	3.747	.649	.421	-.284	.314
PROBSOLV	1234	3.390	.748	.560	-.135	.001
INTERACT	1256	3.513	.857	.735	-.422	-.108
INITDEP	1268	3.528	.777	.604	-.412	.453
RECDEP	1258	3.614	.827	.683	-.337	.029
DEPPOS	1231	3.277	.767	.588	-.403	.277
<i>Outcome variables</i>	<i>N</i>	<i>Mean</i>	$\sigma$	$\sigma^2$	$\alpha_3$	$\alpha_4$
CONPERF	1051	3.907	.546	.298	-.411	1.024
TASKPERF	1086	4.108	.514	.264	-.251	.155

As a main prerequisite for conducting a multilevel analysis, intraclass correlations (ICC) were calculated for each micro-organizational variable in order to see whether a variance between organizations exists. Although observed coefficients differed in size, for most variables they were above the minimum acceptable value of .05 (Hox, 2002) which allowed further investigation and development of *Means-as-Outcomes* regression models. However,

low values of ICC give an evidence of presence of a bigger diversity of work characteristics within organizations than between organizations.

In order to test the first two hypotheses, partial multilevel analyses were conducted where *Means-As-Outcomes* regression models were created for each pair of dependent work characteristics and independent organizational characteristics. At the significance level of .1 it was determined that 60% of observed relationships between pairs of variables are statistically significant. More precisely, cognitive variables had a stronger influence on work characteristics (in 70% of relationships) than social variables (in 50% of relationships). The most significant relationships, which explained more than 30% of variance, were the following:

- *REWORK* and *AUTON* ( $\Delta\sigma^2 = 35.63\%$ );
- *TRAIN* and *NATURE* ( $\Delta\sigma^2 = 33.89\%$ );
- *REWORK* and *NATURE* ( $\Delta\sigma^2 = 39.21\%$ );
- *KNOW* and *JOBSPEC* ( $\Delta\sigma^2 = 34.62\%$ );
- *TRAIN* and *PROCINF* ( $\Delta\sigma^2 = 30.63\%$ );
- *KNOW* and *SKILUTIL* ( $\Delta\sigma^2 = 42.58\%$ );
- *TRAIN* and *RECDEP* ( $\Delta\sigma^2 = 36.70\%$ );
- *REWIND* and *RECDEP* ( $\Delta\sigma^2 = 30.17\%$ );
- *REWIND* and *DEPPOS* ( $\Delta\sigma^2 = 60.28\%$ ).

Detailed list of statistically significant relationships is provided in the Table 3.

Research findings support the first hypothesis where it is clear that cognitive dimension of organizations (employee know-how and cross-functional training) had a significant influence on work characteristics. However, regarding the second hypothesis, it is possible to conclude that the link between social dimension of organizations (pay for organizational contribution and pay for individual contribution) and work characteristics existed, although it was present only partially.

For testing the third and the fourth hypothesis, partial multilevel mediation analyses were conducted for each pair of macro-organizational, micro-organizational and outcome variable. Work characteristics were put as intervening mechanism in relationship between cognitive and/or social characteristics of organizations and work performance as an outcome variable. The analysis was conducted according to the widely accepted procedure defined by Baron and Kenny (1986).

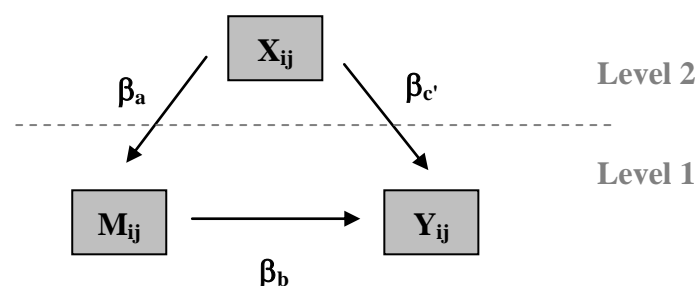
Table 3 Statistically significant relationships between macro- and micro-organizational variables

Macro-organizational variable	Micro-organizational variable	Regression coefficient	Micro-organizational variable	Regression coefficient
KNOW	VARIETY	.130**	SIGNIF	.161***
	NATURE	.101**	JCOMPLEX	.109**
	JOBSPEC	.156***	PROCINF	.151***
	SKILUTIL	.135***	INTERACT	.132*
	DEPPOS	.114**		
TRAIN	AUTON	.128***	VARIETY	.147***
	SIGNIF	.135**	NATURE	.159***
	SKILVAR	.108**	JOBSPEC	.140***
	PROCINF	.154***	SKILUTIL	.104***
	PROBSOLV	.120***	INTERACT	.164***
	RECDEP	.070*	DEPPOS	.116***
REWORG	AUTON	.105***	SIGNIF	.109***
	NATURE	.115***	SKILUTIL	.065**
	INTERACT	.097**	DEPPOS	.081***
REWIND	AUTON	.084**	VARIETY	.088*
	NATURE	.108**	SKILVAR	.072*
	PROCINF	.110***	SKILUTIL	.077**
	PROBSOLV	.071*	RECDEP	.080**
	DEPPOS	.132***		

\*  $p < 0.10$ \*\*  $p < 0.05$ \*\*\*  $p < 0.01$ 

For testing aforementioned hypotheses, a particular type – a lower-level mediation – had to be applied (model 2-1-1), because only independent variable was at level 2, while mediating and dependent variables were at level 1. In order to conduct a mediation analysis testing of *Intercepts-as-Outcomes* regression models was needed with predictors at both levels (level 1 – individuals; level 2 – organizations).

Figure 1 Lower-level mediation (2-1-1)





Multilevel mediation analysis was conducted through the following four steps by applying reduction in coefficients:

**Step 1.** The model was developed with independent level-2 variable ( $X_j$ ) and dependent level-1 variable ( $Y_{ij}$ ), without mediating variable

$$\text{level 1: } Y_{ij} = \beta_{0j}(a) + r_{ij}(a) \quad (1)$$

$$\text{level 2: } \beta_{0j}(a) = \gamma_{00}(a) + \gamma_{01}(a)X_j + u_{0j}(a) \quad (2)$$

**Step 2.** The model was developed with independent level-2 variable ( $X_j$ ) and mediating variable ( $M_{ij}$ )

$$\text{level 1: } M_{ij} = \beta_{0j}(b) + r_{ij}(b) \quad (3)$$

$$\text{level 2: } \beta_{0j}(b) = \gamma_{00}(b) + \gamma_{01}(b)X_j + u_{0j}(b) \quad (4)$$

**Step 3.** The relationship between mediating variable ( $M_{ij}$ ) and outcome variable was determined.

$$\text{level 1: } Y_{ij} = \beta_{0j}(c) + \beta_{1j}(c)M_{ij} + r_{ij}(c) \quad (5)$$

$$\text{level 2: } \beta_{0j}(c) = \gamma_{00}(c) + u_{0j}(c) \quad (6)$$

**Step 4.** Indirect relationship between independent level-2 variable and outcome variable through mediating level-1 variable was determined.

$$\text{level 1: } Y_{ij} = \beta_{0j}(d) + \beta_{1j}(d)M_{ij} + r_{ij}(d) \quad (7)$$

$$\text{level 2: } \beta_{0j}(d) = \gamma_{00}(d) + \gamma_{01}(d)X_j + u_{0j}(d) \quad (8)$$

Summary of mediation analysis results and aggregated number of statistically significant relationships per each step of the analysis are presented in the Table 4.

Detailed statistically significant mediating effects between particular variables showed that relationship between organizational cross-functional training practice and both outcome variables is mediated almost with each work characteristic (in 80% of cases). Significant mediation effects of numerous work characteristics also existed between pay for individual performance and contextual performance (in 40% of cases).

Table 4 Statistically significant relationships of mediation analysis (step-by-step)

Outcome variables	CONTEXTUAL PERFORMANCE					TASK PERFORMANCE				
Steps in mediation analysis	1	2	4	2 & 4	Mediation effect	1	2	4	2 & 4	Mediation effect
Macro-organizational variable	$X \rightarrow Y$	$X \rightarrow M$ (n.s.)	$X \rightarrow M \rightarrow Y$ (n.s.)	(n.s.)	$\gamma_{01} - \gamma_{01}'$ (s.s.)	$X \rightarrow Y$	$X \rightarrow M$ (n.s.)	$X \rightarrow M \rightarrow Y$ (n.s.)	(n.s.)	$\gamma_{01} - \gamma_{01}'$ (s.s.)
KNOW	(s.s.)	6	5	0	4	(n.s.)	0	9	6	-
TRAIN	(s.s.)	3	0	0	12	(s.s.)	3	0	0	12
REWORG	(s.s.)	9	0	0	6	(n.s.)	1	6	8	-
REWIND	(s.s.)	6	0	0	9	(n.s.)	1	9	5	-
TOTAL (%)	70.00	40.00	8.33	0.00	51.67	50.00	8.33	40.00	31.67	20.00

(n.s.) - statistically non-significant relationship (s.s.) - statistically significant relationship ( $p < 0,10$ )

Conducted mediation analysis confirmed the third hypothesis only partially because mediation effect between cognitive variables and outcome variables was present in almost 50% of possible relationships for both task and contextual performance.

Regarding the social variables, it seems that they have a more direct influence on task performance than on contextual performance. However, it should also be partially accepted only for contextual performance as an outcome variable, while it should be rejected for task performance.

## Discussion and Conclusion

The main goal of the study was to determine a mediating role of work characteristics in relationship between organizational characteristics and individual work performance outcomes. The data from the empirical study were subject to rigorous statistical technique. Analysis of multilevel interactions was conducted by applying HLM technique and it was a basis for determining the proportion of variance between and within organizations.

The multilevel research of pair-wise relationships between 4 macro- and 15 micro-organizational variables revealed that, in general, macro-organizational variables have a multilevel influence on micro-organizational variables although this influence differs. While cognitive variables of organizations had a strong and a direct influence on work characteristics, the influence of social variables was weaker, but still existed. Such findings can be interpreted in a way that organizations could hardly be excellent in all areas of their organization design practice. In other words, they emphasize only some of the organization design aspects by which they influence individuals and their work performance.

Table 5 Statistically significant mediating effects between variables

MACRO $X_{ij}$	MICRO $M_{ij}$	OUTCOME $Y_{ij}$	MEDIATING EFFECT $\gamma_{01} - \gamma_{01'}$	MACRO $X_{ij}$	MICRO $M_{ij}$	OUTCOME $Y_{ij}$	MEDIATING EFFECT $\gamma_{01} - \gamma_{01'}$
KNOW	VARIETY	CONPERF	.04602**	TRAIN	PROCINF	TASKPERF	.03746*
KNOW	SIGNIF	CONPERF	.03129**	TRAIN	SKILUTIL	TASKPERF	.03491**
KNOW	NATURE	CONPERF	.02690**	TRAIN	PROBSOLV	TASKPERF	.02280**
KNOW	JCOMPLEX	CONPERF	.01697**	TRAIN	INTERACT	TASKPERF	.01197**
TRAIN	AUTON	CONPERF	.01620***	TRAIN	RECDEP	TASKPERF	.00506***
TRAIN	VARIETY	CONPERF	.04305**	TRAIN	DEPPOS	TASKPERF	.01849**
TRAIN	SIGNIF	CONPERF	.01081***	REWORK	AUTON	CONPERF	.02362*
TRAIN	NATURE	CONPERF	.02552**	REWORK	SIGNIF	CONPERF	.00522**
TRAIN	SKILVAR	CONPERF	.02940**	REWORK	NATURE	CONPERF	.02053**
TRAIN	JOBSPEC	CONPERF	.01640**	REWORK	SKILUTIL	CONPERF	.02580**
TRAIN	PROCINF	CONPERF	.05442*	REWORK	INTERACT	CONPERF	.01578**
TRAIN	SKILUTIL	CONPERF	.04402**	REWORK	DEPPOS	CONPERF	.00056**
TRAIN	PROBSOLV	CONPERF	.01873**	REWIND	AUTON	CONPERF	.02089**
TRAIN	INTERACT	CONPERF	.00359***	REWIND	VARIETY	CONPERF	.03633**
TRAIN	RECDEP	CONPERF	.00160***	REWIND	NATURE	CONPERF	.02634**
TRAIN	DEPPOS	CONPERF	.00236**	REWIND	SKILVAR	CONPERF	.01799**
TRAIN	AUTON	TASKPERF	.01686**	REWIND	PROCINF	CONPERF	.03131**
TRAIN	VARIETY	TASKPERF	.02303**	REWIND	SKILUTIL	CONPERF	.03324**
TRAIN	SIGNIF	TASKPERF	.01995**	REWIND	PROBSOLV	CONPERF	.02505*
TRAIN	NATURE	TASKPERF	.02048**	REWIND	RECDEP	CONPERF	.01103**
TRAIN	SKILVAR	TASKPERF	.02806**	REWIND	DEPPOS	CONPERF	.01561**
TRAIN	JOBSPEC	TASKPERF	.00804***				

Furthermore, the *Job-Modification Framework*, originally conceptualized by Oldham and Hackman (1981), was put in a different context and its main idea was tested by applying the lower-level mediation technique (model 2-1-1). A mediating role of work characteristics in the relationship between organization design and work performance was partially confirmed. Although most work characteristics were mediating variables in at least three relationships (for instance AUTON and NATURE were mediators in five relationships), mediation effect in general was present in 35.83% of cases.

Results also showed that mediating influence was more represented in the case of *contextual performance* than in the case of *task performance* as an outcome variable. Furthermore, its

influence was more significant regarding cognitive variables (cross-functional training in particular) than social variables of organizations. This means that investing in people really pays back to organizations significantly through achieving higher employee work performance. It also supports a notion that people should be understood as a source of competitive advantage.

On the other hand, findings confirmed that rewarding practices had mostly an indirect influence, through contextual performance of their employees, while their impact on task characteristics was more direct. This means that employees will be cooperative and altruistic only if their work characteristics are seminal and encouraging for such a behavior.

Based on the empirical results, a conclusion could be made that some macro-organizational variables have a more or less direct influence on work performance. Additionally, an insight was provided that some work characteristics are more relevant than others, depending on particular organization design practice. In other words, whether a work characteristic will have a mediating role, depends on the nature of the observed organization design concepts, but as well as on the choice of the outcome variable.

However, the research has some limitations. Although various macro- and micro-organizational variables had been observed, due to rigorous research requirements and research scope constraints several interesting ones were not included. Individual sample was based on employees from various parts and levels of organizations, with different occupations. Such a cross-occupational sample offers greater width, but again it potentially results in a greater diversity within organizations, as confirmed by low values of ICC. A number of other possible limitations should also be mentioned, like common-source bias, small values of regression coefficients, subjectivity of respondents, etc.

The contribution of the study is four-fold. Firstly, new insights regarding the relationship between different macro- and micro-organizational variables were provided. By recognizing the existence of cognitive and social dimensions of organizations, a new light was shed on investigating organization design field. In addition, various work characteristics have been jointly tested, allowing for a more generalized view of the work design practice. Secondly, the original *Job Modification Framework* has been tested in a different context by applying different organizational variables, as well as a broader set of work design variables. Large sample at the level of individuals allowed for a joint investigation of numerous variables without questioning statistical power. Thirdly, a multilevel analysis was applied in organizational and work setting, further addressing a need for its wider usage in the area. Very interesting cross-level effects were recognized or addressed. Finally, the research findings offered insights about organization design and work design practice from a new context in a Central and Eastern European country. This can offer new understandings of possible differences in work design practice in different countries and cultures.

Future research studies should focus on further investigation of various relationships between macro- and micro-organizational variables. In doing this, one should apply multilevel lenses because they potentially offer a deeper understanding of complex organizational reality and shed a new light on previously determined single-level effects. In addition, particular and related topics should be investigated in various contexts, which could add a new, cultural perspective of understanding differences between existing organizing practices.

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**ETHICS, ECONOMIC THEORY AND CORPORATE GOVERNANCE****Huehn, Matthias<sup>1</sup>**<sup>1</sup>American University of Paris, France. Email: mhuehn@aup.edu**Abstract**

The paper investigates the foundations of corporate governance. It traces the current practical problems of corporate governance to the epistemological and ethical problems of the current mainstream management theory. Management theory has almost completely succumbed to economism, the ideology of mainstream economics. The paper isolates and discusses the three axioms of economism which are deemed to be especially problematic for management/corporate governance theory. The three axioms are: the assumptions that humans always follow the rational principle, that value-free research and application of management tools is possible, and that theory takes primacy over reality. These axioms plus what has been called the “gloomy vision” create a theory of management which is amoral and which in turns leads to immoral and dysfunctional corporate governance. Thus, the paper takes a very high-level look at the debate about ethics in business and argues for the emancipation of business ethics from mainstream economic theory. Management is viewed as a scientific discipline which derives its value from the contributions it makes to managerial practice while Economics has always been – and has recently become more so – a more theoretical field of thought.

Keywords: Management Theory, Corporate Governance, Ethics.

**Introduction**

In 2005 and 2006 two management gurus published scathing criticisms of *what* management as a scientific discipline teaches (Goshal) and *how* things are taught (Bennis). Both articles caused quite a stir, because they questioned mainstream management thinking and teaching radically. Of the two, Goshal’s notion that mainstream management was indeed evil, creating immoral managers (Bennis accused management professors merely of producing automatons unable to deal with complexity) was by far the more serious accusation. Corporate governance is about putting a structural, legal and ethical framework in place that encourages and enables managers to behave within ethically and legally acceptable parameters and at the same time furthers long-term profitability. Goshal’s ideas are thus very relevant to corporate governance. This paper will argue that Goshal was right and that only a fundamental change in the assumptions underpinning management mainstream theory will lead to a sound theory and practice of corporate governance. I will start by showing what, why and when things went wrong in management theory. Then I will talk about the main epistemological shortcomings – which in my view are massive – of an economised management theory. In a last chapter I will take Goshal’s argument one step further and



explain how immoral management practices which are based on amoral economised management theories undermine Western societies' ethical foundations.

It seems that a large number of leading management scholars share Sumantra Goshal's considerable unease about the mega-trend in management theory towards Hobbesian views on human nature and the mathematisation of what should be a social science. However, Goshal's fundamental criticism is not being incorporated into mainstream theories. Why is that? Mintzberg (1971, 1975, 1979, 1999, 2004, etc.), probably the most important and influential management scholar of the past 30 years has been saying the same things as Goshal for an even longer time, and is also listened to and not acted upon.<sup>42</sup>

How can management scholars draw on Mintzberg's, Goshal's, Drucker's and also Bennis's ideas and still strongly disagree with their general philosophy, when the four authors' writings are permeated by the idea that management is not a number-crunching exercise done by selfish and totally rational maximisers? We have a hypothesis – and a rather provocative one at that – which answers these questions: people have been brainwashed – they believe in an ideology which allows them to strictly separate between their theories and reality. That ideology is economism.<sup>43</sup> We will discuss in this paper how economism acts like a corrosive destroying not only the basis of good (ethical and effective) management practice and theory – and therefore corporate governance – as Goshal claimed, but also how economism is corrupting the social context in which management exists.

### **Management theory has been replaced by ideology**

An ideology and a theory are not easily distinguishable because both contain elements of faith (axioms). If an ideology offers a simple solution to life's recurring complex problems, people often choose the path of least resistance and follow the herd, even if they know the theory/ideology is wrong. There is a large number of definitions of what constitutes an ideology. All of them have in common that an ideology is a collection of theories bound together by a vision or strong beliefs (axioms). Lakatos (1973) called these basic beliefs "hardcore hypotheses".

Popper's falsificationism rests on the postulate that a theory or its hypotheses are testable. If they are not, the whole theory is unscientific (cf. Popper 1934, Lakatos 1973). The demarcation criterion between an unscientific ideology and a scientific research programme, Popper argued, is the falsifiability of a theory in an experiment or through an observation. '[O]ne can

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<sup>42</sup> Despite Walter Nord's (2005) assurances in *Academy of Management Learning & Education*, that 'When Henry Mintzberg Speaks, People React'.

<sup>43</sup> We use the term *economism* without its usual Marxist connotations. By *economism* we mean the ideology of economics; the attempt to declare a sociological discipline as value-free. Any ideology frees its followers from the duty to use their own moral faculties; the result in my view is not an amoral but an immoral society. The term is also not used to denounce Liberalism or Libertarianism as Hans-Hermann Hoppe – whom we will quote later – is the most important living economist in the Libertarian school.

sum up all this by saying that the criterion of the scientific status of a theory is its falsifiability, or refutability, or testability' (Popper 1965: 37).

Scientists are also humans who defend their opinions, even if the facts stand in contrast to them. Being especially smart humans, they even defend the holes in their theories before other people have spotted them, they immunise their theories with what Popper called 'immunising stratagems'. Popper's version of falsification struggled with this. Imre Lakatos developed his Popper's naïve falsificationism into sophisticated falsificationism. He claimed that all research programmes have a limited number of very important hypotheses (the so called hardcore hypotheses). These hardcore hypotheses are surrounded by hypotheses of lesser importance and those act as a protective belt. Repeated falsification of these auxiliary hypotheses in the protective belt would not automatically mean that the whole theory is falsified and has to be abandoned. However, if the hardcore hypotheses are repeatedly falsified (through a clash with reality), the research programme must be given up. In effect Lakatos allowed scientists to employ immunising stratagems up to a certain point, while Popper – somewhat naively – appealed to the scientists' decency.

The argument presented here is that the economic research programme within management in particular and in the social sciences in general is in fact not a scientific research programme but an ideology, whose hardcore hypotheses have been refuted right from the start. It should therefore be given up. An even stronger argument for separating the two research programmes management and economics from each other is that their basic principles (efficiency vs. effectiveness) clash (Hühn 2005). Broekstra is right, when he says, this unhealthy economisation of management is not a new development but a recurring trend:

And here we come to the heart of the matter: the prevailing managerial ideology. Managers are primarily efficiency- rather than effectiveness-oriented. The result is, as Janov (1994) contends, a means-end confusion. (Broekstra 2001: 106)

Fads come and go while the efficiency focus<sup>44</sup> has become the prevalent ideology in management, much to the detriment of what really should be the focus of analysis in management, i.e. effectiveness. Effectiveness cannot be calculated, however, and is therefore of little relevance in economised management.

Scholars like Lindblom and Herbert Simon (1947) have much earlier criticised the application of economic principles in management. This paper is not simply repeating or enlarging on their critiques. We will take the argument a step further, by claiming that the economic view of social sciences stands in total opposition to some of the most important

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<sup>44</sup> In German and Austrian Economics the economic principle is also called the efficiency and rational principle. Thus, Broekstra is complaining about the economisation of management that has developed into a full-blown ideology. Drucker's postulate, that "effectiveness rather than efficiency is essential in business" (1964: 5) has been discarded by the management economists.

fundaments of Western philosophy, the basic ideas of the Enlightenment. A theory which like economism stands in stark contrast to the ethical foundations of a culture, must either be accepted as correct beyond reasonable doubt, or be given up immediately. Otherwise it will – if it is mainstream thinking, which is the case with the economic view – undermine and then completely destroy a culture completely. It should be obvious that there is considerable doubt as to the applicability of the economic principle in the social sciences.

The deteriorating situation with regard to corporate governance we can observe around is just the tip of the iceberg. The governance of corporations (regulated by those who govern a country) and the governance of a country are part of the same complex socio-ethical system and a systemic failure in one part of the system will affect the system as a whole. Bennis and Slater (1964) correctly predicted the downfall of the Soviet system in a Harvard Business Review article. A corrupted ideology in one societal subsystem will affect the whole system. This paper argues that the managerial subsystem is destroying the societal system bottom up through the enforcement of an amoral management ideology.

### **A short critique of economism**

Despite its massive shortcomings – the Duhem/Quine thesis alone is able to destroy Popper's hardcore hypothesis<sup>45</sup> – falsificationism<sup>46</sup> we accept that the mainstream in all scientific disciplines favours falsificationism – at least officially.

For the sake of brevity we will analyse only the most important axioms of economism, those constituting the hardcore hypotheses of the economic ideology. For that we refer to what Nobel prize laureates Herbert Simon, Friedrich August von Hayek and also Sumantra Goshal have written on the subject. We think that there are at least three closely related hardcore hypotheses. The first maintains, that there are hard facts and only hard, i.e. measurable, phenomena are relevant. The second holds, that there is one rationality which is expressed in a meaningful, i.e. mathematically valid, way in the economic principle, and which allows predictions. Finally, the third axiom, which is maybe the most astounding of the three basic tenets of economism, claims that reality is a function of theory, otherwise prediction would not be possible.

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45 Naïve falsification rests on the assumption, that one cannot verify a theory through facts as million of corroborative facts (seeing a million white swans) is proved wrong by finding only one fact (a black swan) that refutes the theory (all swans are white). But, the critics say, what about the theory of seeing which says that the last swan was black instead of white? Who has proved that this is right? The answer obviously must be: no one. A theory can never be tested in isolation. Thus, it is neither impossible to verify nor to falsify theories with facts. For this very reason Imre Lakatos created sophisticated falsificationism which allows social factors (introduced by Thomas Kuhn) into the debate.

46 Popper's falsificationism is still very popular among the scientific community despite its serious shortcomings. Popper's most talented pupil, Imre Lakatos, was even in 1973 quite exasperated, 'I think that the fact Popper's philosophy survived for so long is a sociological mystery. Popper's immortality is secured by this idiotic result.' (1973)

**Axiom 1**

We shall start with the last point. Hans-Hermann Hoppe, the most important living libertarian economist, calls attention to what is a rather critical argument. He proposes that there are two very different situations: natural events and human activities. For each category there are different rules with regard to the relevance of theory and the possibility of prediction. Hoppe criticizes the two extreme schools in economics, the rational expectation theorists and the radical uncertainty theorists for being wrong logically and empirically. He agrees with Lachmann, whom he sees as the most important exponent of the latter school of thought, about the shortcomings of the rational expectation theorists:

“Lachmann and his followers are correct in emphasizing that the problem of predicting my and others’ future actions is categorically different from that of predicting outcomes of given actions or of natural events. In fact, the destructive part of Lachmann’s argument is largely correct even though it is hardly new.” (1997: 55-56)

Hoppe makes two very important statements in this passage. One with which we agree, and one which we would like to, but cannot agree to. First, Hoppe declares that we can, and indeed should (for insurance reasons for example) predict certain natural events. For example “pattern of earthquakes, tornadoes, cancer, or car accidents...” can be predicted with some degree of accuracy (1997: 56). Human actions, however, are another kettle of fish altogether – and cannot be predicted. Hoppe succinctly explains the world-view of rational expectation theorists,

“Rational expectation theorists only replace the model of man as a never-failing automaton with that of a machine subject to random errors and breakdowns of known types and characteristics.” (56)

The rational expectation theorists are of course the economists that have come to rule the management debate.

Let us come back to Hoppe’s second claim – the one to which we would like to agree, but cannot agree. Hoppe says that Lachmann’s argument, that one cannot make predictions about human actions, is hardly new. This may be true for some enlightened economists. For mainstream management theorists like Günter Wöhe, the doyen of German business administration, it is an outrageous idea worthy of their full contempt. In the 21st edition (since 1960) of his 1300 page introduction into business administration Wöhe, like any sane person, says that the assumption of a “homo oeconomicus” is merely a fiction. In the next sentence, however, he pushes all concerns aside and proclaims that the ever rational maximiser is a valid fiction, which is needed to differentiate business administration from sociology. It makes the analysis and prediction of economic reality possible (2002: 26). This is, of course, a totally unacceptable statement: a valid fiction is a contradiction in terms. Nevertheless, it clearly demonstrates the extent to which the notion, that a business

administration scholar can define a theoretic reality (which in turn defines “physical” reality), has been completely accepted.

This “theoretic turn”, i.e. making reality dependent upon theory is enormously important for business administration as a science, for it gives business administration and economics a special position among the sciences (Wöhe 2001: 24). “Economic Science” (*Wirtschaftswissenschaften*), according to this view, is not a mixture of Arts and Science. Rather, it represents a separate scientific discipline, which renders insights from the Arts and Sciences usable through the application of rigorous mathematical methods. Good old physics envy is alive and kicking. Indeed, this shows that the prevalent mindset of management economists has made it widely acceptable. Human interference coming from the Arts is managed by being expressed in the language of mathematics: the rational/economic principle is the most important axiom of the ideology of economics (economicism); without it, everything breaks down. Thus, the postulate (for that is what the economic principle is: nothing but a wish, not based on reality) – which states that every person maximises/optimises all the time (a point which is of course totally untestable) is the pillar on which the theory of economics, on which reality depends, rests. Maybe the bluff is simply too brash to be called. Maybe economists are too lethargic to think about this problem with their theory.

## **Axiom 2**

The second axiom is the rational/economic principle and it plays such a central role that it has been mentioned in the discussion of the first axiom and will feature in the discussion of the third axiom. In the early 1960s, Herbert Simon did the unthinkable: he looked to and evaluated real life, instead of just issuing advice from the safe confines of science’s ivory tower. In doing so, he discovered that managers do not adhere to the rationality principle when making decisions, and that they do not maximise or optimise – they satisfice. Simon had it easier than economists: he was a social scientist and thus not bound by economic theory.

This new, practical-minded “administrative man” represented the opposite end of the continuum to the theoretical “economic man”, who optimised. Both Lindblom and Simon were very clear on one point: *homo oeconomicus* was not only rare in practice; economic man was a superfluous model, a misleading chimera. Their main criticisms were that it is theoretically impossible that anyone could analyse all the data there is in an objective fashion, and then calculate an optimal solution. Their rather tame criticism of bounded rationality was nevertheless enough to shake the foundations of business administration as a science, because its highest axiom (the economic principle) was declared dysfunctional. It is interesting to note that Simon was given the Nobel prize for economics because he criticized the *validity of the economic principle for the practice of management* while today’s Nobel prizes go to game theorists who base all their models on economic man. The criticism of the economic principle has been acknowledged and then forgotten by economists as if it were a minor point. One look at

Gutenberg's (the founder of business administration after the second world war in Germany) model of the organisation (see Figure 1) shows that without the assumption of a unified rationality (that is, without the economic principle) the whole model becomes a very unstable construction. If the underlying assumption that all decision-making<sup>47</sup> humans are automatically guided in their decision-making by one rationality is false – that is, if those human agents would be guided instead by either multiple rationalities or, even worse, irrational or intuitive elements – then calculating a solution would be no longer possible. Moreover, the claim to scientific status afforded by being able to offer such an “objective” decision-making principle, is forfeited. Hoppe, himself a radical Libertarian economist<sup>48</sup>, chides his fellow economists of the Positivist type (1997: 56):

“Such a model of man [assuming a rational decision maker] is no less faulty than the one it is supposed to replace. It not only stands in manifest contradiction to the facts, but any proponent of this model is also inevitably caught up in logical contradictions. First off, if our expectations (predictions) concerning our future actions were indeed as rational as rational expectation theorists believe them to be, that it would be possible to give an exhaustive classification of all possible actions (just as one could list all possible outcomes of a game of roulette or all possible locations of a physical body in space).”

Early organisation theorists who hailed the bureaucracy as the best form of organization believed exactly that: one can create a list of all possible situations and human actions, write them down in the organisational handbook and thus create the perfect organization which adapts automatically. The bureaucracy was meant to be the organisational form where the efficiency principle rules. One need not comment on what is today thought of as an extremely naïve belief. As Hoppe shows, giving up the rational principal does not necessarily mean that economics becomes arbitrary, or even a useless pursuit. It just shifts the attention of economists from the study of human action to the study of phenomena within the external world.

### Axiom 3

The last axiom, the reliance on hard facts, shows even more clearly than the other two that economism is epistemologically not quite up to modern standards. Economists treat facts as if they were “objective” truths, which of course is an utterly childish assumption. Facts are

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47 Today the situation is thought to be much worse, as decision-making is seen as a process which involves non-managers and not an act carried out by few managers.

48 Goshal attacks (Neo-)Liberals of the Friedman fold and sees them as the most important propagators of economism. It would in our view be erroneous to see Libertarians who would subscribe to Friedman's definition of a Liberal, i.e. someone who sees “freedom as the ultimate goal and the ultimate goal and the individual as the ultimate entity in the society” (Friedman 2002: 6 quoted in Goshal 2005: 83) merely as more radical Liberals. Yet, Libertarians like Hoppe do not assume that humans behave like atoms, i.e. that *homo oeconomicus* is a fact (although they certainly believe in Hobbes more than Locke and thus support a gloomy vision). It seems that the situation is even more complicated than Sumantra Goshal described it.

merely theories which are given (by a group of people) a special status. Paul Feyerabend (1975), the brilliant anarchist among the philosophers of science, included poltergeists and other paranormal phenomena in his lists of facts and became quite notorious in doing so.<sup>49</sup> But insisting on the other extreme, i.e. closing one's eyes to the problematic nature of facts, is certainly even more damaging, because science is based on a debate not on silence. The debate about whether value-free economics or management research was possible reached a stalemate when the two camps got bored with the other side's arguments. Basically the aye-sayers argued that objective is needed in science and since it is needed it must be possible, while the other camp held firm to their stance that everything is subjective and therefore objectivity is impossible. Over thirty years and a constructivist debate later, however, there can be no reasonable doubt that value-free (and therefore "objective") research is a practical and theoretical impossibility. Nevertheless adherents to economism, who need objectivity as much as the rational principle in order to be able to cling to their claim to be a proper science, still firmly believe in objectivity. A fact is a fact they say, and thereby affirm that they are Positivists of the most naïve type – about whom Heidegger once quipped that they confuse thinking with calculating. Maybe Heidegger also thought about the fact that economists created a human sub-species. Homo sapiens (the "wise" man) got a younger brother, the homo oeconomicus, the calculating man. This younger brother throws wisdom and common sense out of the window in order to be able to calculate.

A very simple example from a first semester lecture shows the impossibility of value-free economics and the problems caused by economists' failure to accept that subjectivity is inescapable. The author gives Introduction to Business Administration to first semester students. One of the topics dealt with in this lecture is the weighted decision matrix (see Figure 2) – one of the most typical tools of business administration. I briefly explain how a decision matrix roughly works and then let the students explore this tool in a two-hour exercise. They pretend to be top executives of Daimler and their task is to value (!) four potential takeover candidates with the help of four to six criteria (turnover, p/e-ratio, number of employees, image/brand, etc.) and then make a recommendation which company Daimler should buy. The students quickly discover that the most innocuous criteria are the most problematic. Take the number of employees. It looks very much like a sought-after hard fact. The problem is, this "hard fact", like any other fact, does not have any *value* in itself; a *value must be assigned to it*. Porsche has 11,000 employees, while BMW has 110,000 employees. The students are asked assign values ranging from 0 to 10 to all criteria and most student groups give Porsche 10 points and BMW 1 point. Yet, some groups give BMW 10 points and Porsche 1 point. Both have good, plausible arguments for their extremely different valuations of a "hard fact". After encountering an unexpected problem with the "hardest" of all facts, the

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<sup>49</sup> There is an interesting connection between Libertarians and epistemologists in the Feyerabend vein: both are anarchists. Libertarians reject the notion of a state as an authority above the individual and Feyerabend rejects the authority of the scientific high priests (Popper, in his case) defining what is a fact and what isn't.

students become wary. Criteria like image/brand, culture, technology prove are vastly more problematic. An evaluation – the word itself should make that clear – cannot be value-free/objective, because even numbers do not speak for themselves, they must be interpreted and an interpretation is always subjective. When the students discover this, they are relieved and use the tool with greater ease and more creatively. The tool works much better, after it has been cut down to size and the ridiculous assumption that it can be used with mathematical precision.

An argument that is often sold to students is that values only mean ethical/political values and if a scientist uses uncritical value statements, he only has to tell people that he now has left the realm of facts (cf. Wöhe 2001: 55). One may think that this sounds like a practicable rule of thumb; but it isn't. Indeed, it is exactly where economists turn into ideologues. The three foundations of game theory, principal/agent theory and other such mainstream ideologies, includes the rational actor who relies on hard facts, Thomas Hobbes' evaluation of human character, and Milton Friedman's famous statement that "the only social responsibility of business is to make a profit" (1970). All three cornerstones of modern scientific management economics are presented to students as objective and factual foundations, and not as the highly subjective value-statements that they are in reality. Most scholars are not even aware of this, because they themselves have swallowed the fiction that there is value-free research. That means scientists with doctorates in philosophy (PhDs) are like babes in the wood when it comes to rather basic epistemology. A very sad situation. It also means that these people teach economism like (young) priests teach a religion: with a total conviction that they hold the absolute truth. Philip Tetlock puts this very succinctly:

'Placed in the broadest perspective, the current findings remind us that decision theorists are not the only people with strong opinions on the nature of good judgment and rationality. Decision theorists characteristically adopt an explicit prescriptive stance to their subjects of study: there are right answers that can be derived from well-defined axiomatic systems of logic such as Bayes theorem or expected utility theory or game theory. To paraphrase John Milton in "Paradise Lost" their task is to explain the ways of God to man, not the ways of man to God, where God translates for early twenty-first-century audiences as the eternal truths of mathematical models of choice.' (2000: 323)

A whole generation of students has been indoctrinated by the high priests of economism with an ideology that rolls back the achievements of the Enlightenment by feeding them untruths cloaked in the 'pretence of knowledge' (Hayek 1975). The consequences for academia are drastic. Academic work rests on debating different viewpoints in order to get closer to the truth. Should scholars not encourage a critical debate? This should be a rhetorical question as many university mottoes include the word "Truth" (Harvard's motto is of course "Veritas"), but is it? Goshal; Mintzberg, Freeman/Wicks and Parmar (2004) and Bennis/O'Toole (2005) and don't think so and maybe many other academics silently agree but



fear the repercussions of disagreement, and so remain mute. It needs brave deans, editors and reviewers to encourage dissenting views. Goshal, Mintzberg, and Bennis are well-established management gurus, but even they (Mintzberg must be excluded) waited until the end of their careers until they dared to be so critical.

Freeman et al. (2004: 364-5) show the pressures to conform to the prevalent ideology:

‘More subtly, according to McCloskey (1998), the "maximizing shareholder value" view is put forward as a "scientific" theory that is modeled and verified appropriately by ideologists called "economists." Unfortunately, in an attempt to be accepted by their "scientific brethren," several management theorists have adopted the fashion of accepting the economic view of business activity as the most useful one available and have fallen into the trap of the separation thesis. "Maximizing shareholder value" is not a value-neutral theory and contains vast ideological content.’

Dissenting voices are ridiculed and find it very difficult or impossible to publish papers. As academic careers are build on publications, many researchers will undoubtedly shrug their shoulders and succumb to the considerable pressure to conform; thereby helping to destroy what is, according to Mark Blaug the essence of scientific work:

‘Science, for all its shortcomings, is the only self-questioning and self-correcting ideological system that man has yet devised; despite intellectual inertia, despite built-in conservatism, and despite the closing of ranks to keep heretics at bay, the scientific community remains loyal to the ideal intellectual competition... ’ (1992: 42)

The struggle between the value-free economists and the more ethically inclined management scholars can be traced back to the first edition of the Harvard Business Review in 1923. Williams expresses his unease about the rational actor (economic man) model and argues that it is a totally unnatural model which causes all sorts of problems in business life:

As an executive of a steel company I commonly heard the shortcomings of the industrial worker explained by reference to the “economic man,” that hypothetical person to whom nothing is supposed to appeal “unless it’s in his pay envelope.” When later I worked and lived among the laborers of both America and Europe, it was an immense surprise to find my companions using exactly this same “pay-envelope theory” to explain the shortcomings of their employers! Manifestly, something must be wrong with any explanation of human behavior which, while so universally accepted as motive for others, is with equal universality refused for one’s self. (Williams 1923: 332).

### **Economism is spilling over into society in general**

After having established the role of economism in management and having discussed the shortcomings of this research programme, we can now proceed to explaining how economism is destroying much more than management theory. Economism has long ago

spilled over into society in general. Corporate governance is only the most visible bridge between management and public life.

Modern Western philosophy and democratic modes of governance are based on the Enlightenment. The most important message of Enlightenment was that an individual not only has the right – but also a moral obligation – to think for himself/herself. One of the Enlightenment's core ideas is that there is no higher moral authority than one's own conscience, and that the individual cannot not delegate moral judgement to either an institution or an ideology. In so doing, it challenged the power of the church, which had insisted for over a thousand years that the authority to enquire and to think was a divine prerogative administered by itself. The quintessence of the Enlightenment philosophy, Kant's categorical imperative, "Act only maxims which you can at the same time will to be universal law" (Paton 1952: 55), does not focus so much on the right to be free, but on the obligation which freedom places on the individual vis-à-vis other individuals. The responsibility for the greater good is not with God or an ideology but in the hand of every individual. The ethical essence distilled from Enlightenment social philosophy, it is still the most important philosophical statement against totalitarianism and ideology.

Economism directly attacks this core of Enlightenment thought because it binds managers to an ideology and its principles and axioms. What is more, it does so disguised as a value-free science. In order to discuss this point deeper I have taken the liberty to re-arrange Sumantra Goshal's arguments (see Figure 3) slightly. This is necessary because, while Goshal raised all the right points, in my view, he stopped his discussion a little bit too early. Perhaps he was bound by too much scholarly restraint, or he was too humble to enlarge the scope from the effect of unethical management theories upon management practice, to that of their wider significance and impact upon society in general. On the other hand, perhaps he simply believed the danger of economism was obvious enough for his readers to make the connection.

The immoral ideology of economism is the result of the confluence of two streams of thought: the pretence of knowledge and gloomy vision. The pretence of knowledge is the result of the unthinking and uncritical application of the three above mentioned axioms. The gloomy vision is based on Thomas Hobbes' view of man; people are egotistical and bad, they always think of themselves first. Goshal attempted to counter this terribly naïve reduction of Hobbesian philosophy – which was created against the backdrop of the horrors of the English civil war – by examples where individuals act not rational in the economic and Hobbesian sense of the word (selfish). Some anthropologists, however, have a more general argument against a Hobbesian view than Goshal: for them the difference between a human being and an animal is the ability to act against one's own interests. Puzzled for a long time by the fact that human babies were extremely slow learners in comparison to young animals,<sup>50</sup>

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<sup>50</sup> Compare a human baby and a fawn. One learns to run around after 10 months, the other in ten minutes.

anthropologists eventually theorised that the relatively slow learning of human babies encouraged the development of compassion in humans, as they had to care so much longer and more intensively for their young than other animals. If this theory is right, a naïve interpretation of Hobbes' gloomy vision is catastrophically wrong about human nature because it questions the demarcation criterion between human and animal. More important and telling maybe is that economism takes a simple rule of thumb ('humans are selfish') and turns it into an absolute truth ('humans are *always* selfish'). Again, common sense tells us that people are indeed very rarely selfish, because all national cultures condemn selfishness and it would be irrational to go against the whole community all the time. Hobbes' argument after all was, that selfishness is the natural state of humans, he did not mince his word and condemned this natural state as evil. The natural state, however, is covered by culture, religion, the state (Hobbes' Leviathan) and other man-made social technologies. Thus, the gloomy vision wants to turn enlightened and civilised humans into fierce animals, governed by Hobbes' *ius naturalis*.

Goshal (2005: 83) uses a standard scenario from Nobel prize winning game theory to illustrate the absurdity which ensues when the pretence of knowledge and gloomy vision are the basis of a scientific theory:

"Consider, for example, the "ultimatum game" in which one player, designated as the proposer, is given the opportunity to propose a division of a certain sum – a gift – between herself and another player, designated as the responder. If the responder accepts the proposal, the sum is divided as proposed. If he rejects the proposal, neither player receives anything. In any variant of the self-interest-based model of human behavior, the proposer ought to offer only a token sum to the responder, keeping the bulk of the amount for herself, and the responder ought to accept the proposal since even a token sum is more than nothing, which is the only alternative available to him."

As the players are not the Hobbesian wolfs economist claim they are, but normal human beings with a sense of justice and normally developed moral faculties, the proposers almost never offer only token amounts and the responder would never think of accepting a token amount. What good is a theory whose axioms are so obviously wrong and which does not even help to explain/predict reality, when the worth of economics – like most social sciences – depends on its ability to predict?

Departing from a utilitarian perspective, which Friedman said is more important than the model itself (predictive power over scientific rigour as a last line of defence), we would like to come back to the ethical dimension. The argument is not really that these theories are not good but that they are inherently evil (Goshal shrunk back from using that word) – because they free managers from their moral obligations. Economism forcefully brainwashes enlightened citizens and turns them into mindless executors of an anti-Enlightenment ideology: "More specifically, I suggest that by propagating ideologically inspired amoral

theories, business schools have actively freed their students from any sense of moral responsibility" (Goshal 2005: 76).

The New Manager does not have to make difficult value judgements, he simply follows a quasi-mathematical model; New Managers are neutral executors of the economic principle. This ideology has created a number-focused manager who cuts costs, but does not create new business opportunities (Mintzberg/Ahlstrand/Lampel 1999); who analyses endlessly instead of synthesising (Porter 1996: 61; "analysis paralysis: Livingston 1971: 83); who multiplies his salary while he destroys the value of his company and lays off employees by the thousands like Detlef Schrempp of DaimlerChrysler and is still hailed as a role model.<sup>51</sup>

The organisational model that represents the rule of the economic principle is the rational-legal bureaucracy (cf. Mintzberg 1979). Bureaucrats also have no responsibility other than following the organisation's logic. The excuse for unethical behaviour is the logic of bureaucracy: the rational principle. "I am only doing my job and it is not really important in the great scheme". Relieving New Managers from their duty to think for themselves and make value judgements must lead to inhumane and unethical organisational behaviour.

The economisation of society has accelerated considerably in the past 20 years. The effect of publicly amoral or immoral managers on the rest of society is a very serious complication. The business schools have played an important role in spreading economism by producing armies of cloned New Managers. However, it is not only through the sheer number of disciples that the business schools have been so harmful. Normally students have not studied business, when they enroll in MBA programmes, but law, medicine, engineering etc. Thus economism spreads across the discipline's borders. Probably even more worrying is that MBA students are not educated, they are trained in a very short time. People who have not learnt the basics of management are taught the most important "tools" of management economics without learning about the philosophical basis or the problematic nature of the tools. In other words, people with blank (and therefore open) minds are indoctrinated with an ideology without being shown any alternatives. They believe in economism as only the newly converted are able to believe. Have you ever tried to open someone whose mind and soul are firmly committed to the one Truth? 'Against stupidity the very gods themselves contend in vain', Schiller famously quipped. The author is involved in the training of young strategy consultants for a Top Five consultancy and faces the strongest opposition from people who have no management background, except in-house courses. People armed with limited expertise but strong ideological beliefs will not shift their stance, for neither facts nor reason.

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<sup>51</sup> Schrempp was made an honorary professor after destroying 50% of his company's stock value because of his exemplary work. The value of his stock options doubled on the day his successor announced that Daimler would divorce Chrysler. Schrempp made most of his money from his biggest mistake. Moral hazard does not begin to describe the situation.

The ideology of economism has reached all parts of society, and it replaces a morality based on the enlightened philosophy of the responsible individual. Thomas Kuhn's (1962) socio-historical view of the advancement of science is able to explain why a scientifically flawed research programme may be highly attractive to a majority of scientists and remain the paradigm despite being falsified. In the case of economism the appeal lies in the simplification of a reality that is too complex to be understood with mathematical models. When Einstein's special relativity theory was delivered what should have been a fatal blow ("quantum entanglement" was faster than the speed of light and therefore clashed with Einstein's most important axiom) the academic community refused to give it up. They were right to do so, as Einstein was later able to incorporate into his model what he at first "explained" as "spooky action at a distance". In management and economics the situation is very different. The gloomy vision and the economic man concept have been wrong from start and have consistently been refuted in experiments afterwards. It is high time to lift the head out of the sand and face reality. Not only for the sake of scientific progress in economics and management but also for the sake of modern humane society.

### **Quo vadis?**

The economisation of management is maybe the most persistent trend. It has been so persistent that it will be very difficult to reverse it. Arguably the most important management scholars (Mintzberg, Hamel, Goshal, Bennis, Schein, Argyris, Drucker to name a few) have always preached the opposite. It does not bode well for change that the most influential scholars have always stood beside the mainstream. It is also very difficult to see change happening when the flaws of economism are so obvious and the vast majority of professors still feel no need to speak up. Corporate governance is a rather young discipline which has been given a lot of publicity lately because the actual governance of corporations has deteriorated visibly. Therefore corporate governance may be an area where change has a chance. This paper has argued that the reason for the deterioration is the wrong de-moralised theoretical basis of management in general and corporate governance in particular. The role of ethics must given a very prominent role in management theory; it should be obvious that ethics has a direct impact on the governance of organisations. Ethics must be an integral part of any management class, certainly of any corporate governance class. Governance cannot happen through administrators; the creators of democratic countries were all entrepreneurs of freedom. Laws are interpreted by wise men, not applied by law programmes. While wisdom cannot be learnt, the structure of morality can be learnt. That should be the least that managers take with them from business schools when it come to leadership.

The writings of Henri Fayol, arguably the first management scholar and great antipode of FW Taylor, are permeated by the notion that managers must be wise and decent judges. If the judges are not wise, if they cannot handle complex decisions, but are simpletons who – because they have never learnt to think for themselves – have to follow Milton Friedman's

mono-rule ethics of maximising the shareholders' returns,<sup>52</sup> how can employees respect them? How can these *ersatz* managers respect themselves at the end of the working day, at the end of their careers? The concept that the fish always smells from the head is known to most cultures. The governance of any organisation depends to a large degree on the good ethics of a few good and trusted men and women, not on a piece of paper. Paper does not blush, as is obvious in the case of the *German Corporate Governance Kodex*. Many companies signed up and then conveniently forget major codices. The *Kodex* for instance limits the number of directorships a single person is allowed to hold to five. This provision violates Friedmanian logics and it consequently ignored by many directors. Why should you limit your income? The argument you cannot effectively supervise the top managers if you are a member of a large number of supervisory boards, is obviously less convincing than the argument that managers should be egotistical maximisers. Laws and regulations only go so far, personal ethics are ever present and thus act as a much more effective regulator of human behaviour.

With hindsight one can see a straight line from the 1960s to today's managers who are increasingly morally blind. Ethics classes are electives, chosen by softies who are not really interested in a career. In 1971 J Sterling Livingston stated that managers 'mired in the code of rationality' refuse to accept responsibility. John S Tomajan (282) named his 1945 Harvard Business Review contribution 'But Who Is To Lead The Leader?' and concluded that, '[t]he true leader will be entirely selfless.' Selfless, not selfish. The leadership of a company must have a moral compass to be able to lead. The business schools must start to acknowledge the moral vacuum at the top and accept that this in part their responsibility. All people who manage other people (one cannot manage numbers) should also be educated in ethics. Once again, laws and codes do not guide peoples' behaviour as effectively as ethical beliefs. Business schools must stop pumping out soulless maximisers and start to produce educated managers. Otherwise, those who manage will always be tempted to maximise their benefits to the detriment of those they manage and the companies they are supposed to lead to prosperity. A recent research programme, which receives support from many sections of the management community (McFarland 2001, Badaracco 2001, Collins 2001, Mintzberg 2004, Neuschel 2005), stresses that leaders serve and that the best leaders do so silently and humbly.

## Conclusion

I proposed that the ideology of economism has displaced traditional management theory almost completely. This was achieved mainly by pushing the economic principle (efficiency) more and more to the forefront until it was the only consideration of managers and

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<sup>52</sup> Maximisation is a totally unscientific concept anyway, because it assumes that time does not exist. How else do managers know that they are actually maximising profits in the long run, when they maximise them in the current fiscal year? That works only, if managers would be able to see indefinitely into the future.

professors, and at the same time turning effectiveness into a mere constraint. Afterwards I elucidated the massive deficiencies of an ideology that raises theory above reality; focuses on what it assumes to be more easily quantifiable; and assumes that all humans follow the same mathematical formula when they engage in any economic activity. Taken together these axioms of economism create a de-humanised and amoral theory which, when applied, causes managers to behave immorally yet within the moral obligations of their profession as propounded by Friedmanian management scholars. We finally proposed that this immoral (or evil) behaviour by managers cannot be contained within the world of business and slowly but surely is corroding the basis of Western civilisation, Enlightenment. This would close the gap in the feedback loop from management theory to management practices to societies' moral standards, and back to management theory. A vicious circle spinning out of control is gaining momentum. Last but not least we have pointed out that true management scholars like Mintzberg, Bennis, Goshal, Drucker and before them Fayol have always proposed that management is a complex (not simple), highly personal and situational (not following one "law"), and above all moral (not technical) activity. There is no need for a radically new management theory as the basis for corporate governance – it has been there all along.

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## CUSTOMER RELATIONSHIP MANAGEMENT: WHEN THEORY MEETS PRACTICE

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### Abstract

Even though the concept of exchange relationships is not new and has been debated for many decades, application of the concept in practice has not been met with success. Consequently, the paper utilises existing literature in order to guide the effective implementation of CRM in service industries. To this end, it is emphasised that a primary reason of the high failure rates is the myopic adoption of CRM technology as a panacea. CRM is a business philosophy and it is suggested that in view of the complex, multifaceted and distinct nature of exchange relationships, it is imperative to undertake prior qualitative research to better understand if relationships are also desired by customers and if so, the nature of the envisaged relationship. Then, in order to ensure that a valued proposition is designed, emphasis shifts to service employees, process re-engineering with the customer as the focus and facilitating technology.

**Keywords:** CRM, Failure rates, Implementation, Services

### Introduction

Exchange relationships have been extensively researched and debated for nearly 40 years by four different streams of research, namely Business Marketing, Marketing Channels, Services Marketing and Database and Direct Marketing. Similarly, the business community has largely embraced Customer Relationship Management (CRM) since more and more businesses acknowledge the value of customer retention. Nevertheless, in spite of the widespread interest in CRM at both an academic and a practitioners' level, efforts to apply the concept have not been particularly successful. Few academics, however, have paused their on-going search to further refine the concept and actually defend CRM's applicability in practice.

The paper aims to align theory and practice, by focusing the discussion in a specific relational context, that of services whose intangible and inseparable nature is considered as conducive to relationship development (Berry, 1983; Gronroos, 2000). To this end, the paper reviews and discusses the relevant literature on exchange relationships, on the basis of which it recommends how CRM can effectively be implemented in a services setting.

### Literature Review

Customer Relationship Management (CRM) has attracted the interest of a plethora of both academics and practitioners and many argue that CRM has become a buzzword in the

business arena. This interest stems from an acknowledgement of the well-documented benefits of relationship building, benefits which are exemplified in highly competitive and fragmented markets (see for example, Sheth and Parvatiyar, 1995; Payne, 1994; Christopher *et al.*, 2002).

Even more so, in service contexts where the offering is intangible and perceived risk much higher, customer relationships are particularly desirable. In fact, academics from the Nordic School, whose research focuses in services marketing, questioned the applicability of the simplistic 4Ps model and called for a refinement in management thinking and a paradigm shift in marketing, to a new paradigm, i.e. relationship marketing (Gronroos, 1994; Gummesson, 1994). In effect, the work of an array of researchers, such as Berry (1983), Gronroos (2000) and Coviello *et al.* (2002) underlines that services performances are inherently relational.

Consequently, many companies have rushed to adopt CRM programs but have ended up with nothing but failed attempts. That is, even though Relationship Management's origins can be traced back in the 1970s, and there is a wealth of literature on exchange relationships, "successful implementation is elusive to many companies" (Chen and Popovich, 2003 p. 672). Specifically, even though CRM failure rates ranged significantly from 2001 to 2009, they have been reported as high as 70% in 2002, while in 2009 they were of the order of 47% (Krigman, 2009)

In light of such a considerable number of failures, a number of practitioners have offered their perspective on what may lead to a successful CRM implementation (see for example, the Tugboat Media Inc, and Chatham Systems Group). Few academics, however, have gone back to the plethora of exchange relationship theories and made a conscious effort of bridging the gap between theory and practice (see for example, Chen and Popovich, 2003; Mendoza *et al.*, 2007; Amiri *et al.*, 2010). Consequently, the **objective** of this paper is to enhance this body of knowledge, with special emphasis given to CRM application in the distinct and allegedly relational nature of service industries.

Implicit in any effort to implement CRM would be a consideration of three important parameters, namely understand:

- (a) that CRM is a business philosophy,
- (b) whether relationships are applicable in the specific context and, if so
- (c) how they can be operationalised in the specific context.

#### **(1) Customer Relationship Management – a business philosophy**

An important source of the high failure of CRM implementations is the misapplication of the concept in practice. That is, a considerable percentage of companies fail in their CRM journey as they solely focus on technology – they believe that CRM is simply about software.

A plethora of articles are available online, which suggest how to effectively use CRM technology to prevent failure (see for example, Rodriguez and Boyer, 2010).

But this is simply the tip of the iceberg. The real challenge is to truly understand that CRM is not just a tool; it is a business philosophy which underlines the importance of *value delivery* in establishing and cementing relationships with exchange partners.

In their paper, Chen and Popovich (2003) provide such an explanation, underlying that “CRM is a combination of people, process and technology that seeks to understand a company’s customers” and hence “successful CRM implementation requires an integrated and balanced approach to technology, process and people” (p672). Similarly, through their empirical studies, Mendoza *et al.* (2007) and Amiri *et al.* (2010) also point to the combination of the triple of people, process and technology in effectively implementing CRM.

## **(2) Applicability of exchange relationships**

Nevertheless, the mere transition from the myopic perspective of considering CRM implementation possible from technology alone is not enough to guarantee a successful implementation. That is, there is great controversy in the extant body of knowledge as to whether relationships can in fact be applicable in all contexts: some argue that relationships are evident only in certain contexts and suggest that their applicability may well be a function of the industry sector (Buttle, 1996; Moller and Halinen, 2000). Even broad generalisations, e.g. services settings, however, have been critically debated: for instance, Zolkiewski (2004) questions the applicability of relationships in all services using as examples the relationship between a patient with his/her physician and that of hairdressers and their clients as compared to those interactions between a bank customer and his/her banker. This has led in warnings against the overuse and misuse of the term (Zolkiewski, 2004).

Specifically, a number of factors which pertain to the nature of the product offering (e.g. continuous vs. discreet, level of customer involvement), the structure of the market (e.g. availability of alternatives), and the capabilities of the provider (e.g. professionalism) have been analysed as critical in evaluating whether exchange relationships can flourish (Berry, 1983; Buttle, 1996; Pressey and Mathews, 2000). Further, an integral part of relationship building is mutuality: based on social psychology, Barnes and Howlett (1998) suggest that for a relationship to exist both parties must perceive it, while Gummesson, (1994) and Moller and Halinen (2000) argue that both parties need to be active. Hence, it is also imperative to understand whether the customer wishes to establish and maintain a relationship (Barnes, 1994) in the first place. In effect, however, most research in consumer relationships shows that the customer’s perspective is rarely taken into consideration.

On the whole, it can be seen that prior to any implementation a thorough understanding as to what CRM is and what is not is required. This necessitates an investigation of the underlying exchange conditions to determine whether these are conducive to relationship development.

### (3) Nature of potential relationships

Once the underlying exchange conditions have been established, more light can be shed as to what type of relationship may be desired. It is well documented in the literature that under different conditions and situations different relationship types may be appropriate and evident (Wilkinson and Young, 1998; Turnbull *et al.*, 1996; Blois, 1998; Ford *et al.*, 1998; Veloutsou *et al.*, 2002). These may range, for instance, in the degree of dependence, intensity and/or how close or distant they are. Compare for example, how close and personal the potential relationship between a hairdressing salon and its customers is and that of a bank with its retail customers is.

Hence, different relationships will develop in different contexts (Barnes, 1994; Veloutsou *et al.*, 2002) and these relationships will be characterised by different dimensions and will evolve in distinct paths. Such dimensions include satisfaction (Anderson and Narus, 1984; Wilson, 1995), service quality (Christopher *et al.*, 2002), communication (Dwyer *et al.*, 1987; Hakansson, 1982; Moller and Wilson, 1988), adaptations (Hakansson and Gadde, 1992), bonds (Wilson and Mummalaneni, 1986); Dwyer *et al.*, 1987; Liljander and Strandvik, 1995), trust and commitment (Morgan and Hunt, 1994).

Consequently, any effort to effectively implement CRM should not only entail an investigation as to whether relationships can exist and are desirable but also an investigation as to what constitutes such relationships.

### **Recommendations: How do we implement CRM in services?**

The current body of knowledge suggests that in practice the implementation of CRM presents a real challenge to organisations. Hence, in line with current literature, the paper discusses a number of recommendations to aid in the establishment of mutually-beneficial relationships in a services setting.

As a business philosophy, CRM can be successfully implemented only with the appropriate management commitment and a conducive organisational culture. Specifically, a strong management commitment is necessary since CRM implementation requires a considerable investment, but the benefits will not be immediate. That is, even though considerable time, effort and financial investment are necessitated, the potential benefits accrue in the long-term. Hence, organisations which suffer from a short-term orientation and a lack of management commitment will not be able to sustain the appropriate drive and dedication.

Given the right frame of mind, i.e. being customer-oriented (Axson, 1992, Buttle, 1996 and Bennett and Durkin, 2002), organisations will strive to create the *right value proposition*, and to this end they must:

- Understand whether customers are interested in forming a potential relationship with the organisation as well as what different customers perceive as a valuable offering which stands apart from competitors' and can increase customer loyalty (Lovelock and Wirtz, 2004). In light of the complexity and diversity of relationships as well as their context-specific nature (Barnes, 1994; Veloutsou *et al.*, 2002), prior qualitative **research** in each specific context (e.g. both service industry and culture) is needed to understand the type of relationship which is possible and desirable. Qualitative research is especially pertinent in investigating relational phenomena, given the complex and sensitive nature of relationships and is in fact largely employed by the Nordic School which is one of the founding and most prominent research traditions in the area.
- CRM is a process which aims at developing relationships with **selected customers**, thus it is based on segmentation and targeting. Especially in services where choosing the right customers becomes a challenge, service firms need to choose an appropriate customer portfolio (Lovelock and Wirtz, 2004). Specifically, due to the interactive nature of services, the manner in which the customer participates affects not only his/her experience and outcome, but also that of other customers. This, in turn, affects the Lifetime Customer Value (LTV), where LTV is defined as the expected contribution from the customer to the provider's profits over his or her entire relationship. Lifetime Customer Value is estimated using past behaviours to forecast the customer's future purchases, gross margin from these purchases and the costs associated with the customer (Levy and Weitz, 2004). Zeithaml *et al.* (2001) highlight even further the importance of choosing the right customers through their Customer Pyramid, which reveals that there are substantial differences in customers' profitability or LTV.
- The variable nature of service performances does not only pose a challenge to the marketer but it also conducive to relationship development as it enables the **customisation** of the offering. Consequently, service marketers should capitalise on this opportunity so as to enhance their service value. Notwithstanding the above, it is recognised that some services lend themselves to higher degrees of customisation than others, for instance legal services as opposed to banking.
- **Technology** can also help the service marketer's efforts in better understanding and targeting customers as well as in designing valued propositions since customer databases enable the on-going collection and analysis of customer data on such aspects as descriptive information, customer transactions and encounter modes, customer preferences as well as responses to marketing activities. Hence, information technology can be utilised to support the implementation process with relevant and updated information on customer profiles (i.e. demographic

information and LTV) and behaviour. Central infrastructures to CRM applications include data warehouses, Enterprise Resource Planning (ERP) systems and the Internet (Chen and Popovich, 2003).

- Considerable emphasis should also be placed on **service employees** since the delivery of a value proposition and the attainment of customer loyalty is possible only through them. That is, due to the inseparability and variability of service performances, employees become the service, who must ensure, amongst other things, that both the process and the outcome of the service performance meets customer expectations, i.e. what Gronroos (1984) had termed functional and technical quality respectively. As a consequence, Sasser and Arbeit (1976) argued that the first market for the service company should be its employees, who should be carefully selected, trained and empowered to deliver excellent service. A plethora of academics adopted this view arguing that employees are internal customers and jobs are internal products, making Internal Marketing an inseparable element in successful services marketing (Berry and Parasuraman, 1991). Schlesinger and Heskett (1991) provided evidence to this end, when they introduced the Cycles of Failure and Success, while subsequently the Service-Profit Chain highlighted once again the close link between employee satisfaction, loyalty and profitability (Heskett *et al.*, 1994).
- Nevertheless, for service employees to be effective in their positions, the right **organizational structure** must be developed (Copulsky and Wolf, 1990), whereby functional areas, especially marketing, human resources and operations are linked. That is, a concerted effort from both backstage and frontstage employees is essential as well as between employees of different departments, so as to ensure that service delivery is at par. This enables the reduction of a number of non-financial costs incurred by the customer, such as time and physical costs, and essentially increases overall service value. Further, processes and systems must be re-engineered (Axson, 1992), not only to simplify and improve them but also to organise the operations around the customer (Murphy, 1996). Chen and Popovich (2001) also highlight that core business processes should be redesigned and built around the customer: “starting from the customers perspective to involving customer feedback” (p.682). In this way, it can be ensured that the customer is not treated as an object but as an active partner.

## Conclusion

Even though exchange relationships have been debated since the 1970s, the concept is still largely misapplied in practice. Hence, the paper aims to bridge the gap between theory and practice by providing a number of recommendations for an effective application of CRM in a services context.

To this effect, it is suggested that it is imperative to redirect the current discussion on CRM implementation, from the myopic perspective which views CRM as a tool (which can be effectively be implemented through technology alone) to understanding that CRM is a business philosophy. This philosophy adopts a holistic attitude to marketing and underlines the importance of value delivery in establishing and cementing relationships with customers. It is therefore, suggested that qualitative research should be employed in each setting to explore whether customers wish to form a relationship with the organisation in the first place and if so, what type of a relationship. Service organisations should then decide which their valuable customers are and which they wish to target. Finally, they would need to invest both in the re-engineering of their processes and in their service employees, since both of these can significantly affect service value. In this effort, technology can lend a helping hand as it provides a consolidated, up-to-date account of the customers' demographics, behaviour and LTV.

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## RESOURCE DEPENDENCE PERSPECTIVE INTO OUTSOURCING: A STUDY IN TURKISH TEXTILE INDUSTRY

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### Abstract

The purpose of this study is to utilize the framework of resource dependence theory (RDT) context to present the understanding of outsourcing in Turkish Textile Industry which is widely-used in custom manufacturing. This research examines the perspectives of twelve organizations by the data collected through in-dept interviews with the executives of twelve high-ranking textile brands. The results reveal the outsourcing reasons in context of RDT, the current situation of the organizations studied in terms of their strategies on managing, controlling of outsourced manufacturing services. This study provides initial findings of the deliberate decisions of the studied organizations through RDT lens.

**Keywords:** Resource dependency theory, Outsourcing, Textile Companies

### Introduction

Outsourcing implications provide the potential of day-to-day management and strategic decision making. The scope of outsourcing - price reductions, flexibility, quality, technology, core competence, globalization and environmental factors - affects a firm to make an outsourcing decision. These decisions also affect the long-term competitive situation and some risks that the firms had to alter.

Over the time, as the interdependence of world economies increased, the organizations need to maximize productivity and profitability in order to overcome this dependence. Outsourcing therefore emerged as a popular competitive strategy for firms of all sizes in all types of industries (Javalgi et.al., 2009).

Outsourcing presents many opportunities for the firms especially the textile firms. Manufacturing in the low-cost countries such as China, Bangladesh and India offers firms price competitiveness, accesibility to new technologies and quality. On the other hand, there are dependency issues occur while managing the sub-contractors relations in terms of production deadlines, quality control issues, processes and external factors such as political implications of the domestic or outsourcing countries.

The purpose of this paper is based on two main issues. First issue is to explore how firms decide to use outsourcing- under which scope they choose this implication. The second issue

and primary focus of the paper is, by using the framework of resource dependency, to understand the reasons of outsourcing decisions and how much information the firms have on the concepts of RDT to be able to understand outsourcing is an deliberate decision as RDT suggests. RDT context of outsourcing is the focus; because, the components such as uncertainty, dependence and power related dependence issues can be seen as the prospects of outsourcing while the general sight is that many firms consider outsourcing as a cost beneficial factor. RDT postulates that organizations will take deliberate decision to be proactive in their external environments to sustain competitive advantages in potential long-term consequences. RDT provides a rich framework that firms are taking strategic decisions to become active in their environment such as mergers/vertical integration, joint-ventures and other interorganizational relationships, boards of directors, political action and executive succession (Pfeffer and Salancik, 1978). In this paper, outsourcing is taken as a focal strategy through RDT lens for firms to minimize the external uncertainty and environmental dependencies rather than a solid reason as being cost beneficial implication.

The perspectives of twelve high-ranking textile firms were explored through in-dept interviews with their executives who were intimately involved in strategic decision making and on-going outsourcing management in terms of custom manufacturing. RDT themes were explained in detail during the interviews, their perspectives on outsourcing learned and which strategies or implications they are currently using to be actively managing their environments are presented.

## **Outsourcing Literature Review**

A widely used definition of outsourcing is the decision of make or buy. Firms decide what to perform internally versus to buy where and how to in the marketplace (Ellram et.al.,2008).

In 1990's, outsourcing has become a focal issue for many industrial manufacturers. Firms implemented many functions such as purchasing, production and manufacturing through outsourcing. Managers concentrated on stock values and forming oppression to increase the firms' profits. During 90's, to descend costs by outsourcing has become the most appropriate way for firms. By having increasing number of outsourcing in many functions, outsourcing definition has diverted from a solid cost-based tactical implication on purchasing /manufacturing to a strategic management function. As the need of outsourcing to emerge as a strategical decisions, firms have defined various dimensions in outsourcing process referring to their value chain and strategic goals to keep the advantage sustainable.

Outsourcing also can be defined as obtaining goods or services externally as provided by the organizations previously (Kakabadse and Kakabadse, 2000). The main stream of outsourcing mostly cited in the literature is the core-competence component of outsourcing reasons that suggests the restructuring of the firms' activities in order to stimulate the development of their main capabilities (Prahalad and Hamel, 1990). By separating essential and non-essential capabilities and tasks helps firms to specialize and focus on the activities

that generate greater added value (Bustanza et.al., 2010). Within the perspective, firms are deciding which activities to perform in-house and which activities to outsource. As a competitive strategy, outsourcing; possesses firms a sustainable advantage through their corporate strategies. To be able to keep the sustainability, firms need to provide better controls and monitoring outsourced relationships (Amaral et.al., 2004).

Outsourcing may offer the firms: "to convert fixed costs into variable costs, to balance the number of employees, to reduce the needs for capital investment, to reduce costs via economies of scale, to accelerate the development of new products, to obtain access to the innovation and latest technologies offered by the supplier of the outsourced service, to focus our resources on those activities with high added value" (Bustanze et.al., 2010). On the other hand, as containing relationships with the suppliers or the resource holders; it may have some disadvantages such as hollowing-out fear, impact on jobs, wrong evaluation of the suppliers, being interdependent, demand changes, political risks, uncertain environment with limited resources, institutional myopia while deciding what and where to outsource.

The literature offers a wide range of different theories having different perspectives on outsourcing arguments (Gottschalk and Solli-Sæther, 2005). In this purpose, resource dependence theory (RDT) perspective will be introduced as a theoretical framework for better understanding the outsourcing decision and its implications.

### **Resource Dependence Theory**

The resource dependence theory (RDT), introduced by Aldrich and Pfeffer (1976) and developed by Pfeffer and Salancik (1978) assumes that; having its roots from the open-system approach based contingency approach; organizations are a sub-system that all activities are affected by the external environment where they take place. According the RDT perspective, there are two main motives: first one is, in terms of demand and constraints from the environment, organizations behave not only by adapting, but also managing their relationship with the external environments towards their advantage. The second motive is, power can occur potentially important role for organizations, for that reason the environment is more a political characteristic during the decision making process.

Referring the two main motives, RDT assumes that, organizations are not solely self-sufficient and they have to obtain their needed resources from the environment which the relationship issue occurs with the other organizations. An environment that has social and physical factors and the relationships based on resources among organizations which are all have different level of power, enabling a situation: the environment is "uncertain" for the organizations (Pfeffer and Salancik, 1978).

In this uncertain environment, RDT states that the organizations need to obtain resources from other organizations as the resources are scarce. Based on this view, the interorganizational relationships occur and eventually this interaction entails mutual

dependence and power issues between the organizations. In literature, there are various definitions of dependence, however in RDT perspective Svensson's (2002) dependence definitions can fit in context to dependency caused by the interorganizational relationships:

- “technical dependence as when two firms use compatible equipment and adapt their business activities to each other in a technical sense,
- dependence based on time, as when two firms need to synchronize their business activities, dependence based on knowledge, as when two firms learn through interaction about each other's strengths, weaknesses and ability to solve problems,
- social dependence, when interaction between two firms are based on personal relationships,
- economic and juridical dependence when two firms are formally dependent upon each other such as through a written assignment”.

In order to take a self-advantage, organizations behave actively to manage dependence factor. Ulrich and Barney (1984) therefore identified that organizational achievement was the maximization of the organizational power. Within the same perspective Pfeffer and Salancik (1978) assert that organizations are the social actors exist dependently to the environmental resources and they try to minimize their resource dependency. This minimization can be managed by adopting some strategies such as: 1-integrations, acquisition and diversifications (as altering strategies), 2- setting a negotiant environment by establishing cooperative structures and 3- setting a regulated environment by legal, political and social activities.

### **Resource Dependence Perspective into Outsourcing**

As RDT focuses on the external environment of the firm and the dependence on the resources (e.g., skills, labor, technology, metarials, knowledge) for firms to operate, is dealing with the attention of outsourcing implications as well. RDT emphasises on buyer-supplier relationships (which is a one of the main constructs of outsourcing process), focusing on cooperation and coordination among partners to produce mutual benefits (Dyer and Singh, 1998, Dyer, 2000). Therefore outsourcing is a subject of RDT in terms of organizational relations.

As RDT also extends to supply chain management (it is a must to be well-managed). Inholding many subjects such as; strategic purchasing, long-term relationships, interfirm communications, supplier integration etc. (Paulraj and Chen, 2007), outsourcing implications should also be considered as a strategic decision needed to be researched under RDT lens.

In outsourcing,-on the basis of environmental uncertainty- the resource uncertainty is a topic that refers to the environments with low resource uncertainty have a reduced degree of interdependence and less conflict among the firms. That means the firms would easily access to the required resources (Pfeffer and Salancik, 1978). Low uncertainty (means high resource concentration) will have a cause of fewer suppliers to coordinate so that less dependence to

manage and less motivation to reduce uncertainty proactively (Pfeffer and Salancik, 1978). This component of RDT also refers mutual concepts with outsourcing.

In order to behave proactively in resource acquisition, a firm can become partners in joint ventures or acquiring key suppliers or can form linkages with influential individuals in supplier firms (Provan et.al., 1980). This activity refers to the power concept of RDT and also can be considered in outsourcing decision making process to minimize the uncertainties.

Based on RDT, outsourcing can be integrated as a strategy into RDT to be examined in multi resource dependency relations as suggested by Hillman et.al. (2009). When outsourcing components are compared with RDT (see Table 1), interesting insights can be seen into understanding of outsourcing field, which is a dynamic, transforming and continuously wide-spreading implication of today's world (Javalgi et.al., 2009).

*Table 1. Outsourcing elements through RDT*

<i>Outsourcing Decisions</i>	<i>Resource Dependence Theory (RDT)</i>
<i>Strategic Intent</i>	<i>Focus on all business functions</i> <i>Outsourcing core activities</i>
<i>Outsourcing Criteria</i>	<i>Availability of resources and capabilities</i> <i>Building capability</i>
<i>Analysis for outsourcing</i>	<i>Manage uncertainty</i> <i>Core activities</i> <i>Creation of value across all business functions</i>
<i>Impact on the organization's value proposition</i>	<i>The development of capabilities across organizational boundaries</i> <i>Survival and growth</i>
<i>Risks</i>	<i>High</i> <i>High</i>
<i>Outsourcing scope</i>	

*Reference: Javalgi et.al., 2009.*

## Methodology

This research has a confirmatory nature. In this context, situation analysis is the design of our research to reach an integrated view within itself. First, the researchers wanted to determine whether outsourcing reasons of the studied firms apply to RDT context (whether the firms have considered any environmental uncertainty, interdependency, power) and whether RDT perspective is relevant in making an outsourcing decision is a deliberately taken as a strategic implication. Second, by revealing the main reasons of outsourcing, the researchers wanted to provide insight of firms' current situations whether they are actively managing their external environment to have the advantage of sustainable outsourcing implications.

To this end, in-dept interviews were conducted to twelve high-ranking textile firms' executives (General Managers and Procurement Directors) who took place in decision making or in charge of outsourcing operations.

The main question of “how textile firms take outsourcing decisions” was asked to allow interviewees to tell all reasons/factors and also the story of their experiences. There were also some points which ensured related to in-dept interview during the structured questions were asked. All of the interviews took place face to face in executives’ present offices. The data were coded by dividing into categories and then assigned to re-categorization regarding to given specific answers. The interviews lasted in a duration of 50 to 70 minutes. All of the studied firms were using outsourcing based on custom manufacturing as they were used to be manufacturers in the past.

## Data Analysis

To gain more insights into outsourcing decisions, participants were asked to explain how the decision was made to outsource manufacturing function. The insights are in Table 2. The motivations for outsourcing manufacturing function were mentioned and the benefits sought were categorized and the re-categorized insights will be provided in the following sub-titles.

*Table 2. Outsourcing driven factors of the participant firms*

<i>Firms</i>	<i>In firms perspective, outsourcing is...</i>	<i>How/why begin outsourcing when you first decided?</i>
<i>Textile 1</i>	<i>Cost reduction</i>	<i>Saw others being succesful and saving money Desire to have best quality in best prices</i>
<i>Textile 2</i>	<i>Cost reduction with comparable quality of goods</i>	<i>Technological change is important in quality</i>
<i>Textile 3</i>	<i>Quality improvement</i>	<i>issues Growing by cost reduction</i>
<i>Textile 4</i>	<i>Cost reduction</i>	<i>Growing, risk seperation needed to be financial</i>
<i>Textile 5</i>	<i>Cost reduction, risk spreading</i>	<i>strength Saw the benefits of outsourcing in transportation, scheduling, profitability</i>
<i>Textile 6</i>	<i>Good price, competitiveness</i>	<i>Fast production is important, couldn't keep up in house Desired to find best suppliers in best prices with good service</i>
<i>Textile 7</i>	<i>Flexible scheduling, cost reduction</i>	<i>Financial resources are valuable, desire to be a big brand, best in competitive prices</i>
<i>Textile 8</i>	<i>Fast manufacturing at valuable price Risk spreading, cost reduction</i>	<i>Cost leadership strategy, core competence, being fast Supplier advantage in being flexible, various suppliers, best oursourced quality</i>
<i>Textile 9</i>	<i>Cost reduction and managing the risks</i>	<i>If you want to grow and be a competitive brand, you have to use outsourcing.</i>
<i>Textile 10</i>	<i>Flexibility, core competence</i>	
<i>Textile 11</i>	<i>Growth and profitability</i>	
<i>Textile 12</i>		

**Motivation for outsourcing**

To gain more insight on the reasons/factors to outsource manufacturing services, as consistent with the popular belief, we have found strong emphasis on cost reduction/price saving according to the data analyzed. Risk is the second important given answer to our main question, that firms choose outsourcing as a strategy to mitigate risk and to manage the risk.

Quality is also relatively strong emphasis on firms on outsourcing decisions. Thus, given the strongest emphasis on cost reduction is one of the main reason on make or buy decisions. Textile 11 stated that they are paying more if the supplier has a good quality by adding: "for this reason we do not have the same profit margin as our competitors, but we sell high quality with higher price. We are aware of the cheap suppliers in North China, but we never go there. Value is an important matter, when it is not our core-competence, we are ready to pay more". According to RDT lens, this data can be a sign of outsourcing decisions are made deliberately in the purpose of growing and profitability. However, solely cost based decisions is not a concept of RDT.

In terms of RDT, the participants explanations of some can be underlined as; all 12 firms declared that outsourcing implication was decided on the strategy base in order to achieve competitive advantage. This point supports the actively managing organizations of RDT perspective.

Textile 2 had stated: "...cost is important, so quality is. Being cost oriented will not bring competitive advantage in today's market conditions. You have to control your suppliers to ensure the quality issue where this can sometimes cost you up more than you image..."

Textile 11 also emphasised profitability mentioning that: "...considering our country's resources (labor costs, energy costs, metarial costs) it is a must to outsource manufacturing function relatively cheaper offshore countries such as China, India and Bangladesh. This will bring you competitive advantage. If you want your brand to be a leader, first you have all the costs minimized, add the gained value to your profitability and grow as much as you can..." which shows that cost is the primary issue. However, underneath there are various sub-issues as quality, fast production, good supplier relations and sustainability.

**The main insights of the firms into outsourcing in RDT concepts**

In regard to the RDT concepts of uncertainty (see Table 3), dependence and power, all of the participants focused on outsourcing countries where they can mitigate uncertainty and dependence. Uncertainty perceived as a risk which is not completely avoidable. Textile 4 stated as: "uncertainty comes a level after competition when deciding outsourcing" while Textile 6 stating uncertainty: "over-commit issues, delivery dates, quality controls, currency and political factors are the uncertainty factors that suffer us in the beginning, however when you settle a good relations, all vanish". Textile 11, as one of the leader brand paying attention on the lobby activities and association in textile unions, states " it is important to have the

first information on the political and financial implications in domestic market, this can show you the next door to step in". This statement is an important emphasis on environmental uncertainty and actively managing organizations through RDT as environment is not a whole of explicit knowledge. In firms statements, outsourcing itself can be a useful tool to manage and reduce risk (which is perceived as uncertainty), on the other hand, outsourcing on the offshore countries can create uncertainty if all the insights of outsourcing is not well planned.

*Table 3. RDT concepts with outsourcing*

<i>Concept</i>	<i>How studied firms adapt</i>
<i>Uncertainty</i>	<p><i>Following leaders' actions</i></p> <p><i>Outsourcing countries' political, financial, geographical, cultural risks</i></p> <p><i>Retaining experienced suppliers domestically</i></p> <p><i>Taken place in lobby activities with other leader brands and association in textile unions.</i></p> <p><i>Supplier back-up, working with wide-spread suppliers in different offshore countries.</i></p>
<i>Dependence</i>	<p><i>Developing cooperative relationships in order to have long-term relations.</i></p> <p><i>Trust based relationships by having short-term contracts as long-term contract are not a motive to prefer in environmental uncertainty</i></p> <p><i>At least 3 to 4 years cooperation including training, monitoring suppliers to settle the quality and good relationship.</i></p> <p><i>Keep the power imbalance</i></p> <p><i>Being careful in emerging countries such as Africa where power matters.</i></p>
<i>Power</i>	

In the dependence concept; all firms were aware of the interdependence with suppliers they cooperate. Eventhough Textile 6 stated as: "we are not dependent on our suppliers, but all of them are on us". Afterwards re-considering the textile market where the season (delivery time), quality and fast production factors, admitted the interdependence is on, as facing a late delivery can cause a huge catastrophe. All firms were aware of interdependence is an important issue. To balance the dependency among suppliers-buyers, firms do; supplier back-up, developing long-term relationships (mostly on trust based), training the key suppliers, short-term contracts (as the long-term contracts are costly and no one desire to be dependent on one supplier knowing that the environmental uncertainty).

As a third concept, power is seen as an opportunity to keep the outsourcing implication by all firms. Participants agreed on they have the power to manage the risks in their environment. The more specific knowledge they have, the more power occurs in the competition. Textile 3 mentioned on power: "we have 300 suppliers in different countries that



makes us powerful on flexibility on suppliers". This point of view shows the situation of creating new trends on supplier basis and managing the dependency as well.

## Conclusions

This research has both theoretical and outsourcing implication based views. In this situation analysis, firms had explained the reasons/factors in making the outsourcing decisions. The bottom line is that organizations should carefully consider, understand and manage outsourcing activities in their external environment. In theoretical standpoint, RDT is a relevant supportive characteristic, providing insights into outsourcing, the environmental uncertainty, interdependence, power and how to manage in external environment actively.

First pattern regarding outsourcing reasons observed in this study is; cost is the common answer. Most of the firms studied admitted that the cost is the main reason in outsourcing, but quality factor and mitigating risks should not be underestimated. Among the firms, it is also recognized that cost can relatively change. Cost does not always end with price reduction, supplier relations management, backing-up, switching due to uncertainty, training, controlling all are costs including in outsourcing. To be able to manage these unseen costs, firms need to be better understanding of outsourcing in all the way. This finding can make a contribution to other organizational theory that outsourcing should be studied through, Transaction Cost Theory (TCT). Within this theory, it is considered that the "factors that make something more expensive to outsource or perform internally" (Ellram et.al., 2008). TCT can provide all the information related with cost factor and guide firms when making outsourcing decisions.

One salient finding can also contribute to Institutional Theory as; "saw others being succesful and saving money" statement of one of the studied firms, ringing a bell that outsourcing should also be investigated in the concept of Institutional Isomorphism by DiMaggio and Powell (1983).

As a second pattern regarding RDT concepts, all firms agreed to avoid environmental uncertainty. By RDT, firms should focus a political implications as to avoid risks can cause eventually. To be sustainable, lobby activities and association in textile unions can help firms to manage the uncertainties actively. Hence, a very interesting finding of this study is that, firms that are associated in United Brands Association (Birleşmiş Markalar Derneği), lobbied with government in order to reduce extra tax practices planning to be implied in imported apparels and fabrics. This extra tax has reduced on apparels from %40 to %30 and on fabrics from %30 to %20 by negotiation. This finding shows a powerful example of RDT's standpoint of "actively managing organizations". Domestically, the studied firms have also been operating in such a country of import quotas that legislated away in past two years. The external environment they are in is so volatile, as they are now facing with extra tax which is a major problem of firms that are currently outsourcing from offshore countries. Creating a negotiated environment is one of the way out of uncertainties that could change the

competitive advantages. The participants stated as all the outsourcing processes can be change, even though they may outsource domestically after considering the cost issues. Here another finding emerges, the firms that have the lower dependence compared to the higher dependent suppliers can negotiate to alter this extra tax on their trust based relationships. Therefore the importance of buyer-supplier relationships emerge as a major study according to this situation analysis.

### **Limitations and future research topics**

This study is limited by the perspective of general managers and procurement directors of the studied firms. Even general managers are in the decision making process, procurement directors may not have direct responsibility. In focus of this study, both the decision making process and the involvement in outsourcing services to confirm the importance of the relationships studied in both general manager and procurement directors. It would also be beneficial to have more key persons' perspective on RDT and outsourcing.

Another limitation is that the researchers focused only on outsourcing of manufacturing function in textile business without comparing it to inhouse manufacturing or domestic outsourcing. Even the studied firms have operated inhouse manufacturing or domestic outsourcing, it was not a main topic of our research. In this perspective, experiences and learned lessons might help on the answers when framing the situation analysis.

There are many interesting and exciting areas found for the future research. These areas could be as following:

- Participants' perception of uncertainty,
- As outsourcing is a strategic decision, outsourcing impacts as a competitive advantage could be an interesting topic,
- Nature buyer-supplier relationship for a better understanding of outsourcing,
- Future research can take a more in-depth look of outsourcing reasons in context of other organizational theory perspectives such as, transaction cost theory and institutional theory.

In the summary, outsourcing is a developing phenomenon and containing fruitful insights with theoretical perspectives, with further quantitative researches to expand RDT, thus outsourcing as a way to have better understanding of the implications on different markets.

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## MUSIC FESTIVALS: SUSTAINABLE FUTURES? THE CASE STUDY OF TWO SWISS EVENTS

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### Abstract

This article explores perceived and real sustainability measures that are exhibited by two prominent, international Swiss music festivals: Montreux and Paleo. Festivals and events are important generators of income and hence their image and the products they deliver are very important to a locale, community and also the international profile. It would seem incumbent upon certain festivals, especially those with a hallmark status, to assure their audiences and communities that their provision, management and delivery are sustainable.

Montreux and Paleo attract large audiences (230,000) and tourists; in addition they both have different event time-frames and locales, but each affects the community within which they are located. The current research was completed during the summer of 2011. The Montreux Jazz Festival is internationally renowned and has been running for 45 years; Paleo is a festival similar to that of Glastonbury in the UK, having been running for 35 years. The evidence suggests that each Festival has approached sustainability in different ways. Paleo has clear policies and displays obvious evidence of sustainable management: including waste management, carbon foot print calculators and transport management. Montreux, however, displays little visible evidence of environmental sustainability, which is surprising given the international status of this Festival and also the attraction of musicians who have clearly supported the environmental movement, for example, Sting and Bono. This research raises questions of management and image development, especially as the Montreux Festival advocates that there may be adverse financial effects on attendance if visible sustainable policies were introduced. Therefore, we have two similar festivals with very different approaches to sustainable development.

**Keywords:** Switzerland Music Festivals, Sustainability, Tourism, Responsibility, Benchmarking,

### Introduction

Events and festivals have now become an important element in the repertoire of a tourism destination. Indeed, since the inception of tourism, festivals and events have played a significant part in attracting tourists. In many respects, certain events have become *iconic* in terms of the semiotics they portray and emanate a pull factor in attracting tourists to a

location. This is also the case with music festivals, many of which have international status and global attraction including Glastonbury, the London Proms and the Montreux Jazz Festival. Perhaps the most iconic and memorable was that of Woodstock, in which the pop music festival was raised from being simply a regional to an international event.

Music festivals and other events have now become a growth industry, with even small destinations such as Hay-On-Wye in the UK, receiving both national and international prominence, attracting eminent guest speakers including former U.S President Bill Clinton. This growth has been exponential and some would argue that there are now too many festivals to choose from. *Hallmark* or *Iconic* events are now of great importance to a tourist destination and many countries compete for a share of this market.

In addition one could argue that a music festival, or for that matter any other iconic festival, is reflective of the cultural tenets of a country and imparts the culture and positioning of its tourist product. Glastonbury and The London Proms clearly reflect aspects of the culture of Britain. They can be regarded as *Hallmark* events, with the ability to attract large audiences from both the U.K. and abroad. Likewise, other European destinations holding similar Hallmark events are also able to attract considerable numbers of tourists. Certainly, the Montreux Jazz Festival currently ranked as one of the top events in Switzerland, appeals to a broad international audience.

The development of the tourism industry and the topical and important issue of climate change have run concurrently with the development of sustainability (Jenkins 2011). It is purported that a quality tourism product should be one which is linked to the notion of sustainable values. It necessarily follows that in the advent of climate change and the pressures that are being brought to bear on the environment and society, Hallmark events would at least try to follow some guidelines related to sustainability (Dredge & Whitford 2010). It is asserted that it would be expected that large events should also have sustainable principles (Mendiratta 2011). Certainly, sustainability has been growing in importance and is reflected in many tourism policy areas; consequently one would have expected that this would be seen in the running and management of important events (Mair & Jago 2010, Potts & Harrill, 2002).

This is a working paper that examines two Swiss music festivals considered to be prominent and Hallmark events. Both have been running for some considerable time and it was expected that they would be somewhat environmentally friendly, reflecting the image that Switzerland seems to portray to the world. As a working paper, the second stage will include two similar music festivals in Canada, in order to compare Canada's approaches and management of festival sustainability. Currently, a significant number of data collection elements have been completed but there are a number of outstanding interviews that need to be finished before the first phase of the research is completed.

Both the definition and understanding of sustainability are plagued with controversy so measuring the level of sustainability can be problematic and rather ephemeral. The theoretical approach adopted by this research utilised the Brandt Report's definition of sustainability, linking it to the Global Sustainability Criteria (GSTC 2009). This is considered a competent benchmark and is acknowledged as an effective measurement of sustainability. It was also a method used by the research team in previous research and proved valid and reliable and therefore worth using for the present study. As mentioned earlier, there was also *a priori* assumption that Switzerland would exhibit a strong tendency towards sustainability, given its image and tourism industry reputation.

## **The Literature**

### **Festivals & Events**

As noted earlier festivals and events are important products for most, if not all, tourism destinations (Getz 2007). A destination without festivals and events in its portfolio would be very difficult to find. Furthermore, such commodities are used as part of a marketing toolbox (Ali-Knight, Robertson, Fayali, Ladkin 2009) and can reflect a destination's cultural characteristics, resonating with marketing elements utilised to sell the destination and the country. However, the novelty of these products is by no means new, and a review of past literature, demonstrates the importance of culture and festivals in many products over the last 50 years and are reflective of the culture at a destination (Murphy 1985).

Additionally, Hallmark and Mega Events are always prominent in any country's tourist palette (Yeoman et al. 2004). An example of this is the way in which nations compete to secure major events such as the Olympics and the Soccer World Cup. Tourist destinations are anxious to capture these events, which are known to enhance the tourism product and bring increased monies into an economy (Leonardsen, 2007). These festivals and events can be seen as *beacons* of a country's sustainable tourism policy, especially if the management policies of these events are embedded into the ever prominent debate on sustainability and its relationship with climate change (Kinver 2011).

Festivals are also significant economically, socially and environmentally (Getz, 2007). Events impact upon a location in many different ways and generate both positive and negative outcomes; often the social and cultural effects on communities are overlooked (Inta Kotāne 2011).

### **Sustainability**

As mentioned in the introduction, sustainability is still a misunderstood concept (Swarbrooke 1999). Companies and policy makers and tourism actors, do not always see eye-to-eye in the delivery and importance of sustainability. It can also have a number of meanings and perceptions depending upon the understanding and *raison d'être* of an organisation (Milne 1998). The emphasis is still mainly focused on the environment, often ignoring the

social /economic elements and the premise of the Four Pillars (Afgan et al. 2007) of sustainability. In addition there is also evidence of 'Green Washing', which is prevalent in certain companies (Greenpeace 2011). The literature suggests that a common understanding of sustainability is related to pollution, bio-diversity, ecosystems and landscapes (Afgan et al. 2007), overlooking elements of the social and cultural aspects of tourism delivery (Stiglitz, et al 2009).

### Benchmarking Sustainability

There is clearly a need to develop a system of benchmarking that can be used as a competent guide to the sustainability of a product, company or destination. This research considered a number of alternatives to use for this purpose and decided upon the 'Global Sustainable Tourism Criteria' for Benchmarking (GSTC 2009); the rationale being that it was developed using actual companies and validated by tourism agencies. It appears to have developed following consultation with a number of tourism actors and agents and its strength lies in that it can be used by all members of the tourism fraternity, including consumers, to assess sustainable destinations and their products.

In order to make the criteria useable, the researchers summarised the Criteria into *seven general sustainability segments* from 60 identifiable outcomes used by the GSTC. These are presented below in Figure 1:

Figure 1:  
4 SUSTAINABLE FACTORS



Table 1:  
7 General Segments Used for the Evaluation

<b>Environmental</b>	<b>Guidelines of behaviour for visits to culturally and historically sensitive sites and the purchasing policy for environmentally friendly products for buildings.</b>
<b>Legislation</b>	Includes compliance with all relevant international or local legislation and regulations. The international or national legal protection of employees is respected and employees are paid a living wage.
<b>Community</b>	Community matters linked to activities which do not jeopardize the provision of basic services, fair trade and goods are purchased providing small entrepreneurs with the possibility to develop and sell sustainable products.
<b>Cultural</b>	Connected to historical and archeological artifacts which cannot be sold by the business or traded. The business contributes to the protection of historical, archeological and spiritually important properties.
<b>Consumption</b>	Related to precarious purchase of products and energy consumption ought to be indicated and measured. Water consumption should be indicated and greenhouse gas emissions from all sources need to be controlled
<b>Humanitarian</b>	Comprises the training of all personnel regarding their role in the management of environmental, socio cultural, health and safety practices. The international or national legal protection of employees is respected and employees are paid a living wage
<b>Social issues</b>	Related to education, health and community development. includes hiring a percentage of minorities and preventing child labour wherever the business operates

Sources: GSTC 2009

### Case Study: Two Swiss Festivals; Montreux and Paleo

Both these Swiss festivals can be considered to be Hallmark events. One is internationally renowned and attracts many famous international musicians and the other is considered to be local and regional in orientation. The basic statistics for the festivals are as follows:

#### Montreux Jazz Festival

- 16 days
- 12 venues,
- 10 are free
- Open 18 hours a day
- Over 1000 musicians
- More than 1000 hours of music
- 230,000 visitors
- 1,400 staff
- 450 journalists



- 4,000 places in the Auditorium Stravinski
- 2,500 places in the Miles Davis Hall
- Music in Movement with Montreux Jazz Trains and Boats
- 3 World Famous Competitions
- 2 Night Clubs (Montreux Jazz Café & Studio 41)
- Workshops, film screenings, exhibitions, special projects
- Source MJF 2011

### **The Paleo Festival**

- 36th year
- days
- 230,000 spectators expected
- 210 +, shows & concerts
- Six stages and a total of 200 stalls on site
- Biggest Swiss open-air festival
- Major European music festival
- Source: Paleo Festival 2011

### **Methodology**

The research followed a deductive approach and started with the basic premise focused on the research question and supported by aims and objectives.

Research Question: To what extent are Montreux and Paleo festivals considered sustainable events?

Aims:

- To establish the extent of sustainability in the two Festivals.
- To evaluate the level of sustainability in the two Festivals.
- To identify where improvements can be made to ensure a sustainable product.

Objectives:

- To gather secondary data relating to the two Festivals.
- To interview prominent tourism actors connected with the Festivals.
- To draw upon experiential data from the two Festivals.
- To analyse the data collected via the two instruments.

- To decide the extent of sustainability offered by the two Festivals.

The approach taken is that of a qualitative methodology (Brotherton 2010). This is an explorative research project and it was considered that there was a need to gather rich in-depth information from prominent tourism actors, in order to begin to assess to what extent the two Festivals can be seen as sustainable. The two instruments used were those of:

- Experiential visit to the two Festivals and
- Collection of data questioning the visitors and employees.

The second instrument involves a semi-structured interview schedule with selective tourism actors linked with the two Festivals (Robson 2002). The questionnaire schedule involves 15 questions which are reflective of the GSTC (2009) criteria for sustainability. The interviews lasted between 30-40 minutes and are recorded and reviewed. The aim is to interview 16 tourism actors (10 interviews having so far been completed), as well as gaining interviews from Festival organisers, retailers, hotel managers/owners and tourism officials. The sampling frame used for this research was one of judgemental and snowballing selection (Brotherton 2010).

## **Analysis**

The data has been analysed through the use of discourse analysis and content analysis (Robson 2002) in which the text is reviewed for key nodes and codes and then assembled in the form of matrix tables. These individual matrix tables are then further distilled into summary matrix tables to yield overall premises that the data may be showing. The data analysis includes the interview texts as well as the experiential visit comments and observations.

## **Findings So Far**

As noted at the beginning of the paper, this research is ongoing with some remaining interviews still to be collected (6 interviews of the Paleo Festival still outstanding). However, there are apparent themes and indications of what may emerge once the complete data set has been analysed. The Montreux Festival interviews have all been concluded giving a complete picture of the approaches to sustainability at this Festival. The initial findings do tend to highlight a dichotomy between the two Festivals which is to a large extent, also reflective of their websites. The website of the Paleo Festival appears to have sound policies relating to environmental/sustainable management and to some extent social and cultural policies (Paleo Festival 2011). Montreux, however, has limited elements of sustainable policies both on its website and in its marketing information (MJF 2011).

## Results and Discussion: So Far

### Montreux Festival

An examination of the Montreux website reveals limited evidence of any sustainable approaches to the management of the Festival. The experiential evidence is also limited in terms of the visible signs of sustainable management seen mainly in terms of environmental rather than the social and cultural aspects of sustainability. On the website, there was little evidence of sustainability measures, such as carbon mitigation or the sourcing of goods and transport management. The area used by the Montreux Festival does have recycling bins but on visits to the Festival these were usually full with the contents often spilling onto the streets and surrounding areas. The food on sale also reflected less sustainable measures, with fast food dominating, being sourced nationally rather than locally. Interviews with actors also revealed that sustainability was not a priority, rather there appeared to be a reticence and even an anxiety to embrace it; it was felt that visitors might be *put-off* the Festival if sustainability was made too prominent. It is certainly not an immediate priority for the Festival, which is somewhat surprising, given the high profile of many of the participating musicians and also the alleged concern for the environment that many of them have (for example Sting and Bono).

However, free transport was provided to and from parking areas and around the centre of Montreux. Given that it is likely that most of the attendees arrived by car, this has a limited impact in reducing the carbon foot print and mitigating the carbon element of holding the Festival.

However in terms of the local community benefiting economically, there was some evidence to support this. Local hotels and entertainment establishments confirmed that their businesses did benefit from the Festival and that a large number of attendees would have a significant effect upon the area in terms of the economic income generated; it appears therefore that the Festival does bring significant income to the community. The Festival employs 20 full-time staff and 1200 part-time staff plus some 200 volunteers, mainly Canadians, Americans and French. However the part-time element has limited value as it is only for a 2 week period, which raises the question: what do these *local* employees do for the rest of the year?

### Paleo Festival

As mentioned earlier, data is still being collected for this Festival. Paleo, similar to Montreux, has a prominent place in the Swiss calendar of events. The evaluation of its website reveals this Festival considers sustainability to be important and as noted in the literature review this relates primarily to the environment. Environmental strategies and concerns have a prominent focus, but they are not necessarily the main aim or an essential part of the Festival. There is evidence of strategic policy and action being carried out by this

Festival including visible signs of recycling and environmental action including a number of stalls focused upon environmental awareness. Perhaps, this is also helped by the fact that the Festival is on one site and does not have disparate functions elsewhere in the vicinity. It could also be classed as a rural rather than an urban location (Montreux being completely urban). The Festival also attempts to calculate its carbon footprint. In addition, the organisers seem less fearful of customer reaction to incorporating such measures and the transport system seems geared to trying to get the attendees *out of their cars*. There is also an environmental waste management policy which measures the waste produced by the Festival and there are also plans to reduce waste and energy consumption. Only two interviews have taken place with the Paleo actors (which are key) but the initial evidence and the experiential data seem to support the assertion that the Paleo Festival is committed to developing sustainable policies. It is hoped that the planned additional interviews, will support the emerging premise that Paleo is more sustainable than Montreux.

### **Tentative Conclusions**

The two Festivals seem to show a varied response to sustainable measures and management. It was expected that the more renowned of the two Festivals (Montreux) would have exhibited stronger sustainable characteristics. However, it is the regional and less well known Paleo Festival that seems to have the more pro-active approach to sustainability. However, Paleo's focus is mainly on the environment and thus leaves out the six other GSTC factors in its management of sustainability (see Table 1). That said, this may well be down to the perception that the environmental measures are those which are perhaps the most visible and the easiest to market.

In addition the Montreux Festival and its supporting actors did demonstrate an initial reticence to engage in the research, which may be a signifier of the lack of sustainable measures that they are currently (or not) undertaking. Perhaps the urban location of the Montreux Jazz Festival also adds to the lack of sustainability exhibited by it. Although, as has been shown, the monetary contributions and employment factors do appear to have a positive effect upon the community and its economic status. One could also argue that the Festival contributes to the cultural tenets of the location and has certainly internationalised the destination. The dominating statue of 'Freddie Mercury' in the centre of Montreux, is possibly an indication of the importance of this Festival to the locale. However, one would have expected, with the growing importance of climate change and its now 'unquestionable' link to carbon emissions, that carbon foot print monitoring and mitigation, would have been, at least, fairly high in the visible policies and management of the Montreux Festival.

It would appear at this stage in the research, that Paleo is far more embracing of sustainable development, as evidenced by the information that is freely available on the internet, and through interview and experiential data. The Paleo Festival is not as well known internationally or regionally, and is also located on a single rural site which may make it

easier to manage. It appears evident that this Festival is certainly taking the environmental side of sustainability seriously and seems to be producing and delivering policies that are sustainable.

Once again the idea that consumers and attendees are not interested in sustainability is an interesting perspective. It is certainly one that occurs in other areas of the tourism product and perhaps has some validity here too. But to say that sustainability is not important is an entirely different statement. In essence the results suggest that Montreux should be doing more for sustainable development, especially, in terms of Carbon Footprints.

It is also interesting to note that websites can often be an indication of the policies and delivery of the product on offer. The Paleo site has many pages relating to its sustainable and environmental policy. Whereas the Montreux website, has little, if any, information on its environmental sustainability policy.

In conclusion, both Festivals, although within close proximity of each other, seem to approach sustainability in different ways. Currently, findings from the Paleo Festival suggest that in terms of the environmental sustainability aspects of the GSTC criteria, it is ahead of Montreux; however, both Festivals have a long way to go to ensure a completely sustainable product.

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## THE ROLE OF PSYCHIC DISTANCE ON FDI FLOWS FROM THE SOUTH TO THE EAST OF EUROPE

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### Abstract

The purpose of this paper is to examine the influence of psychic distance stimuli on foreign direct investment flows from countries located in the South of Europe towards the new members of European Union from Central and Eastern Europe. By applying panel data techniques, evidence of a negative relation is obtained for distance in democracy, whereas a positive one is obtained for per capita GDP and distance in education and industrial development, which demonstrates that these investment flows are characterized by an efficiency-seeking approach and low educational and technical requirements. This FDI motivation prompts firms to maximize cost advantages such as reduced salaries or input prices. Also interestingly, political risk does not seem an obstacle, in accordance with recent literature on political capabilities. The conclusions highlight the relevance of policies designed to create the appropriate structures for training a qualified workforce, combining attention to present-day economic needs and a wish to avoid a possible foreign investment dependence that generates few positive externalities for the host country.

**Keywords:** Foreign Direct Investment, Psychic Distance, Multinational Enterprises, Central and Eastern Europe, European Union, Panel Data.

### Introduction

Outward and inward FDI from a country or geographical area, the great majority of which is today undertaken by Multinational Enterprises (MNEs), can be systematically related to the structural changes involved in economic development (Lall, 1996) as a consequence of the possible spillovers derived from FDI (see for instance Havranek and Irsova, 2008 or Meyer and Sinami, 2009 for a recent revision of the positive externalities of FDI). This is why nowadays, almost all countries and especially developing countries stimulate the attraction of FDI through financial or other sorts of incentives, reflecting a favourable environment for foreign investors that was hardly the reality some decades ago.

Together with the emerging economies in countries from South Asia, India and China, the new members of the European Union (EU) from Central and Eastern Europe have been able to increase its appeal as a destination for FDI from across the world. Despite the fact that inward FDI levels were below expectations in the 1980s (Baldwin, 1994), the negotiation to adhere the EU represented

a very important incentive to revitalize the FDI flows for the new members, namely Cyprus, Czech Republic, Estonia, Latvia, Lithuania, Hungary, Malta, Poland, Slovakia and Slovenia in 2004 and Bulgaria and Romania in 2007. Thus, according to UNCTAD data, total accumulated investment in the year 2000 stood at around 97,726 million dollars and rose to 229,734 million dollars in 2004, which reflects an increase of 135%. In this same period, the growth of accumulated FDI in the world grew by only 53.87%: in the developed economies by 62.7% and in Central and Latin America by 41.07%<sup>53</sup>.

Southern European economies, despite not being the most important investing countries, represent precisely one of the regions that has most benefited from greater facilities to carry out FDI in the new EU members nowadays, such as infrastructural improvements, lower salary and raw materials costs and significant institutional development (Jiménez, in press). In fact, FDI from Southern European economies have increased their share up to close to 20% of total inward FDI in the region<sup>54</sup>. However, according to Disdier and Meyer (2004) and Durán et al. (2008), as Eastern European countries have progressed in their transitional processes towards EU adhesion, developing economic, social and institutionally, and the factors that drive the decision to localize in Western Europe and Eastern Europe have also followed a convergent trend; there is evidence to demonstrate that relevant differences still exist that make companies, French and Spanish respectively, distinguish an East-West structure in the FDI location strategy. The existence of such a structure raises the question of whether these host countries, despite their adhesion to the EU, are still perceived as culturally and institutionally distant destinations for investing countries in the South of Europe.

As a consequence, this work centres on an analysis of the particular determinants of FDI among countries from the South of Europe and the new members of the EU, but paying special attention to the relevance of psychic distance. Cultural and institutional aspects may be considered one of the most relevant lines of study in the field of international business (Griffith et al. 2008). Precisely, the concept of psychic distance embraces and encompasses cultural distance among other dimensions (Dow and Karunaratna, 2006). Together with the formal ones, it forms part of the informal institutions that determine the third pillar of a new paradigm in business strategy comprising the resource-based, the industrial-based and the institutional-based approaches (Peng et al. 2008).

The use of psychic distance stimuli as the explanatory variable of various economic phenomena may be noted in studies on firm performance (O'Grady and Lane, 1996; Dow and Ferencikova, 2010), the relations between exports and imports (Prime et al. 2009), online internationalization (Yamin and Sinkovics, 2006), the internationalization of knowledge-intensive small and medium-sized enterprises (Ojala and Tyrvainen, 2009) and entry modes into foreign markets (Dow and Larimo, 2009; Dow and Ferencikova, 2010). However, to the best of our knowledge, and with the

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<sup>53</sup> Preparation by the authors of the percentages from data in the UNCTAD World Investment Report 2005 Statistical Annex.

<sup>54</sup> Preparation by the authors of the percentage from data in the Eurostat database and World Development Indicators.



exception of a single Slovakia (Dow and Ferencikova, 2010) they have not been used as a determinant of FDI flows towards the Central and Eastern European countries as a whole region.

The remainder of the paper is structured as follows: section 2 undertakes a review of the literature on the determinants of FDI in Eastern Europe, section 3 describes the sample, the dependent, independent and control variables as well as the diagnosis of multicollinearity and the model, section 4 presents and discusses the results and, finally, section 5 sets out the conclusions.

## Literature Review

Various studies highlight different determinants and features of FDI flows in the Eastern European countries. Lankes and Venables (1996) analyze the motivation -local market versus exports- of the investment, Lefilleur and Maurel (2010) highlight the importance of proximity to suppliers and Damijan et al. (2003) point out that FDI is not generating positive intra-industry spillovers for domestic firms in this region. Taking into account the increase of in the attractiveness of these countries as a destination for FDI, Buch et al. (2003) and Galego et al. (2004) study the possibility of a relocation process towards this region of flows which would otherwise have been destined for the South of Europe, although they found evidence against this hypothesis.

One of the key factor to attract FDI flows, according to the literature, is the institutional environment. Meyer (1995) claims that the political, economic and legal environment is one of the fundamental factors to attract investments to the region, especially in the manufacturing sector. Oxley (1999) and Smarzynska (2002) point out that greater protection of intellectual property rights also incentivize investments made through total ownership. Wheeler and Mody (1992), Brenton et al. (1999) and Bevan and Estrin (2004) also pay attention to the importance of institutional determinants, highlighting that progress during the negotiation process over the adhesion to the EU had a positive effect on inward FDI flows. Nevertheless, as underlined in the previous section, despite the convergent tendency in the determining factors, there is still evidence to demonstrate the existence of relevant differences, which suggests an East-West structure in the location decisions of MNEs (Disdier and Mayer, 2004; Durán et al. 2008).

However, as pointed out previously, literature on the effect of psychic distance as an explanatory variable of FDI flows in this region is very scarce. The analysis of perceived or psychic distance between countries was popularized by the Uppsala School (Johanson and Wiersma-Paul, 1975; Johanson and Vahlne, 1977) who defined the concept as *"the sum of factors preventing the flow of information from and to the market. Examples are differences in language, education, business practices, culture, and industrial development"* (Johanson and Vahlne, 1977, p. 24). Originally, however, the term was used by Beckerman (1956), when affirming that all other things being equal, given certain transport costs, there would be a preference for closer markets from a psychic point of view.

Regardless of the different factors included in the definition of the Uppsala school and in other subsequent positions, the greater part of works has centred solely on cultural differences. However, this constitutes a serious drawback, as psychic distance is a much broader concept that includes

many other sources of distance than cultural related ones (Dow and Karunaratna, 2006; Dow and Ferencikova, 2010; Hakanson and Ambos, 2010; Tung and Verbeke, 2010). Additional factors have to be included in the analysis such as education, industrial development and political systems, in order to be able to correctly understand the complex phenomenon of psychic distance (Shenkar, 2001; Evans and Mavondo, 2002; Dow and Karunaratna, 2006).

Given that measuring the perceptions of the manager just before the decision is taken is usually not possible, and that *ex-post* perceptions imply a causality problem due to the difficulties to differentiate between whether the *ex-ante* perceptions led to a decision being taken, or whether the *ex-post* experience influenced the manager's perception at the time of the survey, the majority of empirical studies centre on macro-level factors known as psychic distance "stimuli" (Dow and Karunaratna, 2006), although accepting that manager perceptions of psychic distance will depend on the psychic distance stimuli to which they are exposed modulated by their personal sensitivity.

On the one hand, a negative relation may be established between psychic distance stimuli between two countries and inward FDI. Greater distance in language and religion increase the uncertainty of the MNE over the correct interpretation and communication with various agents that intervene in the market in which it intends to maintain a presence (Johanson and Vahlne, 1977; Cavusgil, 1980, Dow and Karunaratna, 2006) reducing the appeal of such markets and the probability of the MNE investing in the country. In addition, large differences in the political systems between the home country and the host country will increase uncertainty in communications and the possibility of committing errors when anticipating how the society, local government or other institutions are going to behave in certain situations, or the reaction of competitors to a possible governmental measure, thereby reducing the interest of that marketplace as a possible FDI destination for an MNE (Dow and Karunaratna, 2006).

All in all, this greater foreseeable difficulty in understanding the idiosyncrasies and the environment of the host country, arising from the inexistence of perfect market competition, increases the transaction costs faced by MNEs (Williamson, 1975, 1985), which negatively influences outward FDI. This leads us to formulate the following hypotheses:

H1: "The greater the psychic distance in language between the home country and the host country, the lower the flows of FDI between both countries".

H2: "The greater the psychic distance in social system between the home country and the host country, the lower the flows of FDI between both countries".

H3: "The greater the psychic distance in democracy between the home country and the host country, the lower the flows of FDI between both countries".

H4: "The greater the psychic distance in religion between the home country and the host country, the lower the flows of FDI between both countries".

On the other hand, as Tung and Verbeke (2010) point out, researchers should avoid the trap of thinking that higher distance systematically engender negative outcomes, an assumption that needs

to be carefully reconsidered. In fact, it is also feasible to posit a possible positive relation between the psychic distance stimuli and inward FDI. This can happen when a more positive or neutral reception is given by nationals to individuals from culturally distant countries (Carr et al. 2001) who denominate this effect as *“inverse resonance”*. Also, distance can help firm to develop new capabilities or access to talent not available in closer countries. Finally, a greater distance, when it is positive for the investing country, can also positively influence FDI depending on the motivation of the investment (Jiménez, 2010b).

The different types of FDI can be separated according to their purposes, distinguishing between those that search for new markets into which products may be introduced (*“market-seeking approach”*), resources or factors that are not available in the market of origin (*“resource-seeking approach”*) or increased efficiency and cost reduction (*“efficiency-seeking approach”*). In this case, MNEs search for locations where they can take advantage of economies of scale or where they can carry out their business activity at a lower cost (salaries and other factors) than in the home market. This is especially feasible when the activities that are delocalized do not require excessive training, and frequently occur in the manufacturing sector in which knowledge of a more technical nature is needed. This can drive MNEs that plan the delocalization of their activities with low qualification requirements to attempt to maximize the reduction in salary costs that can they can achieve by investing in those countries in which the psychic distance in education is greater, although not so great that the workforce is unable to carry out the necessary tasks that constitute the activity undergoing delocalization. Equally, and provided a necessary minimum level, overly high levels of industrial development are not necessary in these types of activities, as they do not need the cutting-edge technology neither a very sophisticated buyer with high purchasing power because most of the production is intended to be exported. Thus, MNEs can try to maximize cost reductions of other factors by investing in locations in which the psychic distance in industrial development is much higher. This leads us to formulate the following hypotheses for the education and industrial development dimensions:

*H5: “The greater the psychic distance in education between the home country and the host country, the greater the flows of FDI between both countries”.*

*H6: “The greater the psychic distance in industrial development between the home country and the host country, the greater the flows of FDI between both countries”.*

## **Methodology**

### **Sample and Data Collection**

The sample is made up of outward FDI from Italy, France and Spain towards countries from the new members of the EU from Central and Eastern Europe: more specifically, Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia, from 1999 to 2006, yielding a sample made up of 240 observations. Unfortunately, it was not possible to find reliable data from Cyprus and Malta for many of the variables used in the models which is why they were excluded from the sample.

In the few cases in which the sources that were consulted failed to provide data on a particular year of an explanatory variable, it was decided to estimate that value as an average of adjacent years, so as not to lose observations given the small size of the panel.

### **Dependent Variable**

The dependent variable consists of inward FDI in millions of Euros in the corresponding host country from each of the investor countries included in the sample. This allows us to take into account the fact that in certain cases the investment flow from an investor country is zero or even a negative value in cases of divestment, which prevents calculation of the logarithm, except if the dependent variable is truncated to included only positive values, provoking distortions in the results (Santos Silva and Tenreyro, 2006).

The sources consulted to obtain the data were Eurostat and the DATAINVEX database of the Spanish Ministry of Industry, Tourism and Commerce. Annex 1 shows the descriptive statistics of the dependent variable as well as the independent and control variables included in the model.

### **Independent and Control Variables**

Most studies rely on aggregated measures such as the Kogut and Singh formula (1988), despite the fact that adding the different dimensions in one single index might, erroneously, lead one to think that all of them together are equally significant of the relations under analysis (Sousa and Bradley, 2006; Dow and Karunaratna, 2006). This is the reason why the individual stimuli of psychic distance suggested by Dow and Karunaratna<sup>55</sup> (2006) in education, in industrial development, in language, in degree of democracy, in political ideology and in religion, are included as independent variables<sup>56</sup>.

Each dimension is the single-factor solution of a principal component analysis for a set of instruments<sup>57</sup>. For education, differences in literacy rate and enrolment in second a third-level education are included. For industrial development, ten different indicators are taken into account, namely differences in consumption of energy, vehicle ownerships, employment in agriculture, number of telephones and television, etc. The language dimension is based on 5-point scales that focus on the differences between the dominant languages between any two countries and on the incidence of the investing country's major language within the host country and vice versa. For degree of democracy, differences in political rights, civil liberties and the indices POLCON and POLITY IV are included. The political ideology dimension, following the procedure suggested by Beck et al. (2001), is calculated based on the ideological leanings of the chief executive's political

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*55 The reasons for using these scales instead of others that are also of an exogenous nature, such as those proposed by Brewer (2007), is because, although both overlap in many aspects, those of Dow and Karunaratna (2006) cover a greater set of factors that are normally associated with psychic distance, whereas those of Brewer (2007) are constructed from a perspective of a single country, in this case Australia and are not available for Central and Eastern European countries.*

*56 Following the recommendation of the authors of the psychic distance constructs (Dow and Karunaratna, 2006), in the case of stimuli in language and religion, the nominal and not the absolute value is used.*

*57 See the seminal paper of Dow and Karunaratna (2006) for a more detailed description of the procedure to calculate the different psychic distance dimensions.*

party and the largest political party in the government. Finally, 5-point scales focused on the differences between the dominant religions of any two countries and the incidence of the investing country's dominant religion within the receiving country and vice versa are included in the religion dimension.

As control variables, various macroeconomic magnitudes are included such as the per capita income (GDP per capita) and the growth rate of GDP of the host country, as indicators of its economic development and attractiveness. It is expected that the sign of these variables, in case their relation with the dependent variable were significant, will remain positive. With regard to unemployment, the relation can not be determined *ex ante*, as high rates can signal to MNEs the possibility of contracting workers without difficulty, but also the possible existence of rigidity in the labour market (Disdier and Mayer 2004).

Furthermore, in the same way as Galego et al. (2004), a macroeconomic characteristic that is specific to the investor country –the growth rate of the GDP- is included to take the macroeconomic conditions of the FDI investor countries into consideration.

It may be expected that better infrastructure drives an increase in inward FDI given the greater facilities for transport and communication. To do so, however, not only should infrastructure availability be taken into account, but so should its reliability, in the absence of which the infrastructures lack utility (Asiedu, 2002). Therefore, following the recommendation made by Asiedu (2004), the percentage of electricity loss in transmission and distribution over total electricity produced is also included as well as the percentage of GDP earmarked for the fixed capital formation (which includes the construction of roads, railways, schools and other investments in development infrastructure) with an expected positive sign in the case of significant coefficients.

Together with the urban population rate as a proxy of the degree of development, the level of openness to FDI is also controlled and included in the percentage that the overall inward FDI flow from all over the world represents from total GDP in the host country. In addition, the score of the Corruption Perceptions Index is also included, bearing in mind the relevance of political risk for FDI in this region (Durán et al. 2008; Jiménez, in press). In order to take into account all the different aspects encompassed by the concept of political risk, additional alternative variables will be used as robustness checks (i.e. political restrictions on local government or economic freedom and the protection of property rights).

Finally, in order to take into account that the closer two countries are, the greater the volume of their commercial relations (Anderson and van Wincoop, 2004; Santos Silva and Tenreyro, 2006), the bilateral geographic distance is included, which is calculated as the sum of the distance between the main cities of the countries, weighted by the economic relevance of the different regions in each country (Disdier and Meyer, 2004).

The data sources are Dow (2007) for the psychic distance stimuli, the CEPII for bilateral distances, Transparency International for the Corruption Perceptions Index, and the World Development Indicators published by the World Bank for the rest of the variables.

### Multicollinearity Diagnosis

Annex 2 shows the correlations matrix for the independent variables and its Variance Inflation Factors (VIFs). Given that all the values are below the limit of 10 as recommended by Neter et al. (1985), Kennedy (1992) and Studenmund (1992) and only the psychic distance variable in democracy exceeds the strictest limit of 5.3 proposed by Hair et al. (1999), it may be affirmed that there are no serious problems of multicollinearity.

Despite this, and given that the different constructs for psychic distance usually show high correlation rates between each other (Dow and Ferencikova, 2010), in addition to the model that includes all of them at the same time, the results were tested by including only one dimensions of psychic distance at a time.

### Model

The chosen panel data technique for the analysis gets around some of the limitations of the ordinary least-squares regressions that do not allow the inclusion of the temporal dimension. In order to decide between the use of either a *fixed effects* (FE) or a *random effects* (RE) model, a Hausman test should be performed, such that if the specific common effects are found to correlate with the explanatory variables, a fixed effects model should be chosen. However, the Hausman test in our model does not reject the null hypothesis of no correlation between the specific common effects and the regressors, so the random effects model may be used, more exactly by employing the *Generalized Least Squares* estimation to obtain consistent and efficient estimators (Galego et al. 2004).

Using a random effect panel model enables to include many variables that are time-invariant, such as such as psychic distance stimuli or geographical distance, and to take into account time-variant shocks that affect investors from a home country to a host country (Bertrand et al. 2003; Cuervo-Cazurra, 2008).

Therefore, the following model is the basis for the empirical analysis:

$$FDI = \gamma_0 + \gamma_1 ENROL. SEC. EDUC. + \gamma_2 UNEMPLOYMENT + \gamma_3 URBAN POPULATION + \gamma_4 ELECT. LOSSES + \gamma_5 GDP GROWTH HOST COUNTRY + \gamma_6 FIXED CAPITAL FORMATION + \gamma_7 GDP GROWTH HOME COUNTRY + \gamma_8 GEO. DIST. + \gamma_9 CORRUPTION + \gamma_{10} FDI/GDP + \gamma_{11} GDP PER CAPITA + \gamma_{12} PSY. DIST. EDUC. + \gamma_{13} PSY. DIST. IND.DEV.+ \gamma_{14} PSY. DIST. LANGUAGE+ \gamma_{15} PSY. DIST. DEMOCRACY + \gamma_{15} PSY. DIST. SOCIAL SIST.+ \gamma_{15} PSY. DIST. RELIGION + \varepsilon_{ij}$$

Moreover, as additional robustness tests, additional models will also be checked using *maximum likelihood* (ML) estimation. The results were also tested by using the *population-averaged* (PA) estimators with similar results to ML<sup>58</sup>.

## Results and Discussion

Annex 3 contains the results obtained from the different models under analysis. Models 1 to 7 provide the RE estimation results (first the global model and then models including a single psychic dimension) whereas Models 8 to 14 provide the ML estimation results, respectively. The results show a positive and significant relation between FDI flows and per capita GDP and psychic distance stimuli in education and in industrial development, validating hypotheses H5 and H6. On the contrary, a negative and significant one is obtained for perceived corruption and psychic distance stimuli in democracy. Thus, hypothesis H2 is also confirmed. The rest of psychic distance dimensions do not obtain significant coefficients, so H1, H3 and H4 cannot be validated or rejected.

These results show that FDI flows from the investing countries analyzed in this paper are favourably affected by a greater psychic distance with regard to education. Given that the distance scores are positive in nominal terms for the investing countries, this results demonstrates that the decision makers in charge of the FDI location strategy do not consider that high levels of qualification are necessary in this type of FDI. Instead, they opt to maximize cost advantages, especially salaries, which may be gained through delocalization of part of the productive processes to one region, which were earlier carried out in other regions where the workforce was more expensive because of its higher general level of training or simply because of a higher general level of prices. In fact, these results are consistent with those obtained by Jiménez (in press) and Jiménez et al. (in press), which provide evidence that the manufacturing sector in Spain is the one with the highest propension to carry out FDI in regions where it can benefit from the location advantages based on reduced costs. This bias towards FDI motivated by an efficiency-seeking approach is also confirmed by the positive and significant sign of distance in industrial development, which once again shows that this type of FDI needs relatively little technology development to be carried out, whereas consumer with high purchasing power are not required because most of the production output is sell abroad as exports. Thus, FDI flows can be relocalized in regions where the cost of these factors is advantageous for the MNE.

Consequently, given that the FDI flows are characterized by low qualification requirements, it is reasonable to think that educational policy, in the short term, may relieve the acute social problem of unemployment, if training linked to employment demands is encouraged, prioritizing *ad hoc* vocational training that can take advantage of the current relocation process of productive activities towards those countries. However, if it is intended that the country develop another type of production or industry in the long term, focusing more on value-adding activities (especially those

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<sup>58</sup> Results of the estimation through "averaged-population" are available on request from the authors.

with a high R&D component and tacit knowledge) and less on cost competitiveness, it will be necessary to prioritize the requirements for the qualifications of the workforce. To do so, it is advisable to emphasise advanced level training and stimulate research with the aim of attracting FDI with higher qualification requirements. In spite of the above, it should be remembered that the political decision to invest more heavily in education will not necessarily guarantee the success in attracting FDI that needs a more qualified workforce, as it is a necessary but not a sufficient condition. It is also essential to implement policies that favour this type of FDI with respect to the construction of infrastructures and centres of excellence that achieve the creation of beneficial clusters for MNEs, productivity, fiscal incentives and the development of the financial system.

Regarding the enrolment rate in secondary education, this variable has turned out not to be significant, confirming that the determining variable of FDI flow intensity is the relative difference between the home and host country, and not the evolution of the specific absolute educational level of the host country. This suggests that those countries that wish to increase inward FDI in which high qualifications are necessary, should not only pay attention to improving their own educational levels, but should also try to reduce the distance or “gap” with respect to investing countries. Otherwise, improvements in absolute terms will be achieved but a deterioration of the situation will have occurred in relative terms. The fact that absolute educational levels lack relevance and, on the contrary, the distance with regard to the investor countries is significant, affects educational policy decisions that maintain a relation with the qualification of the workforce and consequent value creation, insofar as if the chosen focus is long-term economic and social development, it will be necessary to define the improvements in relation to indicators from the investing countries and to achieve that the possible investors perceive the reduction in the educational gap. Greater qualification will not reduce the psychic distance if improvements are below those of the investing countries.

The rest of the results are as expected, although the significant and negative sign of the corruption variable may be somewhat surprising. However, once again these results are consistent with those obtained by Hellman et al. (2002) and Jiménez (in press), which show that in certain markets, especially for those with a relatively less advanced institutional development, MNEs can obtain competitive advantages through the development of political capabilities. This means that those with greater advantages than their rivals may take advantage of them in more compromising environments to benefit from their greater experience in negotiating, create networks and even corrupt the authorities of local government, as has been shown for American MNEs (Holburn, 2001) and Spanish MNEs (García-Canal and Guillén, 2008; Jiménez, 2010a). In fact, the results do not vary substantially if, instead of a corruption variable, political restrictions on local government or economic freedom and the protection of property rights are included as variables<sup>59</sup>.

As robustness checks, Annex 4 includes Models 8 to 14 which offer the results when using the *maximum likelihood* (ML) estimation. Results do not change significantly, although the psychic

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<sup>59</sup> Results available on request from the authors.



distance in industrial development is no longer significant when included as the only psychic measure in the model. However, we are confident in our results as it holds its positive and significant coefficient in the global model. Psychic distance in education and per capita GDP keep their positive and significant coefficient whereas corruption and psychic distance in democracy also maintain their negative and significant relations.

As a final robustness check, the results when the dependent variable is truncated to allow the calculation of the logarithm of FDI flows, giving a value of 1 to negative numbers or zeros, were also checked to be able to compare the results obtained from the different models. The results show no significant changes in comparison to those described earlier, except in this case the fixed capital formation coefficient is positive and significant and greater geographic distance has a negative influence on the intensity of FDI flows<sup>60</sup>. However, these results must be taken with caution given that the procedure to calculate the dependent variable provokes distortions (Santos Silva and Tenreyro, 2006).

## Conclusions

The present work, conscious of the changes arising from the enlargement of the European Union, has embarked on an analysis of the relevance of psychic distance variables to the intensity of FDI flows from investor countries from the South of Europe to new members of the EU from Eastern Europe. To do so, a study was conducted on the determinants of FDI flows by using panel data techniques so as to include the analysis of the temporal dimension.

One of the main contributions of the study lies in the empirical evidence it offers on the influence of psychic distance stimuli in education, which favours FDI from these investor countries in Eastern Europe. Broad differences in educational levels between home and host countries act as an incentive to take advantage of lower salary costs in comparison with alternative locations, supporting the delocalization of productive activities, especially those with lower qualification requirements. This result has also been confirmed by the positive influence of psychic distance stimuli on levels of development, which has shown that this type of FDI from the South of Europe is positively motivated by locations in which it is possible to benefit from significant reductions in the costs of factors. In contrast, the absolute educational levels of the host countries did not turn out to be a significant variable, showing that the relative difference in the home/host country combination is the true factor to take into account.

Moreover, it has been shown that per capita GDP and a reduced psychic distance in democracy have a positive effect on the attraction of larger flows of FDI, which undoubtedly reinforces the move towards the cohesion of educational, social and economic EU policies. Besides, greater perceived corruption in the country is revealed to be a factor that also attracts FDI, demonstrating that a significant part of this FDI is carried out by MNEs that are able to manoeuvre with ease in environments that are compromised by high political risk; a result that echoes a recent line of

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<sup>60</sup> Results available on request from the authors.

research into the so-called political capabilities of MNEs, which warns of a possible divergence of interests between the business, the political and the social world.

The results demonstrate that the educational and economic policy of a country, as well as the EU's own policies, should in no way ignore the territorial changes that have taken place over recent years. This is especially relevant for policies linked to employability and vocational training, as there is a very close relationship between the dominant trends in economic investments and perceived educational variables. If Central and Eastern European countries wish to increase inward FDI flows with a higher level of added value for the host economy, not only it is necessary to minimize the educational distance with respect to investing countries, but also to effectively make this reduction perceptible to possible investors.

Also, the results highlight the importance for policy-makers to lend attention to the type of FDI that is attracted to cover the needs or limitations of a country. FDI characterized by low levels of qualification requirements, with the sole objective of reducing costs, might not contribute as many advantages as others with a greater knowledge content and added value in which positive spillovers might turn out to be more beneficial. However, if the aim is to attract other types of FDI, it is necessary to offer the key resources that are sought by the MNEs: a highly qualified workforce, transport and communications infrastructure, the creation of technological parks that generate clusters of centres of excellence, and fiscal incentives for those investments with high R&D components.

It should be pointed out that a limitation to this work, in addition to the small size of the panel, is the impossibility of including other European investor countries from the Mediterranean (Greece and Portugal) in the sample. Reliable data for these countries, and variables such as effective levels of taxation imposed on the MNEs or salaries in the host country are unfortunately unavailable<sup>61</sup>. Also, only the psychic distance stimuli based on exogenous scales and their impact on investment locations have been studied, due to the previously mentioned difficulties to measure the effect of the real perceptions of the managers. It is precisely the combination of both variables which constitutes one of the most important lines of future research that would, in turn, widen our knowledge of the determining effect of psychic distance on firm's decisions.

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<sup>61</sup> One of the sources (*World Development Indicators*) records average salaries for manufacturers in each country, but it only contains data up until 1999.

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**Annex 1: Descriptive Statistics**

<i>Variables</i>	<i>N.</i>	<i>Mean</i>	<i>Std. Dev.</i>	<i>Min.</i>	<i>Max</i>
ENROLMENT IN SECONDARY EDUCATION	240	86.59	5.54	74	96
UNEMPLOYMENT	240	11.23	4.19	4.7	19.9
URBAN POPULATION	240	63.6	7.33	49	75
ELECTRICITY LOSSES	240	10.97	5.19	3	27
GDP GROWTH IN HOST COUNTRY	240	4.62	2.69	-4.79	10.60
FIXED CAPITAL FORMATION	240	25.38	4.33	16.08	35.38
GDP GROWTH HOME COUNTRY	240	2.47	1.44	.037	5.05
GEOGRAPHIC DISTANCE	240	3.19	.17	2.72	3.47
CORRUPTION PERCEPTIONS INDEX	240	43.21	9.68	26	64
FDI/GDP	240	5.42	3.51	.49	20.48
GDP PER CAPITA	240	5785.79	3426.29	1542	17556
PSYCHIC DISTANCE IN EDUCATION	240	.64	.31	.02	1.25
PSYCHIC DISTANCE IN INDUSTRIAL DEVELOPMENT	240	.50	.28	.002	1.11
PSYCHIC DISTANCE IN LANGUAGE	240	.25	.19	-.26	.53
PSYCHIC DISTANCE IN DEMOCRACY	240	.17	.11	.01	.37
PSYCHIC DISTANCE IN SOCIAL SYSTEMS	240	.39	.18	0	.67
PSYCHIC DISTANCE IN RELIGION	240	-.89	.29	-1.29	-.27

**Annex 2: Matrix of Correlations and VIFS**

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	VIFs
1	1																	3.98
2	-.055	1																2.11
3	.018	.095	1															3.59
4	-.198	-.026	.243	1														3.05
5	.349	.02	.167	.238	1													2.42
6	.029	-.294	.121	-.087	.388	1												2.79
7	-.25	.002	.049	.081	-.175	-.04	1											2.46
8	-.143	.186	.293	.421	.27	-.026	.505	1										4.72
9	.478	-.337	-.041	-.266	.204	.525	-.027	-.152	1									4.19
10	-.187	.05	.4343	-.02	.142	.321	.011	.139	.091	1								1.78
11	.571	-.385	-.269	-.476	.113	.389	-.192	-.397	.644	-.136	1							4.56
12	-.088	.252	.174	.273	.04	-.221	.426	.628	-.267	.083	-.42	1						3.88
13	-.018	.028	-.196	.059	-.048	-.335	-.354	-.287	-.213	-.166	-.174	-.4	1					2.61
14	.402	.072	.3423	.025	.153	.314	.043	-.086	.472	.135	.263	.144	-.393	1				4.50
15	-.534	.239	-.243	.376	.168	-.083	-.001	.382	-.493	-.032	-.481	.077	.069	-.568	1			6.38
16	.094	.171	-.084	-.468	-.097	.115	.000	-.179	.221	.000	.257	-.257	-.079	.008	-.107	1		1.52
17	-.304	-.059	.287	.351	.144	.054	-.277	.084	-.047	.353	-.312	-.249	.3372	-.351	.303	-.08	1	3.63

1. ENROLMENT IN SECONDARY EDUCATION 2. UNEMPLOYMENT 3. URBAN POPULATION. 4. ELECTRICITY LOSSES 5. GDP GROWTH HOST COUNTRY 6. FIXED CAPITAL FORMATION 7. GDP GROWTH HOME COUNTRY 8. GEOGRAPHIC DIST. 9. CORRUPTION PERCEPTIONS INDEX 10. FDI/GDP 11. GDP PER CÁPITA 12. PSYCHIC DIST. IN EDUCATION 13. PSYCHIC DIST. IN INDUSTRIAL DEVELOPMENT 14. PSYCHIC DISTANCE IN LANGUAGE 15. PSYCHIC DISTANCE IN DEMOCRACY 16. PSYCHIC DISTANCE IN SOCIAL SYSTEMS 17. PSYCHIC DISTANCE IN RELIGION

**Annex 3 Results of the Random Effects in Panel Estimation**

<b>VARIABLES</b>	<b>Model 1</b>	<b>Model 2</b>	<b>Model 3</b>	<b>Model 4</b>	<b>Model 5</b>	<b>Model 6</b>	<b>Model 7</b>
ENROLMENT SECONDARY EDUCATION	-5.626 (12.154)	7.033 (11.142)	11.557 (10.992)	8.990 (11.350)	-6.512 (11.993)	10.982 (11.101)	9.658 (11.575)
UNEMPLOYMENT	7.188 (15.274)	0.894 (12.743)	4.023 (12.868)	-2.329 (13.777)	9.284 (12.717)	1.646 (13.540)	0.869 (12.910)
URBAN POPULATION	3.843 (10.893)	12.267 (7.590)	13.394* (7.690)	8.926 (8.474)	-4.766 (8.820)	11.562 (7.810)	12.390 (7.789)
ELECTRICITY LOSSES	1.705 (14.656)	-6.965 (11.293)	-8.666 (11.334)	-10.504 (11.954)	0.792 (11.378)	-8.680 (12.180)	-6.350 (11.719)
GDP GROWTH IN HOST COUNTRY	2.818 (19.056)	-3.391 (18.391)	-10.486 (18.673)	-2.674 (18.664)	11.002 (18.722)	-4.956 (18.568)	-4.031 (18.751)
FIXED CAPITAL FORMATION	16.006 (14.707)	3.646 (13.718)	7.680 (14.130)	0.076 (14.148)	8.700 (13.616)	2.231 (13.954)	1.263 (13.936)
GDP GROWTH HOME COUNTRY	9.890 (38.096)	21.941 (33.937)	44.310 (34.455)	26.424 (34.695)	-9.108 (35.205)	32.230 (34.103)	24.122 (36.941)
GEOGRAPHIC DISTANCE	70.582 (584.844)	-582.337 (437.962)	84.575 (393.276)	-9.459 (403.148)	565.176 (417.117)	-95.583 (389.133)	-94.613 (380.082)
CORRUPTION PERCEPTIONS INDEX	-17.975** (8.594)	-12.881* (6.880)	-14.632** (6.852)	-16.765** (7.415)	-22.359*** (7.062)	-14.648** (7.060)	-13.965** (7.030)
FDI/GDP	-12.138 (12.228)	-12.134 (12.179)	-10.253 (12.199)	-10.236 (12.216)	-10.670 (11.970)	-10.476 (12.272)	-8.943 (12.474)
GDP PER CAPITA	0.051** (0.021)	0.040** (0.020)	0.042** (0.021)	0.033 (0.021)	0.033 (0.020)	0.035* (0.021)	0.033 (0.021)
PSYCHIC DISTANCE IN EDUCATION	602.941* (314.036)	498.143** (227.913)					
PSYCHIC DISTANCE IN INDUSTRIAL DEVELOPMENT	567.731** (284.145)		365.953* (216.467)				
PSYCHIC DISTANCE IN LANGUAGE	-113.886 (538.490)			302.169 (378.089)			
PSYCHIC DISTANCE IN DEMOCRACY	-1966.77** (985.818)				-2617.96*** (758.275)		
PSYCHIC DISTANCE IN SOCIAL SYSTEMS	253.641 (364.809)					-46.297 (334.951)	
PSYCHIC DISTANCE IN RELIGION	16.709 (309.449)						-129.536 (226.768)
CONSTANT	-182.016 (1808.023)	659.224 (1576.529)	-1875.374 (1573.628)	-528.766 (1493.046)	167.640 (1433.950)	-722.308 (1477.61)	-800.295 (1442.72)
N	240	240	240	240	240	240	240
WALD TEST/CHI <sup>2</sup>	28.03**	18.1	16.09	13.36	25.71**	12.76	13.44

*Standard errors between brackets*\*  $p < 0.10$ ; \*\*  $p < 0.05$ ; \*\*\*  $p < 0.01$



**Annex 4: Results of the Maximum Likelihood Panel Estimation**

<b>VARIABLES</b>	<b>Model 1</b>	<b>Model 2</b>	<b>Model 3</b>	<b>Model 4</b>	<b>Model 5</b>	<b>Model 6</b>	<b>Model 7</b>
ENROLMENT SECONDARY EDUCATION UNEMPLOYMENT	-7.662 (11.693)	6.515 (10.926)	10.475 (10.920)	7.966 (11.182)	-7.448 (11.719)	9.756 (11.001)	8.085 (11.362)
URBAN POPULATION ELECTRICITY LOSSES	14.674 (12.676)	0.227 (12.854)	2.958 (13.129)	-3.253 (13.935)	11.156 (11.946)	0.428 (13.844)	-0.647 (13.411)
GDP GROWTH IN HOST COUNTRY FIXED CAPITAL FORMATION	3.689 (9.008)	12.178 (7.646)	13.253* (7.809)	8.829 (8.632)	-6.122 (8.343)	11.515 (8.000)	12.430 (8.151)
GDP GROWTH HOME COUNTRY GEOGRAPHIC DISTANCE	5.521 (12.024)	-7.192 (11.323)	-9.087 (11.453)	-10.763 (12.045)	1.492 (10.483)	-8.992 (12.354)	-6.850 (12.125)
CORRUPTION PERCEPTIONS INDEX FDI/GDP	0.437 (18.642)	-2.376 (17.984)	-8.521 (18.456)	-1.071 (18.260)	11.363 (18.314)	-3.127 (18.197)	-1.507 (18.300)
GDP PER CAPITA	21.580 (13.166)	3.459 (13.504)	6.926 (13.981)	-0.088 (13.948)	9.323 (12.955)	1.921 (13.801)	1.040 (13.826)
PSYCHIC DISTANCE IN EDUCATION	3.369 (36.029)	22.027 (33.179)	42.040 (33.972)	25.776 (33.906)	-13.891 (34.637)	30.919 (33.515)	22.836 (36.096)
PSYCHIC DISTANCE IN INDUSTRIAL DEVELOPMENT	89.124 (447.056)	-586.106 (445.060)	88.781 (401.245)	-4.518 (411.554)	596.899 (384.317)	-88.444 (400.619)	-87.295 (399.508)
PSYCHIC DISTANCE IN LANGUAGE	-17.694** (7.348)	-12.954* (6.857)	-14.545** (6.868)	-16.834** (7.445)	-22.625*** (6.548)	-14.709** (7.112)	-14.133** (7.133)
PSYCHIC DISTANCE IN DEMOCRACY	-12.780 (12.136)	-12.106 (11.788)	-10.537 (11.807)	-10.445 (11.805)	-10.691 (11.703)	-10.689 (11.851)	-9.439 (11.986)
PSYCHIC DISTANCE IN SOCIAL SYSTEMS	0.054*** (0.020)	0.040** (0.020)	0.042** (0.020)	0.034* (0.020)	0.031 (0.019)	0.035* (0.020)	0.034* (0.020)
PSYCHIC DISTANCE IN RELIGION	609.603*** (233.106)	500.278** (232.971)					
PSYCHIC DISTANCE IN RELIGION	569.112*** (209.554)		358.955* (223.576)				
PSYCHIC DISTANCE IN RELIGION	-243.944 (408.889)			315.202 (388.734)			
PSYCHIC DISTANCE IN RELIGION	-2183.12*** (788.902)				-2742.91*** (716.517)		
PSYCHIC DISTANCE IN RELIGION	230.366 (253.460)					-39.322 (350.893)	
PSYCHIC DISTANCE IN RELIGION	-10.697 (235.624)						-137.677 (240.173)
CONSTANT	-276.203 (1398.507)	733.682 (1591.316)	-1751.346 (1605.905)	-440.174 (1515.434)	240.604 (1339.114)	-617.861 (1510.83)	-672.085 (1497.34)
N	240	240	240	240	240	240	240
WALD TEST/CHI <sup>2</sup>	52.65***	16.44	14.53	12.75	23.99**	12.11	12.42

*Standard errors between brackets*\*  $p < 0.10$ ; \*\*  $p < 0.05$ ; \*\*\*  $p < 0.01$

## UNFOLDING THE ROLE OF TEAM DIVERSITY IN THE ENTREPRENEURIAL PROCESS

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### Abstract

Research on entrepreneurial team diversity has been emerging, but findings have been inconclusive. We argue that the way entrepreneurship scholars approach diversity can benefit from examining three important diversity types: separation, variety, and disparity. We examine the meaning, shape, and assumptions underlying each type and the implications of diversity for key aspects of the entrepreneurial process as occurring at different stages of the development of an entrepreneurial team. We conclude by discussing future research directions, in order to enhance theory development and address inconsistencies in previous research.

**Keywords:** Entrepreneurial teams, diversity, entrepreneurial process

### Introduction

Recent developments in the entrepreneurship literature acknowledge the importance of entrepreneurial teams as “catalysts” in the creation of new ventures (Harper, 2008: 614). Although traits of team members influence how they frame issues, it is the heterogeneity of these traits among team members that affects how they work together and thus the success of the new venture (Murray, 1989). Hence, a core theme occupying the interest of entrepreneurship scholars is the composition of entrepreneurial teams that successfully recognize opportunities, acquire appropriate financial and human resources, develop broad social networks and respond to highly dynamic environments (e.g., Amason, Shrader & Thompson, 2006; Ensley & Hmieleski, 2005; Forbes, Borchert, Zellmer-Bruhn & Sapienza, 2006; Knockaert, Ucbasaran, Wright, & Clarysee, 2011). However, the success of entrepreneurial teams lies in their ability to act as teams and manage their endogenous diversity as a unity of different individuals (e.g. Blatt, 2009; Vanaelst, Clarysse, Wright, Lockett, Moray, & S'Jegers, 2006; West, 2007; Ucbasaran, Wright, & Westhead, 2003; Zimmerman, 2008).

Despite the emerging interest entrepreneurship scholars have taken on diversity and the way it contributes to the behavior of entrepreneurial teams, their findings have been inconclusive. Firstly, diversity has been approached through different dimensions, for example as differences in cognitive schemas (West, 2007), variation in expertise, functional role and other demographic variables (e.g., Ucbasaran et al., 2003; Zimmerman, 2008). As a consequence, there is conceptual confusion and

inconsistencies in theorizing about the nature of diversity and its role in entrepreneurial teams. Secondly, diversity has been hypothesized as a predictor of various variables such as the ventures' performance (e.g., Amason et al., 2006; Chandler et al., 2005; Knockaert et al., 2011), team effectiveness (e.g., Chowdhury, 2005; Ucbasaran, et al., 2003), and raising capital (e.g., Zimmerman, 2008) in separate studies. As a consequence, the findings have been inconclusive and the holistic impact of the construct on the entrepreneurial process has yet to be understood.

Drawing on the organizational behavior literature and Harrison and Klein's (2007) typology of diversity, we seek to address these inconsistencies by outlining the implications of studying diversity as *variety*, *separation* and *disparity* for entrepreneurial teams. In particular, informed by several examples of diversity theory and research, we explore the impact of diversity on key aspects of the entrepreneurial process that have been found to influence the success of new ventures. These aspects include opportunity recognition; acquisition of financial and human resources; the capacity to respond quickly and effectively to highly dynamic environments (Shane, 2003); the entry of new members (Forbes et al., 2006); and the management of agency costs (Chrisman, Chua, & Litz, 2004; Karra, Tracey, & Phillips, 2006) emerging from the delegation of tasks to new members. We focus on these aspects of the entrepreneurial process, as they comprise different stages of development for an entrepreneurial team. Expanding Kamm and Nurick's (1993) theorization, we propose that the impact of diversity on the entrepreneurial process is relevant at the pre-founding, founding and post-founding phases of a team.

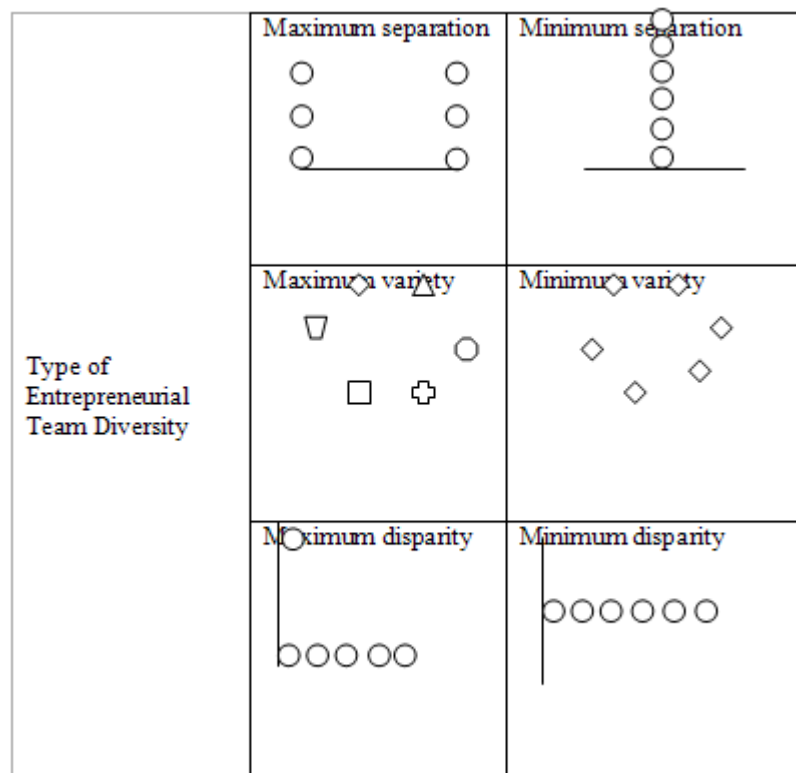
In doing so, we build on previous research and contribute to the entrepreneurship literature in the following ways. First, we integrate the literature on entrepreneurial team composition with research on team diversity, thus identifying the reasons for its inconclusive findings. Second, we explore diversity as *separation*, *variety* and *disparity*, in order to gain a better understanding of the way the three types apply differently to several aspects of the entrepreneurial process, and we deliver propositions. Finally, we discuss the implications of diversity in the context of entrepreneurial teams and suggest directions for future research.

## A TYPOLOGY OF ENTREPRENEURIAL TEAM DIVERSITY

The attempts of entrepreneurship scholars to define entrepreneurial teams have not been conclusive. For the purpose of our theorizing, we approach entrepreneurial teams as comprising of a) members "who jointly establish a business in which they have an equity (financial) interest" and "are present during the pre-start-up phase of the firm", (Kamm, Shuman, Seeger, & Nurick, 1990: 7), b) members who hold significant ownership stakes in the venture and/or are involved in strategic decision making (Ensley, Carland & Carland, 2000; Ucbasaran, et al., 2003), and c) members who join the team as employees and may influence the entrepreneurial process (Shane, 2003). In this way, we approach entrepreneurial teams as adaptive and dynamic systems (McGrath et al., 2000) whose membership and development change as the venture develops.

In addition, we define entrepreneurial team diversity as the degree to which the entrepreneurial team is heterogeneous with respect to various attributes, such as personality, knowledge, perspectives, experience, and power. Drawing on Harrison & Klein (2007), we examine three specific diversity types and their relevance for entrepreneurship. First, diversity as *separation* refers to team members that differ from one another in their position along a continuous attribute—a lateral continuum (e.g., personality, perceptions of opportunities). It reflects disagreements or opposing positions on issues regarding the new venture's goals and processes. Second, diversity as *variety* refers to team members that differ from one another qualitatively on a categorical attribute (e.g., functional background, expertise). It reflects unique or distinctive information regarding aspects of the new venture. Third, diversity as *disparity*, rooted in sociology (Blau, 1977), reflects vertical differences in proportion and inequality among entrepreneurial team members on a socially valued or desired resource (e.g., power, status, equity). Figure 1 presents a graphical representation of the three diversity types at their maximum and minimum levels. Maximum separation occurs when team members are equally split and at opposing end-points of the continuum of the given attribute (Harrison & Sin, 2006). Maximum variety is present when each team member comes from a unique category of the attribute and represents the biggest possible distribution of information. Finally, maximum disparity occurs when only one team member outranks all others; that is, when he or she is at the top of the continuum of the given attribute and all other members are at the bottom.

Figure 1: A Typology of Entrepreneurial Team Diversity



Conceptualizing team diversity-as-variety has been the predominant trend in the entrepreneurship field, assuming that conflicts in entrepreneurial teams are outcomes of the variety of the members' functional position or entrepreneurial experience (e.g., Amazon & Sapienza, 1997; Chandler et al., 2005; Chowdhury, 2005; Ucbasaran, et al., 2003). In the existing literature, it is not explicit why researchers chose to conceptualize diversity as variety, and the other types of diversity remain underexplored while implied (e.g., West, 2007). As Harrison and Klein (2007) note, the explication of diversity can advance the theorization on the composition of teams by providing a better understanding of the impact of attribute-specific diversity. Further, by approaching diversity in entrepreneurial teams as a multidimensional construct (separation, variety, and disparity) entrepreneurial scholars can a) disentangle the assumptions associated with each type of diversity, and b) explore the relationships among and the interactive impacts of diversity types (Harrison & Klein, 2007). Incorporating such insights from the diversity literature into entrepreneurship research seems necessary for future researchers investigating the outcomes of entrepreneurial teams.

## **THE IMPACT OF THREE team DIVERSITY TYPES ON THE ENTREPRENEURIAL PROCESS**

The remainder of this paper outlines specific propositions with respect to the role of team diversity on specific aspects of the entrepreneurial process. For the purpose of theorizing, we focus on a) opportunity recognition and the acquisition of initial resources as the two core aspects (Shane, 2003) of the initiation stage of an entrepreneurial team (pre-founding team) (Vanaelst et al., 2006), b) the capacity to respond to dynamic environments (Shane, 2003) as a core aspect of the implementation stage of the team (founding team), and c) the changes of the members and the management of agency costs, as core aspects of the expansion phase of the entrepreneurial team (post-founding team<sup>62</sup>). Although in previous studies the evolution of the team has been associated with changes occurring at the life cycle of a venture (Vanaelst et al., 2006), in this paper we approach entrepreneurial teams as adaptive systems (McGrath et al., 2000) whose composition changes as they mature and new members join them. Table 1 (Appendix) summarizes the typology of diversity and its implications for the entrepreneurial process.

### **Pre-founding team: Opportunity recognition**

Several scholars stress the novelty of an entrepreneurial idea as a precondition for success of new ventures and a key aspect of new venture creation. Hence, an important first step in the entrepreneurial process refers to how founding teams identify new or emerging opportunities and understand their nature (Ardichvili, Cardozo, & Ray, 2003). Opportunity recognition involves cognitive processes (Herron

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<sup>62</sup> Following Shane's (2003) conceptual distinction between founding and venture team, we approach the post-founding team as comprised of both the founding team members (who have ownership and control of the venture) and new employees.

& Sapienza, 1992) characterized by the elements of creativity (e.g., Hills, Shrader, & Lumpkin, 1999), as well as alertness (Gilad, Kaish, & Ronen, 1989), and active search for opportunities (Hills & Shrader, 1998). Since diversity may influence these processes, we propose that diversity may also affect the identification of new opportunities indirectly.

**Separation.** Maximum diversity as separation reflects perfect disagreement on a) which creative cognition process to adopt, and b) the existence or not of a need for active search and alertness in order to discover new ideas (see Table 1). This perfect disagreement among team members is likely to be detrimental for opportunity recognition. Theories of similarity attraction (Byrne, 1971), as well as social identity and self-categorization (Hogg & Terry, 2000; Tajfel & Turner, 1986) suggest that differences may engender the classification of others as in-group/similar and out-group/dissimilar (subgroups) that may disrupt group processes (Brewer & Brown, 1998; Tajfel & Turner, 1986). Specifically, while people are attracted to similar others and socially identify with them, diversity in teams interferes with identification processes, highlighting the differences between in-group / out-group and leading to difficulties in interaction (e.g., Tsui, Egan & O'Reilly, 1992). Individuals may view the out-group of dissimilar others less favorably, suggesting the possibility of prejudices that people may hold against people who are different from themselves. These biases are likely to create disagreements and maximum conflict (e.g., Jehn, Chadwick, & Thatcher, 1997). For example, in an entrepreneurial team where members have dissimilar beliefs and attitudes, social identification may cause disagreement and conflict over the choice of creativity approaches. One of the robust findings in the conflict literature is that high levels of conflict are likely to be dysfunctional (e.g. De Dreu, 2006; Jehn, 1995). Based on these arguments, we propose that maximum diversity-as-separation may be detrimental for creativity, alertness and active search for new ideas, and in turn for opportunity recognition.

On the other hand, an entrepreneurial team with similar perceptions and attitudes that works closely together also risks the problem of diminishing ability to combine creativity approaches. Extending the previous arguments, minimum diversity as separation or perfect agreement within the team on a) which creative cognition process to adopt, and b) the existence or not of a need for active search and alertness in order to discover new ideas is likely to suppress constructive conflict. Organizational behavior research has shown that the relationship between conflict and performance is inverted U-shaped, where both very low and very high levels of conflict are detrimental to performance (e.g., De Dreu, 2006; Jehn, 1995). Consequently, moderate disagreement and conflict, and creative dialogue among entrepreneurial team members may be beneficial for generation and implementation of new ideas to successful innovations:

*Proposition 1a: Moderate diversity as separation improves creativity, alertness and active search for novel ideas, thus adding to the process of opportunity recognition.*

**Variety.** Maximum diversity as variety reflects multiplicity and plurality of information and perspectives among team members that may encourage creative cognition and enhance alertness and

active search for new ideas. While the process itself is likely to be complex, the basic mechanism that appears to play an important role in the relationship between diversity and the entrepreneurs' discovery of new business opportunities is related to information (Shane, 2003). According to the information/decision-making approach in diversity research (Van Knippenberg & Schippers, 2007), differences in knowledge and expertise may help groups reach higher quality and more creative and innovative outcomes through the integration of different opinions and the stimulation of thinking. When the distribution of knowledge, such as education and functional backgrounds, is at its maximum, "everybody is different, and everybody has a unique viewpoint to offer" (Gibson & Vermeulen, 2003: 208). The latter may enhance brainstorming and alertness, and active search for new ideas. For example, the combination of technology-related and marketing knowledge may serve as the foundation for competitive technological inventions. On the contrary, minimum diversity as variety may reflect redundant knowledge, when for example all members have the same technology-related background, which would restrict the creativity process of the team (Shannon, 1948).

Empirical findings in the organizational behavior literature support the above arguments. Differences in knowledge and skills have been found to increase team creativity and innovation, by enhancing the quality of new ideas (Bantel & Jackson, 1989; Hoffman & Maier, 1961; Nemeth, 1986). Further, diversity has been found to affect performance in terms of alternatives generated (Watson et al., 1993). Among the few entrepreneurship studies that examined such relationships, Henneke & Luthje (2007) found that interdisciplinary heterogeneity in entrepreneurial teams was positively related to product innovativeness in high-tech ventures:

*Proposition 1b: Maximum diversity as variety improves creativity, alertness and active search for novel ideas, thus adding to the process of opportunity recognition.*

**Disparity.** Minimum diversity as disparity reflects equal distribution of power in determining which creative cognition process to adopt and in engaging in active search for new ideas. When no member is disadvantaged with respect to power, this parity is likely to be perceived as fair (e.g., Cohen & Zhou, 1991; Lefler, Gillespie, & Conaty, 1982). On the contrary, maximum diversity as disparity reflects concentration of power of opinion regarding creativity and active search for new ideas on one individual, which is likely to be harmful for opportunity recognition. When one member outranks all others because he or she "owns" a great deal of power, while the rest of team members have very little, the rest of the members are disadvantaged relative to the privileged one. This asymmetry may cause perceptions of injustice and inequity within the team regarding the dominance of one cognitive process of a powerful member over the cognitive process of other members. In a family business context for instance, the father's power as owner of the business over his children may overshadow the creativity of the latter.

The consequences of injustice are widely documented in the organizational behavior literature; they include competition, reduced collaboration and members' input, and even resentful deviance (e.g.,

Bloom, 1999; Pfeffer & Langton, 1993; Siegel & Hambrick, 2005). In addition, research has shown that disparity fosters conformity, silence, suppression of creativity, and withdrawal (e.g., Pfeffer, 1998; Pfeffer & Davis-Blake, 1992):

*Proposition 1c: Minimum diversity as disparity improves creativity, alertness and active search for novel ideas, thus adding to the process of opportunity recognition.*

### **Pre-founding team: Acquisition of initial resources**

Following the recognition of an opportunity, entrepreneurs require resources to exploit it. Such resources are often scarce (Aldrich, 1999), yet obtaining them is significant for start-ups, as new ventures tend to be more successful by their acquisition (e.g. Shane, 2003; Singh, 2000). Two factors can help obtain such important financial and human resources: (a) persuasiveness (Baron, 2000; Barron, 2008), and (b) social networks, since they give a firm access to information and influence (e.g., Adler & Kwon, 2002; Hoang, & Antoncic, 2003).

**Separation.** Diversity may influence the entrepreneurial process of gaining necessary financial and human resources, since it advances persuasiveness and creates linkages with individuals outside the team (Milliken & Martins, 1996). Moderate diversity as separation reflects space for compromise and negotiation among team members regarding the potential and viability of the new venture. This creative negotiation and the resulting moderate level of conflict is likely to enhance members' persuasiveness in demonstrating to third parties that the new venture will be a success, thus enhancing the acquisition of initial resources. Similarly, creative negotiation among members regarding the range, the nature and the necessity of the external networks each member can contribute to the venture is likely to be beneficial in acquiring the necessary resources. On the contrary, perfect agreement or disagreement among members on these issues will generate maximum or minimum conflict, both with negative team outcomes (e.g., De Dreu, 2006).

Empirical results in past group diversity literature support the previous arguments. For example, heterogeneous groups were found to produce higher quality ideas in brainstorming tasks than more homogeneous groups (McLeod, Lobel & Cox, 1996), which may enhance persuasiveness. In addition, this stream of research shows that one of the benefits of diversity in teams lies in the creation of linkages to those not on the team (e.g., Milliken & Martins, 1996). In the entrepreneurship literature, diverse contacts with others in the industry and financial community have been positively related to access to venture capital (e.g., Shane & Stuart, 2002):

*Proposition 2a: Moderate diversity as separation improves persuasiveness and enhances the breadth of social networks, thus adding to the process of acquisition of initial resources.*

**Variety.** Maximum diversity as variety reflects multiplicity and plurality of perspectives that enhance the ability of the team members to influence the opinion of others about the potential and viability of the



venture (Baron, 2000). It also reflects a high range of social contacts among the team members increasing the breadth of the venture's social networks. Consistent with the information/decision-making perspective of diversity research (Van Knippenberg & Schippers, 2007), team members may draw from multiple perspectives and hence improve their persuasive behavior in order to acquire valuable resources. They may also utilize the diverse information from non-redundant social ties and improve the acquisition of initial resources. Past entrepreneurship research supports these arguments; Beckman, Burton & O'Reilly (2007) found that functional and affiliation diversity was positively associated with attraction of venture capital. In addition, a recent study by Foo, Wong, & Ong, (2005) found that diversity of educational level was positively related to the external evaluation of a team's business ideas, the implications of which can be important for the acquisition of necessary resources:

*Proposition 2b: Maximum diversity as variety improves persuasiveness and enhances the breadth of social networks, thus adding to the process of acquisition of initial resources.*

**Disparity.** Finally, maximum diversity as disparity represents concentration of persuasive behavior regarding the potential and viability of the venture on one individual. Consistent with the justice theory (Greenberg, 1987), such disparity is likely to be detrimental for the acquisition of resources. If a single person holds the valued element of persuasiveness, the entrepreneurial team has maximum centralization and members may turn to only that person for advice on acquiring resources (a form of expert power; French & Raven, 1959). In addition, if the valued element is social capital, and it is concentrated on one individual, the structure of the resulting social network is highly centralized, and the network ties unevenly distributed. Only one member is highly central and thus highly influential. The other members are on the periphery of the network with few or even no links to other interpersonal ties (Adler & Kwon, 2002). Centralization may thus restrict the breadth of social networks and negatively influence the acquisition of initial resources:

*Proposition 2c: Minimum diversity as disparity improves persuasiveness and enhances the breadth of social networks, thus adding to the process of acquisition of initial resources.*

### **Founding team: Capacity to respond to dynamic environments**

Since entrepreneurs operate in an uncertain and volatile environment, they must be capable of reacting readily and efficiently to changes in such external conditions (e.g., Lichtenstein et al, 2006). Past entrepreneurship research has shown that founders and founding teams shape a firm's first strategies and actions (e.g., Beckman et al., 2007). New venture success then depends on how the founding team responds to changes in its environment, and how it reflects on possible actions and makes decisions. Diversity has been found to help the team deal with the demands of strategic complexity (Richard, 2000) because the group thinks in more realistic and complex ways about its context. Hence, it may play a role in the capacity to respond successfully to entrepreneurs' environments in many ways. Specifically, diversity can influence the decision-making regarding three elements, which are vital for responding to

volatile environments (e.g., Hitt et al, 2001): (a) new skills' development; (b) social network expansion; and (c) required flexibility.

**Separation.** Moderate diversity as separation reflects an area for creative dialogue and negotiation among members regarding the necessity and the nature of new skills, the expansion of networks, and the level of flexibility required by the venture to respond to a dynamic environment. Moderately opposing views regarding these issues may create the need for reconciliation among the team members. Thus members may engage in elaborate information processing due to constructive conflict and make a better decision (De Dreu, Harinck, & van Vianen, 1999). In support of this argument, empirical research has found that diverse groups with broad network of contacts have better sources of new information in order to respond effectively to uncertain environments (Donnellon, 1993; Tushman, 1977). In addition, environmental scanning is a prerequisite to recognize and adapt to changing requirements of the environment in order to innovate successfully (Miller & Friesen, 1982) and it can be enhanced by diversity as separation. The various "thought worlds" represented in diverse teams may also match different aspects of their environments, thus enhancing the potential for environmental analysis (Rindova, 1999). Nemeth (1986) further argued that the quality of reasoning in majority opinions is enhanced by the existence of consistent counterarguments from a minority:

*Proposition 3a: Moderate diversity as separation improves decision-making regarding needs for new skills, social network expansion and flexibility, thus improving the entrepreneurial team's responses to the dynamic environment in which it operates.*

**Variety.** Maximum diversity as variety also suggests multiplicity and plurality of perspectives regarding building new skills for the venture, deciding on the required expansion of the social network, and the degree and level of flexibility needed by a venture to cope with a dynamic environment. These actions may need important adjustments during the process (e.g., Shane, 2003), which in turn may benefit from the positive consequences of diversity related to processing information and perceiving and interpreting stimuli. Diverse groups have been found to perform better by capitalizing on the diversity of knowledge, functional tools, skills and abilities they possess and improving the breadth of their cognitive ability (Van Knippenberg & Schippers, 2007).

Specifically, diversity as variety tends to encourage problem solving (e.g., Hoffman & Maier, 1961; Watson et al, 1993). Given a problem, people will look for a way to solve it that capitalizes on the knowledge they already possess. Hence, diversity of knowledge may help finding ways to build new skills and expanding social networks. In addition, members of diverse groups communicate more frequently with those outside the group (e.g., Ancona & Caldwell, 1988). This finding suggests that diversity may allow a group to better fulfill any boundary-spanning role it might have as well as to manage relations with the outside constituents (Ancona & Caldwell, 1988) and thus be more flexible and

respond more efficiently to dynamic environments. The combination of diverse experiences and knowledge also fosters the propensity of a team to formulate flexible strategies and to initiate strategic reorientation processes (Wiersema & Bantel, 1992) and increases the team's ability to respond to environmental changes (Cannella, Park & Lee, 2008):

*Proposition 3b: Maximum diversity as variety improves decision-making regarding needs for new skills, social network expansion and flexibility, thus improving the entrepreneurial team's responses to the dynamic environment in which it operates.*

**Disparity.** Maximum diversity as disparity implies unequal team distribution of the power to broaden and build new skills, to expand the social contacts of the venture and to decide on the required degree and level of flexibility, which may impair the team's capacity to respond to changes in its environment. Eisenhardt and Bourgeois' (1988) study of top management team (TMT) strategic decision-making processes provides a relevant example. When a CEO's power far exceeded that of other TMT members, creating high power disparity in the team, the CEO was likely to engage in "tactics for controlling and withholding information," and the other executives in the team were likely to engage in "alliance and insurgency behaviors" (1988, p. 743). Ultimately, evident disparities in team member power impaired team performance by distracting team members from key tasks and interrupting the flow of information. Using another example, in high-tech ventures, team members directly involved in developing the technological solution provided by the venture may often be hesitant to integrate partners with other backgrounds and share decision-making control. This may be perceived as unfair by the rest of the team and disrupt its capacity to responding effectively to dynamic environments:

*Proposition 3c: Minimum diversity as disparity improves decision-making regarding needs for new skills, social network expansion and flexibility, thus improving the entrepreneurial team's responses to the dynamic environment in which it operates.*

### **Post-founding team: Entry of and delegation of tasks to new members**

As the venture team develops, one of the most important decisions it needs to make is to determine the number of new members to add / hire in the existing team (Chandler et al., 2005; Forbes et al., 2006; Shane, 2003). Prior studies have approached the selection process of new members from a resource-dependency view (e.g., Kamm & Nurick, 1993; Ucbasaran et al., 2003) and from a social psychology perspective (e.g., Ruef et al., 2003). According to the first view, the choice to add new members is motivated by the matching between the venture's resource needs and the resources the new members can contribute in order to improve the performance of the venture. The second view argues for the powerful influence of relational trust and homophily between the existing and the new members of an

entrepreneurial team in informing this decision. Each view represents different but not mutually exclusive (Francis & Sandberg, 2000) aspects of the decision-making process the existing founding team may follow to add a new member. This decision becomes more pivotal at the post-founding stage of a venture, as adding a new member requires substantial socialization and adaptation by both the existing and the new members (Adelman & Frey, 1997). Thus, team diversity can influence the addition of new members (the selection criteria and the recruitment process) determining the human and social capital (Forbes et al., 2006) that the new members can bring into the venture and indirectly influencing the entrepreneurial process.

In theory, founding teams should also require less control for agency problems due to the shared interests of the principals and agents (Ang, Cole, & Lin, 2000). The small size of the team also allows for perfect information symmetry within the team. However, professionalization and the addition of new members (regardless if they carry ownership such as in family businesses or not (Chua et al., 2009)) gives rise to the need for the founding team to delegate authority to managers and subsequently monitor their behavior (Hofer & Charan, 1984). The growth potential of a new venture is significantly related to founders' (existing team members) willingness to delegate decision-making authority (Ginn & Sexton, 1990), and diversity on how to approach this decision may significantly affect the entrepreneurial process.

**Separation.** High diversity as separation reflects perfect disagreement regarding how new members can be identified and recruited. It challenges a) the main assumption of human and social capital and resource dependency theories that all existing team members have a common opinion on how to "attract individuals who have the capacity to generate returns or to procure resources" (Forbes et al., 2006, p. 230); and b) the assumption of the social psychological / homophily view that team members are attracted to similar others in terms of attitudes. In the case of an equal split of opinions regarding efficiency and homophily criteria to recruit new members, the team delays the selection process, and creates confusion over the recruiting process and its timing (Forbes et al., 2006). On the other hand, moderate diversity as separation allows existing members to identify a balance between the relational trust and the efficiency characterizing a new member in order to join the venture. Through this balancing process and the resulting moderate level of conflict, existing team members may gain clarity (Chandler et al., 2005; Kemer et al., 1985) over their and the new members' goals and expectations, and diminish the length of the recruitment and socialization process of the latter (Hainen & Jacobson, 1976). Moderate separation of opinions over the identification of new members is expected also to facilitate a more efficient utilization of the social networks of the existing members, as well as the timing of hiring new members.

Similarly, high diversity as separation regarding the delegation of tasks to new members reflects perfect disagreement among existing members on the governance structure of the venture, which directly influences the performance of the latter (Daily & Dutton, 1992). Disagreement over governance choices creates delays in the process and prevents the team from developing common and shared goals regarding the distribution of tasks to new members and the monitoring of their behavior. On the other hand,

minimum disagreement within an entrepreneurial team may facilitate the process of delegating tasks to new members but prevents the exploration of alternative choices of governance structure, which is likely to expose the team to unforeseen agency costs:

*Proposition 4a: Moderate diversity as separation improves the entry of new members and facilitates the delegation of tasks to them.*

**Variety.** High diversity as variety reflects multiplicity and plurality of experience regarding a) the selection criteria and recruitment process of the potential new members, and b) delegating specific functions to new members and monitoring their behavior. Brown and Campion (1994) highlight how recruiters' perceptions and the way they interpret and use biographical data influences the screening process of potential employees. As biographical data reflect abilities the potential employee possesses and predict performance (Howard, 1986), the recruiters' cognitive process of recognizing abilities may be influenced by their prior recruiting experience and their functional background. In this way, the lower the variety of the cognitive processes adopted by recruiters, the more likely it is for biases to occur and restrict the screening and selection process. High levels of similarity among the recruiters' cognitive process and perceptions on abilities lead to hiring individuals who share the same perceived abilities with their recruiters (Reuf et al., 2003). For example, teams that consist predominantly of engineers and scientists run the risk of focusing on technology-oriented abilities and underestimating the need for additional abilities that add to strategic flexibility in order to meet changing competition and demand. Thus, even though the similarity attraction paradigm (Byrne, 1971) suggests homophily as key determinant of the selection process, such a rationale restricts the range and scope of the screening and selection of new members. This might not be of urgency in the case of pre-founding and founding teams, but it becomes pivotal when the founding team needs to expand and accommodate the venture's growth needs. Conversely, high diversity as variety among recruiters reflects multiple selection criteria, plurality of recruitment practices and diversity in terms of perceived new members' abilities.

Similarly, the wider the experience of the team members with different governance structures and mechanisms to manage agency costs, the more likely it is for the team to facilitate the delegation of tasks to new managers. Limited or no experience at all in delegating authority to new members may lead to errors of judgment in terms of anticipating agency costs that emerge following the recruitment of new members. Driven by similarity in their experience of governance, the existing members may choose a governance structure which might be close to their experience but not satisfying the needs of the new members, leading the latter toward free-riding behavior:

*Proposition 4b: Maximum diversity as variety improves the entry of new members and facilitates the delegation of tasks to them.*

**Disparity.** Building on theories of relative deprivation (e.g., Deutsch, 1985), researchers commonly predict that status or power disparity incites competition, differentiation, and (resentful) deviance among

unit members (e.g., Bloom, 1999; Pfeffer & Langton, 1993; Siegel & Hambrick, 2005). Maximum diversity as disparity, regarding the selection, recruitment and task delegation to new members, reflects concentration of power over this decision and process on one individual. The top-management-team literature suggests that the concentration of power may result from the legitimate hierarchical status of these individuals within the team (e.g., Hambrick, 1981) due to their ownership stake in the venture or their presence in the founding team. In entrepreneurial teams, the founder CEO occupies a position of unique influence “serving as the locus of control and decision-making” (Daily et al., 2002; p.391). In the context of family businesses, attributes such as age and gender may also allow for emerging disparity over power in the entrepreneurial team.

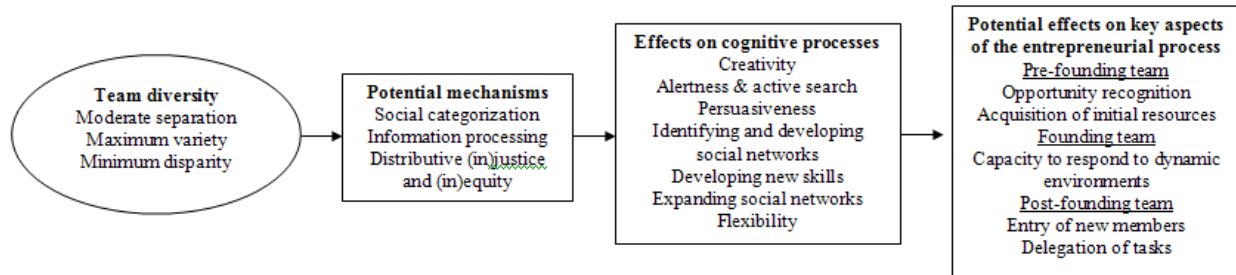
While the concentration of power on one individual may speed up the screening and selection process of new members, the bounded cognitive process of recognizing abilities of these influential members may restrict the range of potential new members screened and eventually selected. Further, the fact that other existing members cannot influence the selection process of new members may cause deviance and increase perceptions of distributive injustice (Rock & Shanock, 2006). The powerless members may view the recruitment of a specific new member as favoritism (i.e., in a family business, the father hires his daughter without consulting the rest of the team members). Even though minimum disparity of power over the decision to recruit a new member may slow down the screening and selection process, it is also associated with increased information flow and communication (Glick et al, 1993). Thus, at the post-founding stage of their development, entrepreneurial teams appear more efficient in recruiting and selecting new members with a minimum diversity of power among existing members.

Similarly, a founder's status influences governance choices. Agency theory suggests that such centralized leadership leads to domination within the team and poor performance (Daily & Dalton, 1992). This may discourage new members' participation and commitment to the team, making them more prompt to withhold information from the founders / owners and create agency costs for the latter. In addition, centralization of decision-making power over delegating tasks to new members may activate perceptions of distributive injustice within the post-founding entrepreneurial team. Therefore, minimum disparity of power within the post-founding team reflects fair distribution of decision-making authority to all team members, which may improve the delegation of tasks to new members:

*Proposition 4c: Minimum diversity as disparity improves the entry of new members and facilitates the delegation of tasks to them.*

The framework we presented is intended to be indicative of the broad range of effects team diversity may have on the entrepreneurial process through various mechanisms. Figure 2 presents an overview of the effects proposed.

Figure 2: Theoretical Framework of the Role of Team Diversity in Entrepreneurship



## Discussion AND RESEARCH IMPLICATIONS

The motivation of this paper is threefold. First, diversity in entrepreneurship and organizational behavior research has produced inconclusive results. Second, a recent conceptualization of diversity as separation, variety and disparity (Harrison & Klein, 2007) appears relevant for understanding the effects of entrepreneurial teams' composition. Third, each type of diversity may influence differently key aspects of the entrepreneurial process, such as opportunity recognition, acquisition of initial resources, the ability to respond effectively to dynamic environments, and the selection and delegation of tasks to new members, as the team evolves. We draw from the organizational behavior literature on diversity and propose a new point of view to theorize on, and operationalize, diversity in entrepreneurial teams. Thus, we contribute to the entrepreneurship literature in the following ways.

First, by reviewing the existing entrepreneurship and organizational behavior literature on the ways team diversity has been approached, this paper is a first attempt to understand holistically how the different diversity types may be potential antecedents of enhanced aspects of the entrepreneurial process. In this way, diversity is not approached as a one-dimensional but rather as a multifaceted construct, with each of its facets affecting the entrepreneurial process in different ways. This in-depth holistic view of team diversity may stimulate reflection and help increase our understanding of the effects of entrepreneurial team composition.

Second, we propose a role for distinct amounts of the three diversity types on the entrepreneurial process. Drawing on Harrison and Klein's (2007) argumentation, we deliver propositions, which disentangle the impact and assumptions of each type of diversity at different amounts and on different aspects of the entrepreneurial process. Future research can benefit from empirically testing these propositions, thus reconciling inconsistencies of past research findings regarding the impact of team diversity.

Third, by studying entrepreneurial teams as adaptive and dynamic systems, we propose that issues of diversity need to be approached differently at each stage of the team's development. For example, while high homophily (minimum variety) may be present during the pre-founding team formation, low homophily (maximum variety) might be more appropriate and beneficial at both the initial and later stages of the development of an entrepreneurial team, when it tries to expand resources and support the growth needs of the venture.

Further, although we focused on several specific aspects of the entrepreneurial process, we also acknowledge that diversity has more general behavioral implications on how a team copes with novelty (Blatt, 2009) and uncertainty (McMullen & Shepherd, 2006). Novelty is conceptualized based on a) the team, with implications for the levels of trust among the team members, b) the market, with implications for the venture's identity, and c) management, with implications for the knowledge and experience specifically required to manage the venture (Blatt, 2009). Maximum diversity as separation and as disparity within an entrepreneurial team reflects a high degree of uneasiness, unfamiliarity, disagreements and power distance among the team members regarding key aspects of the venture, the market, and work-related attitudes and behaviors, prolonging team-, market- and management-based novelty. On the other hand, maximum variety of experience among the team members may assist the members to better cope with novelty in terms of the team, market and management of the venture, as team members complement on their competencies and information they hold.

Uncertainty is conceptualized in terms of a) the amount of uncertainty perceived by team members, and b) the members' willingness to bear uncertainty (McMullen & Shepherd, 2006). Maximum diversity as separation over the amount of perceived uncertainty among the team members and their willingness to bear uncertainty may result in conflicts, causing delays in recognizing and enacting on an opportunity. On the other hand, maximum diversity as variety reflects non-redundant information and knowledge which may actually help the team to realistically determine the amount of environmental uncertainty and resolve issues regarding uncertainty, as each member draws from different experiences in perceiving and bearing uncertainty. Maximum diversity as disparity may also have significant implications for the dynamics of the team and the success of the venture. The concentration of power on one team member in determining the amount of environmental uncertainty may limit the responsiveness of the venture, as the rest of the members do not equally contribute to the collective understanding of the uncertainties the venture is facing. Similarly, maximum disparity of power, as reflected by only one team member's decision-making power over the entrepreneurial action required to face uncertainty, leads to low levels of commitment by the rest of the members and increases the likelihood of free riding behavior of the latter.

### **Theoretical and methodological implications**

Albeit not exhaustive, our framework begins to address how entrepreneurship research can advance our understanding of the effects of entrepreneurial team composition. Having argued that specific types



of diversity at different amounts would have positive effects on the entrepreneurial process, we also acknowledge that team diversity has to be interpreted as a double-edged sword (Milliken & Martins, 1996) since its effects can be complex. For instance, while increased heterogeneity may produce productive group tension, reduce groupthink (Janis, 1972), and improve decision-making (Sawyer, Houlette, & Yeagley, 2006), different educational and functional backgrounds may also render effective group functioning more difficult (Murray, 1989; Williams & O'Reilly, 1998) and inhibit decision-making. In addition, while similarity implies high consensus and strong continuity of strategy (Pfeffer, 1981; Wiersema & Bantel, 1992), as well as greater trust and comfort (Byrne, 1971), homogeneous teams are also less inclined to introduce new ideas and discuss entrepreneurial issues (Murray, 1989; Wiersema & Bantel, 1992).

We thus avoid simple conclusions and clarify that neither more nor less diversity is beneficial to the entrepreneurial process. Rather, its effects depend on the three types of diversity and the three mechanisms of social categorization, information processing and distributive injustice (inequity) through which core cognitive processes of the team and the members are affected by diversity. Accordingly, careful examination of the possible diversity effects may enrich the entrepreneurship literature by shedding light on how entrepreneurial teams can influence new venture success. Future research might further consider whether diversity needs to exist within the founding team, or if team members can tap into the value of diversity through their network (e.g., advisors). Systematic entrepreneurship research through this lens is thus needed and this paper offers a thorough theoretical framework in this direction.

Moreover, while diversity as variety has been well received by entrepreneurship scholars, approaching diversity as separation and disparity presents two fruitful areas for future research. For instance, family businesses represent empirical settings in which disparity of power, as resulting from age, gender and other ownership attributes, is a significant factor that may influence the entrepreneurial process and the dynamics of the entrepreneurial team (i.e., succession, delegation of authority and power to younger generations). Similarly, corporate entrepreneurial teams, where separation of opinions results from the social-identification of members with different in-groups (e.g., internal vs. external to the corporation, middle- vs. low-level managers), can also provide a fruitful empirical setting for entrepreneurship scholars to expand the scope of their research.

Approaching diversity as a multidimensional construct also has significant methodological implications for research designs. Harrison and Klein (2007) provide a thorough discussion on how researchers can design studies that capture the three types of diversity, operationalize diversity driven by the theoretical specification of diversity as separation, variety or disparity, and distinguish between perceived and actual diversity. Entrepreneurship scholars can benefit from these suggestions. Borrowing from research on diversity faultlines (Lau & Murnighan, 1998), future research may also approach diversity of specific attributes simultaneously as separation, variety and disparity, and methodologically explore the interactions and appropriate combination of diversity types in an entrepreneurial team.

Further, we have adopted a dynamic view in approaching team diversity as a construct that changes over time, influenced by the work of Vanaelst and colleagues (2006). We encourage entrepreneurship scholars to incorporate time into their studies as reflected at the stages of team development, which are different from the stages of development of the venture. Future research may thus benefit from longitudinal designs that capture the evolution of an entrepreneurial team while examining the impact of its diversity.

## Practical Implications

As we learn to better understand the dynamics associated with start-up team diversity and entrepreneurial outcomes, we may offer valuable insights and guidelines to founders about how to compose new venture teams. We proposed that maximum diversity-as-variety is beneficial to the entrepreneurial process and underscored the importance of fostering heterogeneous compositions of entrepreneurial teams. Considering that most studies on entrepreneurial teams identify homophily as a significant factor in determining the composition of the pre-founding team (e.g., Ruef et al., 2003), we encourage business founders to consider closing potential gaps in their competency maps at the pre-founding stage, rather than seeking similar others, perceived as more familiar and trustworthy. In addition, actors such as universities, business angels or venture capitalists may need to encourage leading entrepreneurs or technical-oriented entrepreneurial teams to integrate partners with complementary knowledge and abilities, from different disciplines, at the early stages of their development. Finally, family businesses can benefit from considering how disparity of power among the family members may impair specific aspects of the entrepreneurial process and the development of the team.

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## Appendix

Table 4: The implications of maximum and minimum degree of three types of diversity on the entrepreneurial process

<i>Diversity type</i>	<i>Separation</i>	<i>Variety</i>	<i>Disparity</i>
<i>Meaning and synonyms<sup>63</sup></i>	<i>Composition of differences in (lateral) position or opinion among unit members, primarily of value, belief, or attitude; disagreement or opposition</i>	<i>Composition of differences in kind, source or category of relevant knowledge or experience among unit members; unique or distinctive information</i>	<i>Composition of (vertical) differences in proportion of socially valued assets or resources held among unit members; inequality or relative concentration</i>
<i>Attribute examples</i>	<i>Opinions, beliefs, values, and attitudes, especially regarding team goals and processes</i>	<i>Content expertise, functional and educational background, industry experience</i>	<i>Income, prestige, status, decision-making authority, social power, equity</i>
<i>Pre-founding team</i>			
<i>Opportunity recognition</i>	<i>Creativity</i>		
	<i>Maximum diversity: Equal split within the team and on opposing end-points regarding which creative cognition process to adopt</i> <i>Minimum: Perfect agreement within the team regarding which creative cognitive process to adopt</i>	<i>Maximum diversity: Multiplicity and plurality of information and perspectives enhancing creative cognition</i> <i>Minimum: Lack / similarity of information and perspectives restricting creative cognition</i>	<i>Maximum diversity: Concentration of power on one team member in determining the creative cognition process</i> <i>Minimum: Equal distribution of power among all team members in determining the creative cognitive process.</i>
	<i>Alertness and active search</i>		
	<i>Maximum diversity: Equal split within the team and on opposing end-points regarding the required level of alertness and active search in order to discover new ideas</i> <i>Minimum: Perfect agreement within the team regarding the required active search in order to discover new ideas / High (or low) levels of collective alertness in order to discover new ideas</i>	<i>Maximum diversity: Multiplicity and plurality of information and perspectives enhancing alertness and active search for new ideas</i> <i>Minimum: Lack / similarity of information and perspectives restricting alertness and active search for new ideas</i>	<i>Maximum diversity: Concentration of power on one team member in engaging in active search for new ideas</i> <i>Minimum: Equal distribution of power among all team members in engaging in active search for new ideas</i>
<i>Acquisition of initial resources</i>	<i>Persuasiveness</i>		
	<i>Maximum diversity: Equal split within the team and on opposing end-points regarding</i>	<i>Maximum diversity: Multiplicity and plurality of perspectives in determining</i>	<i>Maximum diversity: Concentration of persuasive behavior on one team member</i>

<sup>63</sup> Source: Harrison & Klein (2007)

	<i>the potential and viability of the new venture</i> Minimum: Perfect agreement within the team regarding the potential and viability of the new venture	<i>the potential and viability of the new venture</i> Minimum: Lack / similarity of perspectives in determining the potential and viability of the new venture	<i>regarding the potential and viability of the venture</i> Minimum: Equal distribution of persuasive behavior among all team members regarding the potential and viability of the venture
	<i>Breadth of social networks</i>		
	<i>Maximum: Equal split within the team and on opposing end-points regarding the range, the nature and the necessity of the contacts each member can contribute to the venture</i> Minimum: Perfect agreement within the team regarding the range, the nature and the necessity of the contacts each member can contribute to the venture	<i>Maximum: High range of social contacts among the team members increasing the breadth of the social networks of the venture</i> Minimum: Low range of social contacts among the team members decreasing the breadth of the social networks of the venture	<i>Maximum: Concentration of social contacts which can benefit the venture on one team member</i> Minimum: Equal distribution of social contacts which can benefit the venture among all team members
<i>Founding team</i>			
<i>Capacity to respond to dynamic environments</i>	<i>Developing new skills</i>		
	<i>Maximum diversity: Equal split within the team and on opposing end-points regarding the necessity and the nature of the new skills</i> Minimum: Perfect agreement within the team regarding the necessity and the nature of the new skills	<i>Maximum diversity: Multiplicity and plurality of perspectives in broadening and building new skills for the venture</i> Minimum: Lack / similarity of perspectives in broadening and building new skills for the venture	<i>Maximum diversity: Concentration of the power to broaden and build new skills for the venture on one team member</i> Minimum: Equal distribution of the power to broaden and build new skills for the venture among all team members
	<i>Expanding networks</i>		
	<i>Maximum diversity: Equal split within the team and on opposing end-points regarding the necessity of expanding the venture's social network and the nature of the required new social contacts</i> Minimum: Perfect agreement within the team regarding the necessity of expanding the venture's social network and the nature of the required new social contacts	<i>Maximum diversity: Multiplicity and plurality of perspectives regarding the required expansion of the venture's social network and the nature of the new social contacts needed</i> Minimum: Lack / similarity of perspectives regarding the required expansion of the venture's social network and the nature of the new social contacts needed	<i>Maximum diversity: Concentration of the power to expand the venture's social network on one team member</i> Minimum: Equal distribution of the power to expand the venture's social network among all team members



	<i>Flexibility</i>		
	<i>Maximum diversity: Equal split within the team and on opposing end-points in determining the required level of flexibility</i> <i>Minimum: Perfect agreement within the team in determining the required level of flexibility</i>	<i>Maximum diversity: Multiplicity and plurality of perspectives regarding the required level of flexibility</i> <i>Minimum: Lack/ similarity of perspectives regarding the required level of flexibility</i>	<i>Maximum diversity: Concentration of the decision-making power on one team member regarding the required level of flexibility</i> <i>Minimum: Equal distribution of the decision-making power among all team members regarding the required level of flexibility</i>
<i>Post-founding team</i>			
<i>Entry of new members and delegation of tasks</i>	<i>Maximum diversity: Equal split within the team and on opposing end-points regarding: (a) the selection criteria and recruitment process of new members; and (b) delegating specific functions to new members and monitoring their behavior</i> <i>Minimum: Perfect agreement among team members regarding: (a) the selection criteria and recruitment process of new members; and (b) delegating specific functions to new members and monitoring their behavior</i>	<i>Maximum diversity: Multiplicity and plurality of experience regarding: (a) the selection criteria and recruitment process of new members; and (b) delegating specific functions to new members and monitoring their behavior</i> <i>Minimum: Lack / Similarity of perspectives and experience regarding: (a) the selection criteria and recruitment process of new members; and (b) delegating specific functions to new members and monitoring their behavior</i>	<i>Maximum diversity: Concentration of power on one team member regarding: (a) selecting and recruiting new members; and (b) delegating specific functions to new members and monitoring their behavior</i> <i>Minimum: Equal distribution of power among all team members regarding: (a) selecting and recruiting new members; and (b) delegating specific functions to new members and monitoring their behavior</i>

## **AUTOTELIC CAPABILITIES AND KNOWLEDGE INTENSIVE ENTREPRENEURSHIP IN LOW TECH SECTORS**

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### **Abstract**

In this paper Autotelic Capabilities (ACs) are introduced as the necessary abilities for the individual firm to create new forms of competitive advantage based on knowledge, in order to survive early death and prosper in the mature business ecosystems of low tech sectors, in a first attempt to shed light on the unexplored strategic side of the entrepreneurial start up activity in low tech sector within the notion of knowledge intensive entrepreneurship (KIE).

The logic of grounded theory was followed in the analysis of multiple exploratory case studies with the individual low-tech company as the unit of analysis. Companies of the three most representative low tech sectors in Greece were selected from databases after sectoral experts' recommendation. Triangulation through the use of multiple data sources, theoretical perspectives, and methods increased the credibility and validity of the results.

This exploratory research is a first endeavor to specify a conceptual framework and the nature of the capabilities necessary for new knowledge intensive ventures to achieve a strong initial competitive position in an open economy. It introduces autotelic capabilities (ACs) (bricolage, improvisational and transcendental), which enable enterprises create and deploy the intangible, mostly knowledge- based assets that will prevent early death and permit market dominance, as well as the conditions to do so. The present research further introduces the integration of bricolage and improvisation into second order strategic capabilities, offers insight on dynamic capabilities origins and establishes relations among dynamic and autotelic capabilities. Finally, we articulate the implications of ACs for managerial practices and future entrepreneurship research.

It is the very first research on KIE conceptual frameworks in low tech sector with a capabilities' approach. The concept of Autotelic Capabilities is a first attempt to connect corporate, knowledge intensive and strategic entrepreneurship, regarding the emerging stage of venture creation and the initial competitive advantage. The autotelic capabilities framework comprises a rather aspiring research agenda for many research fields within the unexplored concepts of both KIE and low tech. Novel concepts such as the transcendental capability and the entrepreneurial landscape spaciousness are introduced. It is further the first attempt to indicate the significant role of dynamic

capabilities in low tech firms providing some primary relations among autotelic and dynamic capabilities and offering insight on the origins of the second ones.

**Keywords:** new venture, low-tech, knowledge intensive entrepreneurship, competitive advantage, dynamic capabilities, autotelic capabilities

## **Introduction**

During the last ten years at least, a significant number of firms in traditionally named low tech (TLT) sectors enclose a dynamic approach of knowledge in order to flourish in saturated and vulnerable markets. Entrepreneurs start new knowledge intensive business, transcending traditional limits and combining several knowledge bases.

The recent focus on capabilities in entrepreneurship has allowed researchers to unfold abilities necessary for effective entrepreneurial activities. Successful companies appear to benefit from a well-honed set of entrepreneurial capabilities which they have developed and refined over time (Zahra, 2006). Yet, strategic entrepreneurship lacks relevant integrative frameworks- especially for the “take – off” level.

Our approach through the autotelic capabilities (ACs) framework tries to explain how and why the launch of new ventures that intensively use and/or create new knowledge in order to acquire a strong hold in the markets can be successful. Exploring the black box of Knowledge Intensive Entrepreneurship (KIE) sectors and more specifically trying to answer questions on how KIE is established in traditional sectors in terms of knowledge – based competitive advantage that provide the company’s successful evolution is a matter of strategy. Corporate entrepreneurship research would benefit from examining the nature and content of ACs as well as when and how it affects KI new ventures. A first stage of such an examination is the focus of this article.

This is the very primary work on it and the very first statements. We try to sketch an outline for the autotelic capabilities approach taking into account the increased importance of KIE in TLT sector. ACs create external changes in the domain of the existing business ecosystem. Limited research exists today on the entrepreneurial capabilities that affect the start-up stage and no research when referring to TLT sector or KIE. The autotelic capabilities approach is promising both in terms of future research in many research fields including strategic management, entrepreneurship, innovation and knowledge management, as well as of entrepreneurial and managerial aids in order to shape new entrepreneurial courses in today’s complex business environments.

## **Knowledge Intensive entrepreneurship in Traditional Low Tech sectors**

Entrepreneurship has been correctly characterized as one of the most intriguing but equally elusive concepts (Peneder, 2006). Scholars of entrepreneurship have struggled to create an appropriate conceptual framework for the field (Ihrig *et al.*, 2006; and Venkataraman, 2000)

with dozens of definitions of entrepreneurship (e.g. Schumpeter, 1934; Kirzner, 1973; Zahra and Garvis, 2000; Ireland *et al.*, 2001; Langlois, 2007; Henrekson, 2007).

The term knowledge-intensive entrepreneurship has been used mainly for technology based firms in high tech sectors and lacks a very clear definition (Brännback *et al.*, 2003; Burger and Helmchen, 2008; Malerba, 2004, 2008, 2010). Furthermore, there is no definition while there is still a debate on whether KIE can exist in low tech sectors.

Burger and Helmchen (2008) labelled “knowledge-based” entrepreneurs those entrepreneurs who meet at least two of the following conditions: (i) creation of a new combination, (ii) creation of new knowledge, (iii) employ knowledge developed originally in science.

Traditional Low Tech (TLT) sectors cannot easily produce extreme novelties based on new, “out of the lab” technology. Their markets are generally mature, slow-growing and subject to over-capacity and high levels of price competition. Traditional industries have been seen as more prone to competition from low-wage countries and less aggressive in terms of competition and innovation. Thereupon, when a new venture enters the market, it owns to surprise in order to survive and become competitive. Knowledge bases, combinative knowledge and absorptive capacity contribute to the creation of novelties to serve the above precondition. On the other hand, the ability of transcending the sectoral context is crucial for KIE in TLT sectors (Kreinsen and Schwiege, 2010). Knowledge generation in LMT companies can be linked to knowledge beyond internal sources, derived widely from other firms and institutions of relevant or non relevant sectors.

Combining the general and rather abstract definitions of KIE with the views on KIE and innovation in TLT sectors insofar, the following definition for the purposes of the present study is developed:

Knowledge Intensive Entrepreneurship in Traditionally Low Tech sectors exists when, with the purpose of creating a venture, the agents build on knowledge in order to turn a transcendent idea into business, putting knowledge in the core of all entrepreneurial activities instead of physical assets. This is mainly done by questioning existing knowledge and identifying and collecting new knowledge of various areas and levels, which has to be integrated and transformed for novel independent knowledge production (either productive or reproductive).

Knowledge-intensive entrepreneurship as the act of establishing a new venture is about cognition, heterogeneous knowledge selection and coordination in order to commercialize novel combinations or re-combinations at areas of products, processes, services or organizational models and acquire a first share in an existing or a new market. Autotelic capabilities enable the triggering of all mechanisms needed to establish the initial knowledge

based advantages through the exploration, creation and exploitation of opportunities that give birth to transcendent ideas.

### **Capabilities Approaches and New Venture Creation**

Research on entrepreneurship has extended from the exploration of the dynamics of entrepreneurship in terms of opportunity recognition (Shane and Venkataraman, 2000), corporate innovation and new product development (Deeds et al., 2000), organizational birth and evolution (Aldrich, 1999), and the growth of new and small organizations (Hanks et al., 1994). S. Hanks, C. Watson, E. Jenson and G. Chandler, Tightening the life-cycle construct: a taxonomic study of growth stage configurations in high-technology organizations, *Entrepreneurship Theory and Practice* 18 (1994) (2), pp. 5–29. Hanks et al., 1994). Soon enough the resource-based perspective drove the entrepreneurship literature to develop the notion of “entrepreneurial capabilities” in order to explain new venture performance (Arthurs and Busenitz, 2006) or innovativeness (Picot et al., 1994). The term refers to the ability of identification and exploitation of the necessary resources in order to act upon opportunities in the market, or to create new market opportunities. Later Zahra stated that nascent firms' entrepreneurial activities entail the element of innovativeness. Ihrig et al (2006) attempting a knowledge-based approach to entrepreneurship, described the entrepreneurial process, from the venture idea to the newly formed business's strategic success, in terms of the development of knowledge following Boisot (1998).

On the other hand, in the field of strategic management, numerous theories and frameworks have been developed that attempt to explain how firms achieve and sustain competitive advantage finding substantial relevance within the field of entrepreneurship; the resource based view and the dynamic capabilities framework were the most dominating ones among them. Still, the resource-based view of the firm only tells why firms have success in the present context. It gives no clear understanding about how a firm through entrepreneurial action achieved their present fit (e.g. Alvarez and Busenitz, 2001). Bocardelli and Magnusson (2006) also argue that the important seed and start-up phases are not sufficiently covered by the resource-based theories which rarely have considered the early stages of firm development.

The dynamic capabilities perspective (Teece, Pisano and Shuen, 1997; Teece, 2007) focuses on the competitive advantage that is provided by a certain resource constellation over time to fit changing business environments (Baretto, 2010). Teece (2007) states that the ambition of the dynamic capabilities framework is: “nothing less than to explain the sources of enterprise-level competitive advantage over time”. Dynamic capabilities have been detected and analyzed in high – technology industries, large, diversified and multidivisional firms (Zollo and Winter, 2002) and multinational companies in international environments (Teece, 2007). They presuppose a rapid technological change and ignore the huge importance and potential of LT industries, as well as SMEs which constitute the majority of European firms at all

sectors. There are hardly any studies on the relationship between dynamic capabilities and knowledge intensiveness in low tech sectors. There is no evidence of the dynamic capabilities' existence and role in low tech companies either in their start up stage or later in their life and the development of their competitive advantages. Moreover, there is little evidence on their role in Knowledge Intensive Entrepreneurship (KIE) and none when KIE refers to low tech sector.

Although a growing body of research highlights the importance of entrepreneurial activities for the conception, development, configuration and maintenance of dynamic capabilities in new ventures (Boccardelli and Magnusson, 2006; Zahra *et al.*, 2006; Sapienza *et al.*, 2006), there is little or no research on whether dynamic capabilities exist during venture creation. Arthurs and Busenitz (2006) draw a clear distinguishing line between entrepreneurial and dynamic capabilities, while Helfat and Peteraf (2003) argue that an organization in the founding stage cannot have any dynamic capabilities.

Regarding knowledge-intensive entrepreneurship, an essential prerequisite is the capability to question existing knowledge and identify and acquire (new) relevant knowledge from other knowledge bases (Kirschen 2010). According to Kreinsen (2010), such reflective competences of low-tech firms depend heavily on specific *capabilities*, such as the configurational and the transformative ones (cf. Bender and Laestadius, 2005; Hirsch-Kreinsen, 2008). Literature on knowledge intensiveness in TLT sectors has been questioned through kinds of knowledge and ways of combining existing codified knowledge with practical knowledge in competitive ways (Pavitt, 1984; Napolitano, 1991; Hirsch-Kreinsen *et al.*, 2005; Robertson and Patel, 2007; Lichtenthaler, 2009), and a clear orientation to process innovation (Fagerberg, 2005; Heidenreich, 2009). Papers drawn from Economics of industrial dynamics (e.g. Gans *et al.*, 2002; Kirzner, 1973 etc) have outlined the importance of innovativeness as closely related to KIE as well as the important seed and start up phases of traditional firms but haven't gone further till now.

The recent focus on entrepreneurial capabilities has allowed researchers to specify the abilities and resources required for effective entrepreneurial activity providing a deeper understanding of the entrepreneurial process (Foss *et al.*, 2004; Arthurs and Busenitz, 2006). Yet, the numerous theories over the past two decades (e.g. Henderson and Clark, 1990; Zahra and George, 2002; Bender, 2004; Grimpe and Sofka, 2009) do not refer to innovative knowledge intensive start-up entrepreneurial actions. According to Zahra *et al.* (2006), most research and theory building focuses on established firms in high technology industries thus ignores new ventures and SMEs, and most have emphasized innovation, new product development, or new market entry activities to illustrate concepts.

Furthermore, the entrepreneurship literature has been criticized for being too concentrated on the process of launching new business concepts neglecting the strategic element of it (Hitt & Ireland, 2000; Hitt *et al.*, 2003; Boccardelli, 2006). Even when management scholars began to

recognize the value of incorporating entrepreneurship into strategic management research (e.g., Ireland, *et al.*, 2001; Alvarez & Barney, 2007), there was no effort to relate a capabilities framework with the early stages of firm creation and development, especially in low tech sectors. Paradoxically strategists seem to neglect the process by which resources are discovered, turned from inputs into heterogeneous outputs, and exploited in order to create a new business. Even the few ones that have tried to partly explore it, stay caged in high tech sectors. (e.g. Boccardelli and Magnusson, 2006; Zahra *et al.*, 2006), ignoring the importance of TLT sectors and still not incorporating knowledge intensiveness of such ventures.

## Objectives

In this paper, we seek to accomplish two objectives. First, we establish, define and discuss the nature of autotelic capabilities and show their importance and role in the starting stage of any type of KI venture after having defined KIE in low tech sector. Second, we discuss the key conditions under which ACs can bring about appreciable initial competitive advantage, keen to allow a successful venture entrance in existing mature and saturated competitive arenas.

Considering that the general and broad views on entrepreneurship and the existing capabilities' frameworks cannot capture the specificities and peculiarities of KIE in TLT sectors, the fundamental concept of knowledge intensive entrepreneurial process signifies a "black-box" challenge. In cases of KIE in traditional sectors there are usually no investments in direct R&D which secure patents and exclusiveness on unique products or academic patenting in various technological classes (Kreinsen, 2010). On the other hand it seems obsolete to start a new business or approve a spin off in the clothing sector in Europe or USA, a conventional wheat mill or another furniture plant. And yet, there are new firms or spin offs in these sectors that start dynamically, survive and prosper.

We argue that possessing and cultivating further the autotelic capabilities is a major success factor when knowledge intensiveness is engaged. ACs drive the cognitive process of forward-looking imaginative choice, enact the acquisition and management of knowledge and information and enable the triggering of changes that can greatly alter the rules of the saturated competitive arenas and determine victorious entrants in the marketplace. ACs provide the bridges between entrepreneurs' aspirations and visions, opportunities and resources where knowledge is both the mediator and moderator on a constant interaction with the external environment.

*'And, when you want something, the entire universe conspires in helping you to achieve it.'* (The Alchemist, Paulo Coelho, 1988)

## Research Method

The logic of grounded theory was followed in the analysis of a multiple exploratory case study (Yin, 2003) with the individual low-tech company as the unit of analysis. Data were

collected from sectoral databases, the Amadeus data base and ICAP, while sectoral experts were interviewed and gave information about new, knowledge intensive ventures. The most representative low tech sectors in Greece are the food and beverages, wood and furniture, and textiles and clothing industry. The identified sectors have also a significant share of employment and value added for the European manufacturing industry and economy as a whole.

The goal was to acquire a sample of knowledge intensive ventures covering all Greece, which would satisfy the following criteria:

- KI venture creation among 1998-2007 in order to have survived early death
- More than three employees
- The company should evidently be a first mover or assigned to the most innovative companies in the market or product field.

The final sample consists of thirty case studies, ten from each sector carried out from November 2009 to January 2011. Three pilot interviews (one for each sector) permitted the improvement of protocols and interview general guidelines.

Multiple sources were used such as information by different interviewees (entrepreneurs, core team members), visits to the plant and reviews of company and public documents, such as administrative documents, reports, news (internet and press), secondary sources (literature, awards and information from company web sites) and a standardized questionnaire on hard facts and data of the cases. Triangulation through the use of multiple data sources, theoretical perspectives, and methods (Schwandt, 2001) increased the credibility and validity of the results.

Entrepreneurs of each firm and other senior managers were asked about the story of their venture's creation, on the innovative business concept, history and firm's evolutionary behavior up to the present time, biographies, and future expectations. They generally offered very detailed responses, timelines and histories for their firms. The typical interview lasted 2.5-3 hours, with some lasting much longer followed by supplementary telephone conversations. All interviews were taped and transcribed.

Although none of our questions asked directly about capabilities and were more directed to the exploration of KIE within the founding processes through main characteristics, determining factors and impacts, the reviews of transcripts revealed a wealth of data on certain capabilities' dimensions that led to the autotelic capabilities concept. It further proved the existence of the dynamic capabilities in these low tech firms and offered rich information on the transformation of the autotelic to dynamic capabilities and how the first become expressions of the second in the company's lifespan.



Table 1: Descriptive Summary of Sample

<i>FIRM</i>	<i>Legal form</i>	<i>Location</i>	<i>Year of foundation</i>	<i>Year of corp. venturing</i>	<i>Number of employees</i>	<i>product family</i>	<i>sales structure National /Exports</i>	<i>educational level of entrepreneurs</i>	<i>educated staff</i>
F1	SA	Larissa	2007		8	veneers, veneer stitching	90/10	University	2
F2	SA	Grevena		2004	126	lacquered/printed MDF laminate flooring	75/25	Technical School	13
F3	SA	Karditsa	2007		14	Kitchen, wardrobe	100/0	TEI	4
F4	Ltd	Grevena	2003		11	panels, flooring, glue – laminated products	100/0	TEI	2
F5	Ltd	Kozani	2001		19	Evropanel for furniture wall	100/0	TEI	1
F6	SA	Korinth	1924	2005	185	Plywood wooden flooring decorative panels	50/50	MASTER University	13
F7	SA	Larissa	2003		16	Wood pellets	100/0	TEI	1
F8	SA	Xalkidiki	1998		30	Kitchen, wardrobe	100/0	PhD	5
F9	SA	Xalkida	1980	2006	10	decking fedges	40/60	Master	6
F10	SA	Katerini	1974	2005	11	Kitchen, wardrobe	100/0	TEI	2
A1	SA	Larissa	2003		58	antipasti olive spreads	0/100	Master University	7
A2	SA	Larissa	2002		9	cucumbers	100/0	University	2
A3	SA	Volos	1998		7	whole egg yolk , albumin	97/3	Master	2
A4	Ltd	Korinthos	2003		9	organic , quasi pharmaceutical chocolate	93/7	Master	7
A5	SA	Serres	2001		30	conventional and biological wheat flour, gluten-free wheat flour , bio-functional flour and relevant foods	80/20	University	16
A6	SA	Agrinio	1995	2000	180	parboiled rice , exotic rice, specialties	80/20	University	3
A7	Ltd	Lamia	1960	2000	35	Gourmet dairy products	80/20	University	3
A8	SA	Larissa	1958	2000	345	milk juices yogurts cheese	80/20	Secondary Education	75
A9	Ltd	Kilkis	2006		18	snack crackers snack cheese ups	0/100	PhD	12
A10	SA	Agrinio	1995	2001	50	oil olives spreads-dips	18/82	PhD	5
T1	Ltd	Larissa	1995	2000	65	Dyeing –finishing	40/60	Master University	9
T2	SA	Oinofyta	1961	2004	158	special use and high performance fabrics,	70/30	Master University	2

						garments and protective systems, for armed forces, police, fire brigade and industry			
T3	SA	Larissa	1992	2005	9	dyeing handmade, inno-dyeing	70/30	University	2
T4	Ltd	Kilkis	1990	2000	136	tricot	70/30	University	16
T5	SA	Xanthi	1989	2004	180	Mattress, bed linen	55/45	Univeristy	45
T6	SA	Beroia	1937	2000	197	<a href="#">cotton yarn, cellulosic fibers blended yarns multi-ply yarns</a>	30/70	Master University	31
T7	SA	Thess/ni ki	1942	2000	250	underwear sleepwear and lingerie	90/10	University	28
T8	SA	Thess/ni ki	1978	1999	94	Children's brand clothing	60/40	University	18
T9	SA	Farsala	1970	2004	321	textiles	30/70	Master	34
T10	SA	Larissa	1950	2004	605	carpets	50/50	University	107

F: wood and furniture, A: food, T: textiles and clothing

TEI: Technological and Educational Institute

## The Autotelic Capabilities approach: an overview

KIE processes which shape the starting competitive advantage in TLT competitive arena may be analysed in terms of capabilities for orchestrating and mobilising knowledge and other resources at the disposal of firms.

Paraphrasing Eisenhardt and Martin (2000), we assume a strategic and organizational lens, rather than an economic one and we refer to “Autotelic capabilities” which constitute the foundations of successful KIE and play the starring role in the start of a new enterprise or corporate venturing. They are precursors of dynamic capabilities at the venture creation stage and turn into expressions of dynamic capabilities in the company's lifespan.

The term “autotelic” denotes that the motivational driving force (“telos”) comes from the agent itself (“auto”) and not by any external source. It belongs to the humanistic psychologist Csikszentmihalyi who studied the creative activities of people who were deeply involved in very complex activities. Since knowledge intensive entrepreneurship is a rather complex and multifaceted phenomenon, the term describes perfectly the endogenous character of the agents' capabilities which are responsible for KIE in TLT sectors.

Traditional sectors act today in environments open to international competition and well developed global markets. Traditional companies need to constantly reinvent their trajectories and unshackle from the past, due to the constant devaluation of conventional products. That presupposes that at various points in time they make certain decisions on the domains they prefer to be committed to. Autotelic capabilities enable the successful choice, elaboration and implementation, offer excellence in being ready to take over when a

prosperous innovative idea or opportunity arises within environments where knowledge is till now rather poorly developed by the majority.

We define Autotelic capabilities the entrepreneurs' / firm's abilities to engage in non routine activities, improvisation and a flexible and paradox way of collecting and establishing knowledge assets and asset combinations in order to realize transcendent business ideas and address complex entrepreneurial environment through new ventures.

Autotelic capabilities influence the location, selection and the ways of selection of resources and skills and use a priori knowledge in order to capture existing knowledge from various domains. They are strategic higher order capabilities since they enable the shaping of the entrepreneurial ecosystem and ensure and support the creation and successful implementation of dynamic capabilities.

Autotelic capabilities involve organizational as well as individual skills. When a new venture is established, they are more individual - centric, while later they are embedded in the organization. They are characterized by the interplay of entrepreneurs' abilities to envision cognize and mobilize action. ACs are distinguished from dynamic capabilities by the existence of an action orientation and an emphasis on both individual and collective aspects of the process which DCs miss (Bingham et al., 2007).

Autotelic capabilities incorporate the search for novelty through improvisation and bricolage, and creativity through transcendental thinking in order to build a competitive advantage at the early stages of a firm. ACs are responsible for the shaping of emergent conditions by creating and not simply discovering opportunities. They engage in exploration out of the boundaries of the firm and usually even of the industry they belong which is a vital role of ACs in building initial competitive advantages.

They activate the "entrepreneurial" and cognitive component of the dynamic capabilities and provide their flexible shaping and use, as well as the flexible transitions from individuals to processes. They precede dynamic capabilities and prepare and frame the "when" and "how" dynamic capabilities can be developed and successfully applied. In our research all, except two firms were found to have developed dynamic capabilities although most of the respondents could not recall the exact time they engaged their routines and dimensions. Still, none had started using them in the founding stage.

Over time, according to the present research the relationship between autotelic and dynamic capabilities becomes intricately interwoven. The autotelic capabilities become partly expressions of the dynamic ones. Still they dominate again when a new challenge appears (corporate venturing). At this stage, although firm -embedded, the autotelic capabilities become again a matter of entrepreneurs or selected managers. Autotelic activities are then mostly a matter of sensing and seizing, in order to create novel future paths.

The emerging autotelic capabilities can play a role in filling the gap between mainstream resource-based and dynamic capabilities strategy and knowledge based entrepreneurship literature – at least for traditional sectors.

### **Toward an Autotelic Capabilities Framework**

Knowledge Intensive Entrepreneurship in low tech sectors enacts mechanisms and processes of selection, association, elaboration and/or simplification that allow an unexplored till now way of combining different and complementary information, technology, tacit and codified knowledge borrowed from various sectors, disciplines and regions in the solution of a specific problem set by the agents, which stimulates action and which usually requires the joint contribution of various stakeholders. Consequently the emergent innovations are both the media of applying successful KIE and the results and outputs of KIE.

Even in so-call mature markets products have become complex, supply chains have become global and niche producers emerge around the globe enhancing competitiveness. New entrants need to establish and develop their own ecosystem (Teece, 2009) where they can network in order to reap knowledge, resources and innovations of other firms (e.g. suppliers or machinery makers) and create the conditions necessary for them to be welcomed in the markets. KI entrepreneurs of the present research made literally hundreds of decisions on their way to a finished entrepreneurial concept. They occupied capabilities to improvise and re -interpret knowledge and resources at hand in order to cope with changing and demanding although mature - called markets.

Therefore, there is substantial space for autonomous creation (Kor *et al.*, 2007). Conceiving the entrepreneurial process as “the process, from the venture idea to the newly formed business’s strategic success, in terms of the development of knowledge”, according to the broader knowledge-based approach to entrepreneurship of Ihrig *et al.* (2006), autotelic capabilities constitute the driving force of all necessary actions and decisions, by complementing each other and acting simultaneously and not sequentially as the existing models propose. Moreover, knowledge is in the core of all relevant activities focusing on assets of strategic interest.

### **Bricolage capability**

KIE activities of TLT firms need to transcend the sectoral borders for the sake of resources and mostly knowledge. Knowledge and information have no limits today, while on the other hand entrepreneurs and organizations suffer certain limits and are terribly finite actors. KI entrepreneurs develop *bricolage capabilities* in order to successfully tap distributed competence and knowledge, reemploy and reframe them, and recombine them creatively, or otherwise, create a concept of intuition. This may be scientific, technological, technical or practical knowledge, design competence, or expertise, codified or tacit knowledge.

TLT KI entrepreneurs create new ventures out of loosely pieces of knowledge, which are derived by trans-sectoral search and which alone may be nothing in terms of novelty or differentiation. This capability to “...creating new forms with current resources” has been defined as “bricolage” by anthropologists (Levi-Strauss, 1966). The notion of bricolage has been already used in entrepreneurship, innovation, organization and knowledge management research (Duymedjian & Rueling 2010; Garud and Karnoe, 2003; Baker *et al.*, 2003). In terms of levels of analysis, bricolage has been considered as an individual activity (e.g. Weick 1998), an organizational process (e.g. Ciborra 2002) and a form of inter-organizational dynamics (e.g. Garud and Karnoe 2003).

The present research proved that KIE in TLT sectors presupposes the existence of a *bricolage capability* that is strongly shaped and affected by knowledge and scientific areas, knowledge bases and networks within the value chain.

Across our case studies, founders engaged in bricolage with regard to knowledge providers, suppliers, customers, financing, advice and employees. Close co-operations were developed in a concentric way, using pre-existing networks as a basis for networking expansion. At start up stage, team based structures, built on trust and proximity enable founders to be involved in rapid decision making and have access to knowledge and information.

Compared with the spectacular advancements in high-tech sectors, the bricolage approach appears as more simplistic. Yet, in order to be effective, bricolage tends to release synergies and certain processes of learning. This is achieved by merging and adjusting pieces of knowledge and other resources of different actors involved in research, design and production, which transcend sectoral limits. Learning can come from any piece of the value chain including advice from suppliers, feedback from customers or market information.

Bricolage capability is well recognized among entrepreneurs or entrepreneurial teams at the early stages of KI entrepreneurial activities in TLT sectors. In many cases it is successfully transferred in procedures and processes as all autotelic capabilities at an organizational level. In all cases where dynamic capabilities were detected, bricolage acted as the precursor of sensing (first microfoundation as described by Teece (2007)), while it then turned to an expression of it as well as of reconfiguration.

### **Improvisation**

The initial entrepreneurial idea as shaped in the mind of the entrepreneur(s) or the organization will have to be many times reshaped, whether it is knowledge, production technology, an organization or a marketing mix matter. In all case studies, the ability to create and execute new plans on the fly proved to be an important ability to possess, since all agents were often forced to make decisions extemporaneously, using only the resources available to them in the moment.

What is rather oxymoron in a case of startup is that while the first movements are vital for its sudden death or survival, there is the most ambiguous period in its life. TLT enterprises need knowledge but almost always cannot lean on the assistance of a unique innovation as in high tech sectors. Still they act in an exponentially changing and constantly evolving environment. The need to repeatedly rework the initial concept in the light of new knowledge or other changes accentuates the volatility of the existing frameworks.

Literature on improvisation has been growing substantially since the mid 1990s, building on the organizationally oriented work within Weick (1979). Improvisation has been discussed in literature of strategic decision making (Eisenhardt, 1997), organizational learning (Barrett 1998; Miner *et al.*, 2001), product development (Kamoche and Cunha 2001), technology adoption (Orlikowski 2000), and strategic adaptation (Crossan and Hurst, 2003).

Improvisation implies the pre-existence of a set of resources upon which variations can be built (Orlikowski & Hoffman, 1997). All cases also highlighted real –time information as a crucial dimension. Real time information can be formal or informal, internal or external, generalized and vague, or very precise and unique. Regardless the degree and type, available information especially on knowledge allows a fluid communication and interaction among founders and the environment.

The target is to fill in the gap between vision and action, dream and reality. In order to achieve the desired results, a wide range of cross-functional skills, competences and extensive knowledge are required by entrepreneurs and members of the entrepreneurial team at the startup stage. An important number of the founders referred to learning through feedback from collaborators, suppliers, machine manufacturers, competitors and other members of the business ecosystem. Small failures and mistakes were also treated as sources of knowledge that could be directly useful or kept in mind for later use.

Improvisation entails flexibility, a spontaneous respond to arising circumstances and obstacles and allows exceptions to rules. Mixtures of try and error, and experimentation exploit information, crosscheck science results and “technology pushes” or integrate pertinent available knowledge. The research revealed that improvisational capabilities enabled exploring, continuous experimenting, tinkering with possibilities without knowing where one’s queries will lead or how action will unfold. *“Once we had decided the basic materials, we tried many possible combinations in lab. Even when presenting some at the international trade show, we were not sure about the final results....”* (A1’s president).

In all cases, there exists also a constant trend to dissatisfaction, which does not apply a negative sense or a rejection of the present state, but a constant need for something new and different. By doing this, the organization is articulating a future state of the reality it wants to achieve, inducing action in its members by making explicit the distance between current reality and vision (Senge, 1990). Teamwork and collaboration supports other’s leads.

Improvisation supports the birth of the sensing processes, while it then turns to expression of many dimensions of all three dynamic capabilities such as the business model delineation, effective communication, decentralization and co-specialization (Teece, 2007).

### **Transcendental Capability**

Improvisation and bricolage capabilities, although fundamental, are not adequate to support KIE in TLT sectors, especially in turbulent environments. The actual and main question of KIE focuses on why and how TLT entrepreneurs create new opportunities. A novel idea within the everyday company's course can succeed or fail with all known consequences. But the introductory to the entrepreneurial ecosystem idea, where the new venture will challenge a place and a share, is decisive for its survival or the straightforward entrepreneurial "death".

In entrepreneurship literature there is a common acceptance that entrepreneurs think differently and see new opportunities where most others see either a benign environment or even emerging threats (Alvarez and Busenitz, 2001). This capacity is due to *the transcendental capability (TC)*, the ability to see beyond symptomatic solutions (Senge, 1990) and come up with an innovative opportunity, beyond the simplistic combination of pieces of knowledge, derived from any point of the value chain.

In order to go beyond stereotyped solutions, certain kinds of knowledge enlarge the sphere of an individual's / organization's judgments beyond the limits of experience. And it is in this very kind of knowledge which transcends the world of the senses, and where experience can neither guide nor correct, that TC enables investigation in a variety of fields- be them knowledge, empirical or of other types-, which by their importance can be considered far more excellent and by their tendency far more elevated than anything common entrepreneurial practice can find in the sphere of common entrepreneurial phenomena. This is precisely the meaning of KIE in TLT sectors, as well as the reason of why and how it is successfully applied through a variety of means, processes and mechanisms.

Entrepreneurs form by anticipation genuine concepts which do not relate immediately to the object but for the use of conscious rational processes instead of the use of empirical origin. This cognitive capability has to determine the origin, the extent, and the objective validity of knowledge and is derived by Transcendental Capability. This ability facilitates a path carving within chaos, limiting any "deals" with the laws of market / technology and business understanding and reason in so far only, as they refer *a priori* to set objects, as well as both the empirical and the pure knowledge of existing sources – internal or external. It forms the specific difference between KIE and plain entrepreneurship, enacting all mechanisms needed to allow unexplored knowledge paths and produce innovative business concepts. Entrepreneurs further exercise original choices and syntheses and create business concepts through such imaginative mental *a priori* acts.

Here lays the answer to questions such as: How do entrepreneurs create forward-looking concepts and knowledge intensive novel combinations? The fruits of TC are the only ones that can permit a newcomer to be established in an already hard and seemingly saturated market environment, entice customers, deliver value to them and persuade them to pay for value. TC enacts the mechanism of risking rather anything, even at the peril of error, than that one should surrender such investigations, either on the ground of their uncertainty, or from any feeling of contempt.

TC holders develop *a priori* knowledge which is transcendental, or based on the *form* of all possible experience, while the rest lay on *a posteriori* knowledge which is empirical, based on the *content* of experience. They resemble Copernicus who revolutionized astronomy by changing or reversing the point of view and taking the position of the observer into account.

Transcendental capability enables the ability to cognize the nature of what is going to offer competitive advantage according to *a priori* principles, to paradoxically thinking. It recognizes and analyzes all resources of knowledge and its abilities that lead to knowledge – based entrepreneurial results by a constant interplay between the adjustment of the objectives to the abilities and the adjustment of the abilities to objectives making use of the “Copernican Turn”. It is responsible and the driving force for the initialization of sensing and seizing, while it is the main cause of reconfiguration, in terms of constant alignment and realignment of assets.

## Conditions

Within the AC framework, knowledge does not depend so much on the object of knowledge as on the capacity of the knower. Within the existing chaotic knowledge system an organization needs to have a constant sensation of where it is and where it wants to go, a type of “knowledge strategy”. This task involves the thorough determination of its cognitive situation and the search for ways that lead to objective knowledge. In order to position themselves and prepare to take off, agents have to (1) start from a higher sphere of entrepreneurial being, and (2) make sense of the entrepreneurial landscape spaciousness. Our research revealed that all asked entrepreneurs and organizations fulfilled both.

In traditional sectors markets seem saturated and innovation is not easy. Globalization and trade liberalization make spaciousness in traditional business seem utopian. Most entrepreneurs tend to protect themselves from emerging threads and changes. On the other hand, at the founding process space is limited to the agents’ experience and knowledge. Efforts turn to low price strategies, faster deliveries for bulky products (e.g. furniture – a last bastion that fell after IKEA’s smart idea) or locality (e.g. fresh milk and feta cheese).

Cognition of space leads to conscious efforts to widen ranges and scopes. *Spaciousness* is the conscious excess of the limited “known” because of the existence of the unlimited “unknown” which stimulates forward looking thinking and shapes visions. It enacts the two



other autotelic capabilities in order to cause expansion, enrich experience and locate gaps and opportunities. It depends on the agents' attitudes and cognitive capabilities. Actually it is the entrepreneurs' sense of spaciousness that defines the width and the quality of sources to seek, resources required and combinations made.

Entering a *higher sphere of entrepreneurial being* denotes the ability to have a panoramic view of global markets, value chains and inter-sectoral industry potential. Inspirations come from complex data retrieved by multiple sources and alternative directions and surpass the mere defensive attitudes of survival through common strategies. Entrepreneurs of the sample admitted to have started out of the tight local and sectoral limits, recognizing connections among different input and translating information in novel ways so that their outcomes could inspire new ways of thinking. A9 company started by seeking reasons in global markets for transforming traditional Greek products into gourmet delights, while A1 and A5 engaged in a search of science to overcome simplicity and add value to similar products.

In traditional sectors there are core rigidities in both innovating and market shares, which seem unimportant or do not even exist in high tech sectors. Advances in ICT are welcomed but innovative food is treated with suspiciousness. Entrepreneurs have to anticipate that their ideas and judgments will be confirmed; otherwise the new idea will result in early death. Likewise, Casson notes that: 'The entrepreneur believes he is right while everyone else is wrong.' (1982) but this is not a feeling of superiority but a result of judgment.

In the framework of autotelic capabilities the dimension of judgment and the evaluative concept based on knowledge, specify the above conditions under which a concept in question is acceptable and realizable with some degree of confidence. According to Penrose (1959) "astute entrepreneurial judgment goes beyond vivid imagination, good insights, and self-confidence". It also involves "organization of information-gathering and consulting facilities within a firm, and leads into the whole question of the effects of uncertainty on, and the role of expectations in, the growth of firms" (in Korr *et al.*, 2007). Judgment brings together understanding and sensibility, hence concepts and ideas by making difficult decisions in a short time frame with imperfect data.

## Discussion

Literature has so far emphasized the risk-protection function of dynamic capabilities in response to exogenous shocks (Newey and Zahra, 2009) and their recognition as a potential source of achieving and sustaining competitive advantage in established organisations (Teece et al, 1997; Eisenhardt and Martin, 2000; Zollo and Winter 2002; Zahra et al, 2006), failing to consider or question whether these capabilities can sustain the birth of a new company. Literature has further neglected the significant amount of low tech SMEs while KIE is still in its infancy although there is a rich literature regarding high tech and technology based sectors.

The present exploratory study which initially intended to explore KIE as a central transformative mechanism for low tech sectors i.e. find out what KIE can mean in the context of low-tech sectors and which specific characteristics it has, turned to surprising results regarding the strategic side of entrepreneurship. It proved not only the existence of dynamic capabilities in low tech established companies, but also the existence of a capabilities' set which seems to be vital for the birth of KI low tech ventures.

KIE opportunities within the low-tech sectoral system are very seldom and hard to identify. Thus, ACs enable the breaking of the barriers of established developmental paths by selecting new knowledge and technologies that stand out from the resources of the existing sectoral systems, such as scientifically generated knowledge. Using improvisation they combine and recombine knowledge, resources and opportunities in order to alter the existing business and question the entrance of new products, processes or services.

The transcendental capability is a totally novel concept which explains "*how*" innovative knowledge intensive concepts are built in order to offer the competitive starting advantage. TC in coexistence with bricolage and improvisation capabilities creates the entrepreneurial platform for innovation. Autotelic capabilities allow the transcendence through non convenient but rather functional ways. Knowledge and transcendental thinking presupposes consequence of opinions and beliefs, as well as communication. Reasonable grounding can refer to future conditions and aspirations and thus this ability to ground reasoning under future parameters constitutes the distinctive difference among success and failure in KIE at least in TLT sectors.

KIE's definition is also a first attempt to imprint this key socio-economic phenomenon that drives innovation and economic growth within the framework of low tech sectors. KI companies are involved in the economy as mechanisms to translate knowledge into innovation which can be radical or incremental but in any case will facilitate entrance to a complex and rather hostile business ecosystem.

Improvisation and bricolage have been treated till now as concepts, mechanisms, media, or just activities of an organization. The present research reveals that they are both more than that; they are integrated structured capabilities. The results are among the first in literature to confirm their existence in low tech sectors and their role in the founding process and the company's strategy.

The development of the ACs concept contributes to the literature on strategic management, dynamic capabilities and entrepreneurship, in several ways. Our definition and description of ACs and their role for new entrants into the competitive game of so – called saturated markets challenges multiple aspects of research and theory grounding. Our approach highlights the major problem of new venture creation under the scope of strategic management and expands the capabilities view to both corporate and knowledge intensive entrepreneurship. It further shifts focus from high tech to low tech which due to path

dependences and mostly incremental innovations have been almost ignored, as well as towards SMEs which constitute the majority of companies in Europe.

ACs framework further bridges the gap between opportunity discovery and creation or knowledge exploitation and implementation, engaging a real time interaction among them through bricolage and improvisation. Adding the transcendental capability we try to answer the “how” questions on new venture creation based on knowledge, innovation and new path creation.

ACs can also be considered as an extension of the dynamic capabilities framework. Although they may start as individual capabilities, they soon turn to organizational ones, being embedded in systems and the new venture’s culture. Although the mechanisms of their embeddness have not been studied yet (and this is a suggestion for further research) they do become expressions of dynamic capabilities, since they can be recognized among their microfoundations. This is a new direction for the dynamic capabilities framework, since there is some new insight on the origins, the content and the transformation of DCs depending on the stage of the company.

Daring a comparison to the radical changes that high tech introduces in an increasingly faster pace, ACs allow a potential of altering industries even in low tech sectors. The so called traditional food sector has lately embraced biochemistry and biotechnology, denoting novel relationships among new stakeholders. ACs facilitate new networks and alternative and transcendent ways of knowledge combination in order to create viable and novel business opportunities. The conditions described above of spaciousness and an overall knowledge of the entrepreneurial landscape allow for a good manipulation of potentials, resources and opportunities.

### **Implications for Practice**

Several implications for entrepreneurs or top managers arise from this study. Strategy in the early stages of firm development appears to be difficult to address with traditional, analytical management approaches (Boccardelli and Magnusson, 2006). The ACs framework facilitates the start of any new knowledge –based venture in low tech sectors. It underlines the importance for entrepreneurs to balance the three autotelic capabilities that provide competitive advantage when crafting their strategies which is missing from the relevant literature so far.

Cognition and experimentation, planning and improvisation go hand in hand in order to be novel and flexible and offer the new in the shape of the familiar. An exaggerated focus on building core competencies such as dynamic capabilities at the very early stages of a venture may be dangerous, as such a focus applies for known markets, something which may apply to an established firm, but not when entrance denotes changes and innovation.

The framework will help entrepreneurs / managers to consider the individual components of the cognitive process, the rules, resources and skills necessary to achieve initial competitive advantage. Yet, the transcendental capability will make them consider paradox thinking, see beyond the simplistic combination of pieces of knowledge, which may come from any point of the value chain. They actually need to create new knowledge and information, from the inside out, “in order to redefine both problems and solutions and in the process, to re-create their environment” (Nonaka and Takeuchi, 1995).

### **Implications for Theory and Future Research**

The concept of Autotelic Capabilities is a first attempt to connect corporate, knowledge intensive and strategic entrepreneurship, regarding the emerging stage of venture creation and the initial competitive advantage. This new theory is not offered as *a fait accompli*. Further theoretical and empirical research is needed to establish the existence of ACs, tighten the framework, describe dimensions and their measures and construct a compact and comprehensive relevant theory which would act as an umbrella of the few but fragmented existing theories on low tech entrepreneurship and further explain KIE where theory is still in its infancy.

The study has certain limitations. First, it is based on a grounded method approach to formulate the theory from data collected in thirty companies in low tech industries. Despite the fact that this methodological approach provides an opportunity for rich data collection and theory development and the fact that thirty cases is a considerable number, it still imposes some limitations on the findings. Second, the findings from this research do not confirm a theory but create a theory, which is limited to companies participating in this research. Hence, it requires for follow-on study using the framework to test the findings and evaluate the theory and also provide in-depth detail on the phenomenon.

Researchers should also show how ACs are related to dynamic and operational capabilities, and try to watch and describe the mechanisms of their embedness and existence as expressions of the dynamic capabilities. Some other areas of research would be the evaluation of the relationship between ACs and performance, whether ACs exist in high tech and the determination of the conditions under which ACs are effective.

The fields of strategy, entrepreneurship, innovation, knowledge and organizational behavior, manufacturing and business management should be engaged in order to unlock the riddles behind the term of KIE in low tech sectors. The autotelic capabilities framework comprises a rather aspiring research agenda. The framework advanced can help scholars understand the foundations of KIE in TLT sectors and assist agents delineate strategic decisions, actions and priorities.

Besides the new framework, the present research introduced the upgrade and integration of bricolage and improvisation into second order strategic capabilities under the umbrella of the

autotelic capabilities. More evidence is needed through field research in both high and low tech SMEs.

## Conclusion

We have sketched a mere synopsis of the autotelic capabilities approach, a first attempt to touch the unexplored strategic side of the entrepreneurial start up activity in low tech sectors within the notion of knowledge intensive entrepreneurship. This exploratory research has set the existence of the autotelic capabilities framework as critical to understand the origins of KIE at least in low tech sectors, based on thirty samples of knowledge intensive firms of three main traditional sectors, “born” in the contemporary turbulent business ecosystem. We have highlighted the importance of ACs in the achievement of initial competitive advantages for KI low tech enterprises; this explanation together with the attempt to define KIE in low tech sectors adds to the literature of both entrepreneurship and strategic management. We have further defined the conditions under which autotelic capabilities can flourish and stimulate novel knowledge intensive venturing that promises survival and competitiveness. We have also drawn some attention on the existence of dynamic capabilities in low tech firms and their emanation by the autotelic ones, which is to our knowledge the first attempt to examine their existence in low tech arenas. Our discussion sets an agenda for research on several issues and invites future empirical examinations of how KIE is established in both low and high tech sectors as well as relations and interactions among autotelic and dynamic capabilities.

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**BIRDS OF A FEATHER FLOCK TOGETHER: THE RELATIONSHIP BETWEEN  
LEADER-FOLLOWER SELF REGULATION CONGRUENCY, LMX, AND  
ORGANIZATIONAL COMMITMENT**

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**Abstract**

Recently, there has been growing interest in understanding the influence of leaders on followers as a process related to followers' identity and self-concept (e.g., Kark and Shamir, 2002; Kark and Van Dijk, 2007; Lord and Brown, 2004; Lord, Brown, and Freiberg, 1999). Substantial research on leader-member exchange (LMX) has contributed to the understanding of leader-follower (or supervisor-subordinate) relationships (Gerstner and Day, 1997; Graen, 2006). Though substantial research has indicated that building high quality LMX has beneficial effects on the well-being of the dyad and on work and organizational outcomes, limited attention has been devoted to understanding how such relationships develop (House and Aditya, 1997; Wang, Law, Hackett, Wang, and Chen, 2005). Kark and Van Dijk (2007) have linked the theory of leadership with the theory of self-regulatory focus (SRF; Higgins, 1997), and recently they have focused on the relationships between the theory of LMX with the theory of SRF (Kark and Van Dijk, 2008).

**Keywords:** Self regulatory focus, leadership, LMX, organizational commitment

**Introduction**

The current study examines the effect of self-regulation congruency between leader and follower on leader-member exchange (LMX), and follower's organizational commitment. Based on Self Regulatory Focus theory, two types of leader-follower dyads were identified: A congruent dyad, in which both leader and follower are holding the same regulatory focus (i.e. both of them are promotion-focused; both of them are prevention-focused) and a non-congruent dyad, in which each of the dyad's parts hold different regulatory focus (i.e., promotion-focused leader with prevention-focused follower and vice versa).

We hypothesized that leader-follower dyads with congruent SRF will be characterized by higher LMX in comparison to non-congruent dyads. We also hypothesized that the dyad's congruency will affect follower's level of commitment to the organization. Finally, we hypothesized that the effect of the dyad's congruency on organizational commitment will be stronger among high LMX dyads than among low LMX dyads.

## Summary of hypotheses

H1. Congruent dyads (promotion-promotion; prevention-prevention) will experience higher quality of LMX than non-congruent dyads (promotion-prevention; prevention-promotion).

H2. Congruent dyads (promotion-promotion; prevention-prevention) will experience higher levels of follower's organizational commitment than non-congruent dyads (promotion-prevention; prevention-promotion).

H3. LMX will moderate the effect of congruent versus non-congruent dyads on organizational commitment: Specifically the effect of dyad's congruency on commitment will be stronger when LMX is high as compared with low LMX.

## Method

A total of 122 workers consisting 61 dyads of managers and their direct subordinate were sampled. The manager's sub-sample consisted of 33 males and 28 females. The overall mean age was 40 years (range 23 to 65), their seniority in management positions ranged between 1 to 35 years (mean=5.4, *SD*=5.6), and their mean education (years) ranged between 12 to 23 (mean=15.7, *SD*=2.0).

The subordinates sub-sample consisted of 27 males and 34 females. The overall mean age was 33.5 years (range 21 to 62), the majority (64.5 %) had no management experience, and their mean education (years) ranged between 7 to 20 (mean=14.8, *SD*=2.5).

Managers responded to a questionnaire that included measures of Self Regulatory Focus (Lockwood, Jordan, and Kunda, 2002), and Leader Member Exchange (Liden and Maslyn, 1998). Subordinates received the same measures and one more additional measure for subordinate's Organizational Commitment (Meyer and Allen, 1991). Consistent with the suggestion of Gerstner and Day (1997), data on the LMX was collected from both sources, managers and subordinates. In the introductory page of the questionnaires, the participant's confidentiality was guaranteed. Participants got the questionnaire via e-mail or personally.

## Results

In contrast to our prediction, the congruent dyads were not characterized by higher quality LMX compared to the non-congruent dyads. Thus, H1 did not confirm. The sum of LMX for each type of dyad's congruency is summarized in Table 1.

In accordance to our prediction, the levels of commitment were higher in the congruent dyads compared to the non-congruent dyads, for affective and normative commitment but not for continuance commitment. Table 2 summarizes the means of commitment types (affective, normative, continuance) according to four types of dyads congruency. A demonstration of the effect of dyad's congruency on organizational commitment is presented in Figure 1a (affective commitment) and Figure 1b (normative commitment).

Also as predicted, for affective and normative commitment, the results show that manager's LMX moderates the congruence-commitment relationship. Specifically, the relationship between leader-follower congruency and follower's commitment is higher when the LMX (perceived by the manager) is high. This interaction effect is presented in Figure 2a (for affective commitment) and in Figure 2b (for normative commitment).

## **Discussion**

The results presented in the current paper could further our understanding of the underlying mechanisms of leader-follower dyadic relationship and self-regulation congruency. They indicate that congruency in SRF does not effect the level of LMX. However, in situations in which there is high level of LMX congruency can contribute to organizational commitment. LMX can develop based on other aspects, such as gender, life history, professional background or other characteristics. When a high quality relationship develops than fit becomes more meaningful and moderates certain outcomes. Future researches should further examine the hypotheses using a larger sample and conceptualizing promotion and prevention regulatory focus nt only as a stable characteristic, but also as a situational variables. It should also focus on other outcomes (organizational identification, employees well being and performance). Implications for theory and practice will be further discussed.

Table 1: LMX Quality in four groups of Congruent and Non-congruent Dyads

	Promotion-focused Subordinates		Prevention-focused Subordinates	
	Promotion focused Managers (Congruent) n=17	Prevention focused Managers (Non Congruent) n=15	Promotion focused Managers (Not Congruent) n=9	Prevention focused Managers (Congruent) n=20
LMX Perspective				
Subordinates				
Mean	5.58	5.65	5.03	5.43
Sd	1.16	0.86	0.95	0.85
Managers				
Mean	5.53	5.57	5.55	5.14
Sd	0.73	0.58	1.09	0.87

**Table 2:** Organizational commitment means and standard deviations in four groups of Congruent and Non-congruent Dyads

	Promotion-focused Subordinates		Prevention-focused Subordinates	
	Promotion focused Managers (Congruent) n=17	Prevention focused Managers (Non Congruent) n=15	Promotion focused Managers (Not Congruent) n=9	Prevention focused Managers (Congruent) n=20
Organizational Commitment				
Affective				
Mean	3.99	3.67	3.63	4.07
Sd	0.71	0.49	0.73	0.73
Continuance				
Mean	2.95	2.83	3.64	3.75
Sd	1.05	0.73	1.45	1.21
Normative				
Mean	3.60	3.33	3.31	4.03
Sd	1.13	0.96	0.81	1.06

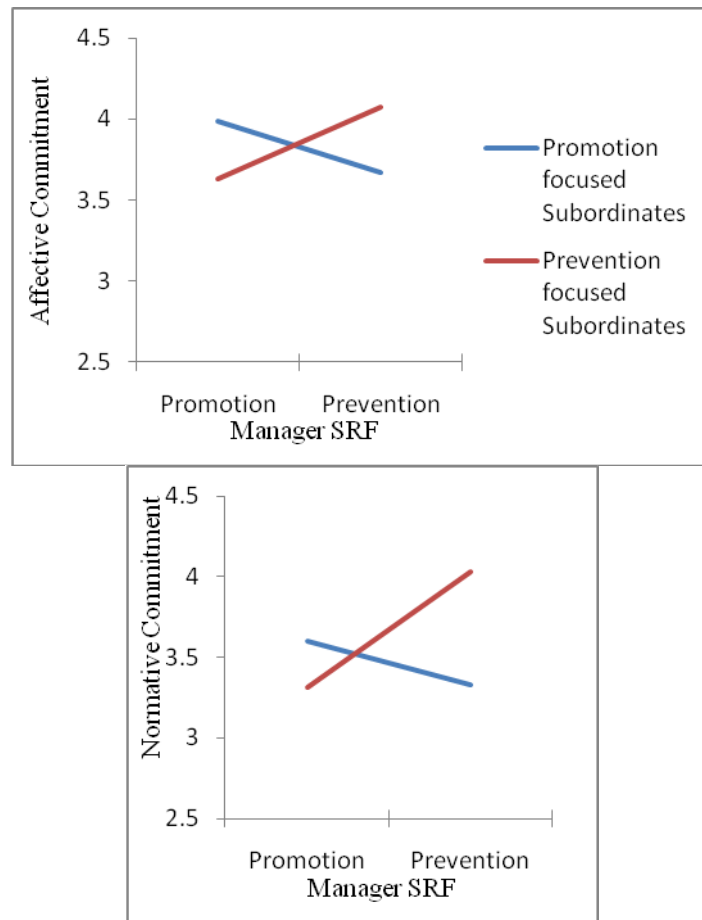


Figure 1a.

*Affective Commitment as a function of Manager and Subordinate SRF in Dyads, (N=61).*

Figure 1b.

*Normative Commitment as a function of Manager and Subordinate SRF in Dyads, (N=61).*

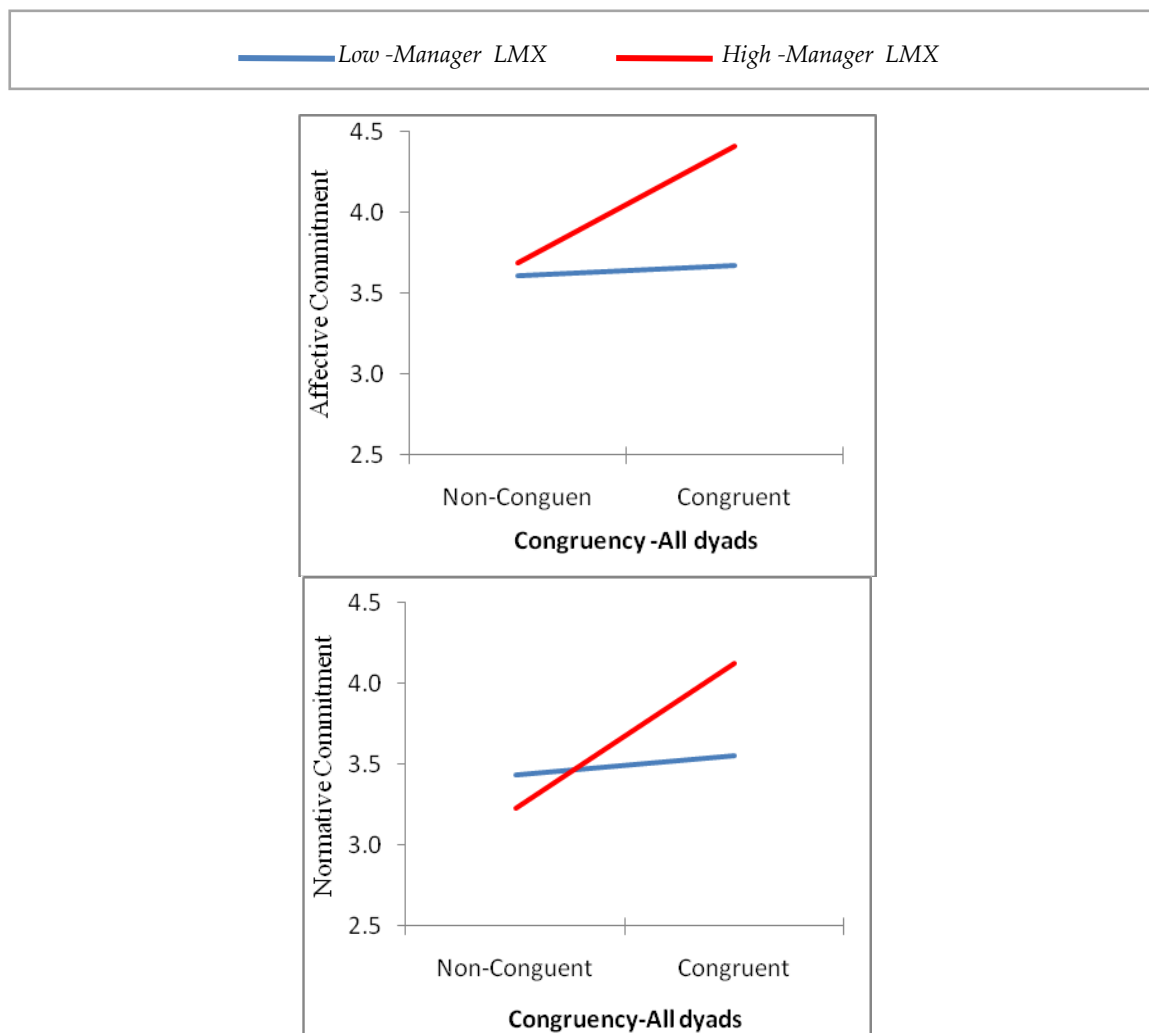


Figure 2a. Moderating role of LMX Manager on Congruency and Affective Commitment. (N=61).

Figure 2b. Moderating role of LMX Manager on Congruency and Normative Commitment. (N=61).

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## THE IMPACT OF BUSINESS CONDITIONS TO FRANCHISING IN CATERING SECTOR IN LITHUANIA

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### Abstract

Franchising is a very popular business development form in the world, especially in service sector. However, it is not widely used in new EU member states, such as Lithuania, and other developing countries. Therefore, the aim of this article is to analyze prevalence of franchising in Lithuania and potential of its usage among Lithuanian capital companies operating in catering sector. It is determined that franchise system has five main elements and all process of franchising business system establishment, which consists of four steps, is influenced by four groups of factors: marketing, management, legislative and human. To find out the situation of franchising business in Lithuania a questionnaire survey of Lithuanian capital companies operating in catering sector was carried out based on the model of franchise system development created by article authors. Seven assumptions about unfavourable business conditions were tested and six were found to be unsupported. Results of investigation revealed that these companies have a strong potential to develop their businesses using franchising, however, it is not mainly the business conditions that stop the use of franchising. The main obstacles are: the lack of knowledge about intellectual property protection and foreign markets, lack of unique and exclusive business ideas and strong brands, as well as lack of information about franchising as a business development form.

**Keywords:** franchising, internationalization, business development, catering sector, contractual business relations.

### Introduction

Franchising as a business development form dating back more than one hundred years and in last decades franchising popularity extremely increased due to intensive processes of globalization, because all customers seek for the same well-known brands and quality (Mendelsohn, 2004a, Alon, 2006; Blair, Lafontaine, 2005).

In Lithuania as in the whole world franchising is the most popular in services sector. However, only 0.2 % of the whole catering sector companies in Lithuania operate in franchising mode, whereas only 0.02 % of all companies in Lithuania operate in franchising mode (according to the data of Lithuanian statistics department in 2009). Therefore, it can be stated that franchising is very poorly extended in Lithuania.

However, franchising as a business development form is very relevant in the context of international business environment, especially for such a small country as Lithuania. Thus, the aim of this article was to determine current situation of franchising in Lithuania and potential prevalence of franchising among Lithuanian capital companies operating in catering sector.

### **Franchising system development model**

Development of franchising business consists of particular steps, starting from favourable conditions for the system to emerge (Mendelsohn, 2004b), intention and ability of franchisor to form franchise based on his business (Ehrmann, Spranger, 2007a; Sherman, 2004; Windsperger, Clinquet, 2007), then the establishment and initial development of franchising system and its further functioning. It is determined that business can be expanded using franchising if it has well-known brand (Sherman, 2004; Mendelsohn, 2004a; Blair, Lafontaine, 2005; Combs et al, 1994) business performance is successful (Windsperger, Clinquet, 2007; Tuunanen, 2007; Sherman, 2004; Majocchi, Pavione, 2002) and can be formed into clear system (Blair, Lafontaine, 2005; Sherman, 2004; Mendelsohn, 2004a; Ehrmann, Spranger, 2007b; Perrigot, Clinquet, 2007). Also when brand and other intellectual capital of the company are secured by legal system and laws (Mendelsohn, 2004b), business owner does not have sufficient financial resources for independent business development (Ehrmann, Spranger, 2007a) and/or quite big differences of potential market exist (Windsperger, Clinquet, 2007). Finally, potential franchisees have to exist, who would be interested in particular franchise (Sherman, 2004; Majocchi, Pavione, 2002).

Six areas influencing franchising business development conclude the model: elements of franchising, process of franchising development and functioning, management, marketing, legislative and human factors. Those franchising elements are the most important factors influencing franchising system, whereas management, marketing, legislative and human factors are their supplements. All these factors in one or another stage of franchising establishment and/or development influence franchising system and determine its successful and effective growth. Franchising cannot exist without its main elements, whereas all other factors are at some level necessary to determine good operation of the system.

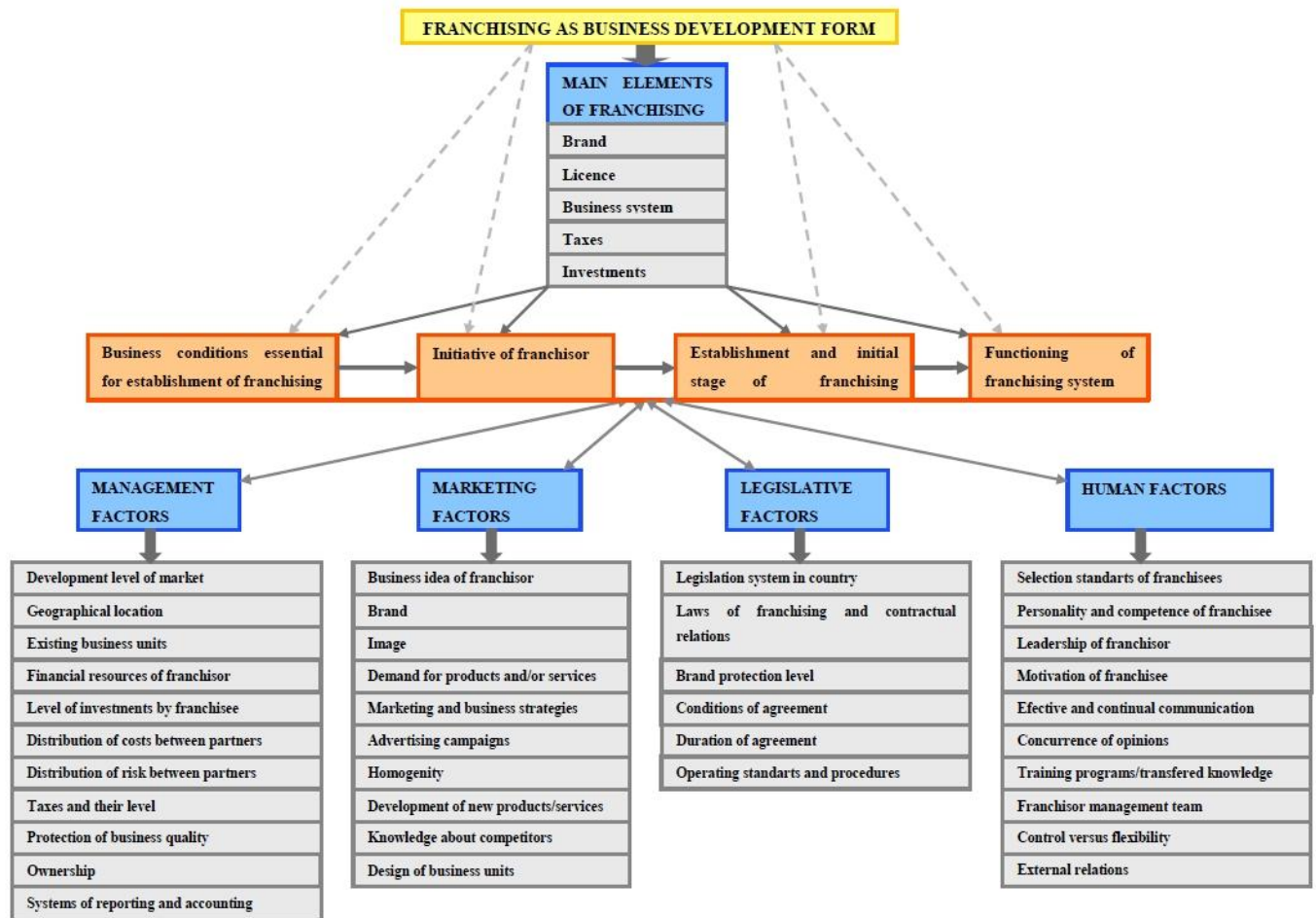


Fig 1. Franchising system development model  
(Prepared by the authors)

## Methodology of research on franchising business situation in Lithuania

The goal of empirical research was to determine current situation of franchising in Lithuania and potential prevalence of franchising among Lithuanian capital companies operating in catering sector. Quantitative research method was chosen, therefore questionnaire was designed and research was carried out from 7<sup>th</sup> of May to 18<sup>th</sup> of April, 2010 according to the factors named in the model (Fig. 1). Current franchising situation in Lithuania was investigated from the perspective of franchisor. During the investigation only Lithuanian capital companies (one respondent per company) that have a potential to use franchising in the future were analyzed, because establishment of new business units and therefore growth of Lithuanian companies is very positive expression for economy in Lithuania. The problem defined in the goal of empirical research was analyzed by verifying seven **assumptions**.

Lithuanians lack entrepreneurship, also the market of Lithuania is very small and the biggest part of Lithuanian capital companies are small or middle size, so they can be managed from one operating center.

*P1 Small market of Lithuania is negatively related to tendency to develop business independently, therefore, it is no need to use such business development forms as franchising.*

The main problem of Lithuanian capital companies is the lack of financial resources, because these companies do not have enough cumulated finances to operate successfully if demand for goods and services disconcerts.

*P2 Due to lack of financial resources, Lithuanian capital companies do not want to expand their business, especially to foreign markets.*

Lithuania lacks well-known global level brands, because main part of Lithuanian capital companies are oriented towards the local market and due to their small scale cannot dedicate big financial investments to increase popularity of their brands.

*P3 Lithuanian brands are not known because companies almost do not invest into their brands.*

Big part of customers in Lithuanian are sensitive to prices, so they choose suppliers of goods or services firstly by the price and are characterized as not loyal and with unstable demand.

*P4 Business is not suitable for development using franchising because it does not have stable demand for its production and has little loyal clients.*

The main characteristics of Lithuanian capital companies is their small scale, limited to one or two business units, usually without long term strategy and standards to ensure business quality.

*P5 Lithuanian capital companies cannot form their business model and propose it for the potential buyers because they do not have homogenous business units' style, business standards and quality requirements.*

Many of Lithuanian capital companies are orientated towards the local market, therefore are limited only to local market perception and do not analyze events influencing business environment on the global scale.

*P6 Perception of advantages and disadvantages of franchising by Lithuanian businessmen are in line with their perception about business environment they are operating in.*

Companies in Lithuania lack confidence and cooperation between each other, especially during negative economic situation.

*P7 In case of franchising, when relations between franchisor and franchisee are so intensive, franchisors are not minded to trust other company that can influence their business negatively, because there is lack of confidence among all business partners and clients in Lithuania.*

In 2009 (Lithuanian Statistics Department) there were 2769 companies in catering sector in Lithuania, but there is no exact number how many of them were in Lithuanian capital only. Therefore with 95 % probability and 10 % error 93 companies in total had to be surveyed. Companies for the survey were

selected using convenience sampling method (*Pranulis, 2007*), therefore only companies that could be reached by email were surveyed and the counted number (93 in total) was used only as orientation for determination of the total amount of respondents. In public information resources 450 different emails of Lithuanian capital companies operating in catering sector were gathered, to which the link to the questionnaire was sent. In total 95 appropriate answers of the Lithuanian capital companies operating in catering sector were collected.

### Survey instrument

Questionnaire consisted of five blocks. The first block identified particular business area of the company, background of capital and business size. The second block determined respondents experience and opinion about franchising as business development form. The third block determined the specificity of respondents business taking into account management, marketing, legislative and human factors. The fourth block revealed opinion of the respondents about franchising advantages and disadvantages and the most important characteristics of potential franchisee. Finally the fifth block of the questionnaire identified demographic characteristics of respondents and function in the company. *Cronbach alpha* coefficient was used to evaluate reliability of the questionnaire, which was very high for the whole questionnaire (0.938).

### Results

Investigation revealed that only 7 out of 95 respondents had business units abroad. 63% (N=60) of the respondents managed only 1 business unit (Table 1). Respondents represented only small and middle enterprises, as 40% (N=38) of them had up to 10 employees and 52% (N=49) of them had from 10 to 50 employees. Quite young respondents were surveyed, as even 50% (N=48) of them were 20 – 30 years old. Distribution of the respondents according gender was quite equal, 52% (N=49) of men and 48% (N=46) of women were surveyed. Even 81% (N=77) of the respondents had higher education, in addition 13% (N=12) had unfinished university education which can be explained by their young age. 64% (N=61) of the respondents had top occupation in the company, 43% (N=41) of them were the owners or shareholders of their company and 21% (N=20) were the top managers. The fact that most of the surveyed companies were small or middle size and had quite small amount of employees, so the owners or shareholders of these companies also work in them and were surveyed during this research, was realized before the survey.

*Table 1. Characteristics of survey respondents  
(Prepared by the authors according survey results)*

Characteristics of survey respondents	Options of the answers	Distribution of the answers
Number of company business units	1 2 3 – 5 >5	63% 18% 15% 4%
Number of company employees	Up to 10 10 – 50 50 – 250	40% 52% 8%
Distribution of respondents by age	20 – 30 30 – 40 40 – 50 >50	50% 32% 15% 3%
Distribution of respondents by gender	Men Women	52% 48%
Distribution of respondents by education	Higher university education Higher non university education Unfinished university Professional education Secondary education	66% 15% 13% 3% 3%
Status of respondents in company	Owner/Shareholder of the company Top level manager Middle level manager Specialist	43% 21% 17% 19%

#### **Evaluation of possibilities of Lithuanian capital companies operating in catering sector to develop their business using franchising**

In Figure 2 statements divided into different groups according to assignation to particular business function are represented. All of these statements were valued by the respondents in 7 points scale from “totally disagree” to “totally agree”. Neutral position “neither agree, neither disagree” was valued by 4 points. Mean of every statement evaluation and means for separate categories of business factors were derived.

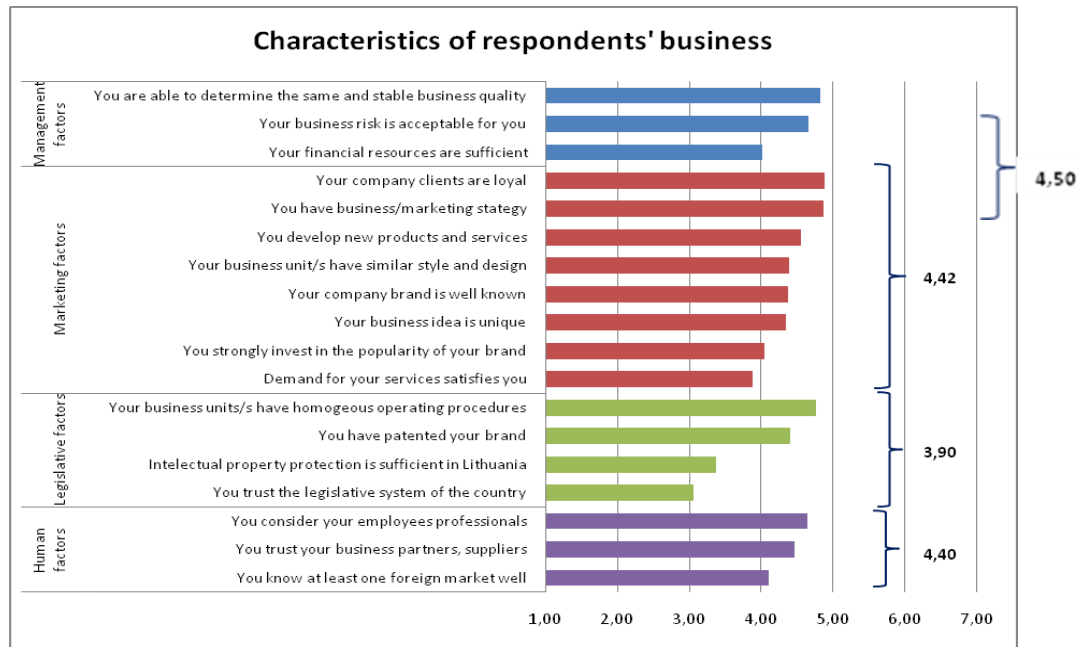


Fig. 2 Characteristics of business in the companies where respondents work  
(Prepared by the authors according to the survey results)

Therefore, it can be stated that respondents worstly evaluated the legislative factors related to their company environment, as their total mean is only 3.9 points. In the field of legislative factors, legal scheme and laws related to protection of brand are more applicable to franchisor, that legal and safe franchising business operation could be determined. Worstly in this category respondents evaluated legal system of the country (3.05 points) and that Lithuania has sufficient intellectual protection (3.37 points). Generally, even 68% (N=65) of the respondents did not trust the legal system in Lithuania, 18% (N=17) neither trusted nor did not trust and only 14% (N=13) of them trusted the legal system in Lithuania. However, the other two statements related to internal legislative factors of company, particularly that respondents have patented their brand and their business unit/s have homogenous operating procedures were evaluated more positively (respectively 4.41 and 4.76 points). On principle, potential franchisor cannot expand his business using franchising if he has not patented his brand before hand, because it is necessary to patent the brand in case of franchising. Only 47% (N=45) of the respondents had truly patented their brand. Conclusively, it can be stated that only a little less than half of the respondents patented their brand, but more than a half of them had homogenous operating procedures that could allow for almost half of them to develop their business using franchising immediately, but the other half should patent their brand before hand. After estimating the correlation between legislative factors (Table 2), it can be stated that correlation is the most significant between trust in legal system and sufficient intellectual protection (coef. 0.552, when  $p=0.01$ ). This means that trust in external legislative factors and sufficient intellectual protection are related, and the more legal system of the country is trusted, the more trusted is the level of intellectual property protection.

Table 2. Correlation between legislative factors (Spearman coefficient)  
(Prepared by the authors according to survey results)

	Your business units/s have homogenous operating procedures	You trust the legislative system of the country	Intellectual property protection is sufficient in Lithuania	You have patented your brand
Your business units/s have homogenous operating procedures	1.000			
You trust the legislative system of the country	.365(**)	1.000		
Intellectual property protection is sufficient in Lithuania	.347(**)	.552(**)	1.000	
You have patented your brand	.220(*)	.016	-.048	1.000

\*\* When two-sided correlation significance is less than 0.01

\* When two-sided correlation significance is less than 0.05

Group of marketing factors (Fig. 2) was evaluated more positively than negatively (on average 4.42 points) by the respondents. Business idea, brand and its popularity of potential franchisor business can be assigned to the most important marketing factors because they determine if particular business can be attractive for franchisees. However, these factors were evaluated just slightly positively, respectively 4.34, 4.37 and 4.05 points. Therefore, it can be stated that for the respondents their business idea did not seem totally unique or exceptional, their brand was only slightly known, but they invested to popularize their brand only on average. As the brand is one of the five main elements of franchising, it can be stated that only 51% (N=48) of the respondents had well-known brands, so they could expand their business using franchising, but the remaining part of the respondents should additionally invest to make their brand more attractive for potential franchisees. However, in this case the respondents evaluated popularity of the brand, so it is possible that they evaluated their brand popularity better than it is really known in the market. Strategic business/marketing plan is one of the main factors enabling the development of franchising system. In this case the respondents stated that they had business/marketing strategy (4.87 points). The other essential factor is demand for the goods and services of franchisor, because it determines the attractiveness and possible business success. However, this factor was evaluated the most negatively of all marketing factors, on average 3.88 points. It was determined by the fact that equal number of respondents stated that they are satisfied and unsatisfied by demand to their services (particularly over 37%, N=35). And even more than one quarter of the respondents stated that they were neither satisfied, nor unsatisfied by the demand for their services. Other very important factor related to demand is loyalty of clients. However, in this stage some contradiction emerged, because most of the respondents stated that their clients are loyal (4.88 points). So this fact shows that although part of the respondents are not satisfied by demand of their services, but remaining clients are quite loyal, so the



respondents have to increase the amount of loyal clients to expand their business using franchising successfully. Homogenous style and design of business units determines that franchisor is able to expand all franchising system by the same principle. This factor was evaluated by the respondents more positively (4.39 points), because slightly more than half of them (53%, N=50) confirmed that they were able to determine homogenous style and design of their business units. However, almost one third of the respondents stated that they were not able to determine homogenous style and design of their business units, which is a very big disadvantage for business development in franchising mode when all business units have to be the same or very similar. Respondents more positively (4.56 points) evaluated the statement that they develop new products or services. After assessment of correlation between marketing factors (Table 3), it was determined that among most of them medium or at least weak positive relation existed. Therefore, it can be stated that by improving some of marketing factors in company, other marketing factors also improve because their development usually is carried out in complex and depends on the efforts of the particular company.

Table 3. Correlation between marketing factors (Spearman coefficient)  
(Prepared by the authors according to survey results)

	Your business idea is unique	Your company clients are loyal	Demand for your services satisfies you	Your business unit/s have similar style and design	Your company brand is well known	You strongly invest in popularity of your brand	You have business/marketing strategy	You develop new products and services
Your business idea is unique	1.000							
Your company clients are loyal	.225(*)	1.000						
Demand for your services satisfies you	.508(**)	.392(**)	1.000					
Your business unit/s have similar style and design	.262(*)	.186	.252(*)	1.000				
Your company brand is well known	.179	.235(*)	.161	.362(**)	1.000			
You strongly invest in popularity of your brand	.284(**)	.233(*)	.467(**)	.215(*)	.511(**)	1.000		
You have business/marketing strategy	.094	.437(**)	.383(**)	.256(*)	.064	.303(**)	1.000	
You develop new products and services	.570(**)	.381(**)	.405(**)	.343(**)	.259(*)	.286(**)	.421(**)	1.000

\*\* When two-sided correlation significance is less than 0.01

\* When two-sided correlation significance is less than 0.05

Group of human factors (Fig. 2) was also evaluated slightly more positively than negatively (on average 4.40 points) by the respondents. Human factors influence both franchising business partners similarly. In this case, respondents agreed more that they consider their employees as professionals and trust their

business partners and suppliers (respectively 4.64 and 4.46 points). Trust and ability to select appropriate employees allow us to make an assumption that potential franchisor will be able to select appropriate franchisees for their business. External relations determine effective operation of business and later of all franchising system, therefore are very important for franchisor. However, respondents evaluated their knowledge about foreign markets the most poorly compared to other human factors (particularly 4.11 points), although it is a necessary factor for expanding business abroad. Though, almost half of the respondents (46%, N=44) stated that they had the knowledge about at least one foreign market, but even 38% (N=36) of them stated that almost or totally did not have any knowledge about foreign markets. That is a very big disadvantage for potential business expansion using franchising.

Respondents evaluated group of management factors the best compared to other business factors (Fig. 2). These factors influence both business parties. Because whether franchisor evaluates the market positively and sees any possibilities to expand there using franchising also depends on the management factors. Existing franchisor business units show if business is successful and has potential to operate in franchising mode. Therefore, the statement related to this fact was evaluated the best among other management factors, particularly 4.82 points. Other very important management factor is risk tolerance, which was also evaluated very positively (4.66 points). This means that business risk is acceptable for the respondents so it can also be acceptable for potential franchisees. The last management factor is financial resources of franchisor, which have to be sufficient for business development. However, in this case the respondents evaluated their financial resources only on average (4.01 points) because the answers of respondents split almost equally, 43% of respondents stated that their financial resources are sufficient for business development (43%, N=41), whereas even 39% (N=37) of them stated that their financial resources are not sufficient for business development. Therefore, it can be stated that if financial resources of a company are not sufficient for business expansion, franchising business system cannot be formed and proposed in franchising mode as initial financial investments are requested. However, if amount of financial resources is average in the company, it can still have enough money to form franchising system and then expand business by using franchising, because it requires much lower amount of money than developing business alone. After assessment of correlation of management factors, it should be stated that all management factors had positive relation with each other.

### **Verification of research assumptions**

After empirical investigation was carried out and results were evaluated, verification of seven research assumptions can be done.

First research assumption (P1) – WAS NOT CONFIRMED. Because 57% (N=54) of the respondents stated that they see possibilities to expand their business in Lithuania, and only 32% (N=30) neither agreed, nor disagreed with this statement. This means that a part of Lithuanian capital companies operating in catering sector that see possibilities to expand their business abroad, also still see some possibilities in Lithuania. Therefore, it can be stated that Lithuanian capital companies for business

expansion can use business development form, like franchising, both: in Lithuania, and in foreign markets. What is more, when asked about real plans of business development, 51% (N=48) of the respondents agreed with the statement that they plan to expand their business in Lithuania in the next 2 years. It is also approved by positive correlation between three statements: that small Lithuanian market stimulates business development in Lithuania; that respondents see some opportunities for business development in Lithuania; and that they even plan to do that in the next 2 years (Table 4).

Table 4. Correlation between business development factors (Spearman coefficient)  
(Prepared by the authors according survey results)

	Small market in Lithuania induces to expand business in Lithuania	You intend to expand your business in Lithuania during the next 2 years	You see possibilities in the market of Lithuania to expand your business
Small market in Lithuania induces to expand business in Lithuania	1.000		
You intend to expand your business in Lithuania during the next 2 years	.250(*)	1.000	
You see possibilities in the market of Lithuania to expand your business	.359(**)	.594(**)	1.000

\*\* When two-sided correlation significance is less than 0.01

\* When two-sided correlation significance is less than 0.05

Second research assumption (P2) – WAS NOT CONFIRMED. Because despite the fact that 39% (N=37) of the respondents did not agree with the statement that their financial resources are sufficient for business development, 43% (N=41) of them stated that their financial resources are sufficient for business development. And although just 26% (N=25) of the respondents planned to expand their business in foreign countries, even 51% (N=48) planned to do that in Lithuania. Thus, limited financial resources did not discourage Lithuanian capital companies operating in catering sector to plan their business expansion.

Third research assumption (P3) – WAS NOT CONFIRMED. Because 51% (N=48) of the respondents stated that their brand is well known, and 36% (N=34) of them agreed with the statement that they invest into their brand. Although even 38% (N=36) of the respondents neither agreed, neither disagreed with this statement, it can be stated that despite the fact, that only average level of Lithuanian capital catering sector companies investment into the popularity of the brands, they are quite well-known. However, it should be pointed out that the evaluation of the popularity was rather subjective, as it was made by the representatives of the companies.

Fourth research assumption (P4) – WAS NOT CONFIRMED. Firstly, 65% (N=62) of the respondents stated that their clients are loyal, but their opinions about the demand for their services differed, because equally 37% (N=35) of the respondents agreed and disagreed with the statement that demand for their

services satisfies them. Therefore, it can be concluded that Lithuanian capital catering sector companies have their loyal clients but their number is not satisfying, so the companies have to invest resources to increase the number of loyal clients and this way overall demand for their services, and only then think about business expansion in franchising mode.

Fifth research assumption (P5) – WAS NOT CONFIRMED. Because the respondents agreed with all three statements: that their business units have homogenous style and design (53%, N=50), that their business units have similar procedures and operations (56%, N=53) and that they are able to ensure the same and stable business (68%, N=65). This means that Lithuanian capital companies operating in catering sector are able to ensure condition of their business and business units' homogeneity, so they are able to form their business model and propose it to potential franchisees.

Sixth research assumption (P6) – WAS NOT CONFIRMED. No significant difference was observed between the answers of the respondents which agreed and disagreed that franchising is a perspective way of business development. Because in total 60% (N=57) of the respondents stated that their business is influenced by events from both: Lithuania and rest of the world and even 53% (N=50) of them stated that franchising is a perspective way of business development. Therefore, it can be stated that Lithuanian capital companies operating in catering sector evaluate franchising as business development form positively and understand that they operate not only in Lithuania, but also in global market.

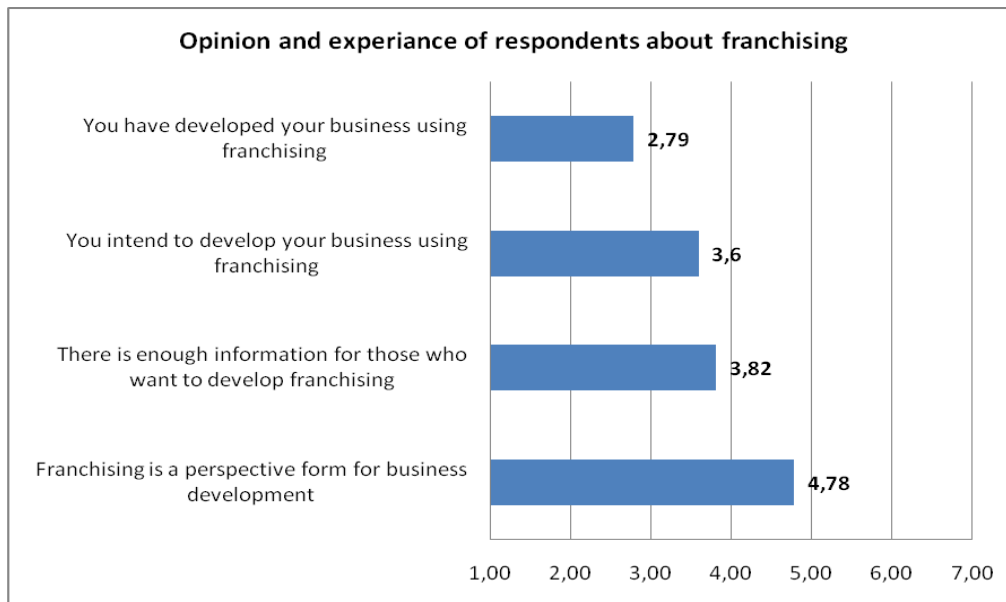
Seventh research assumption (P7) – WAS CONFIRMED. Respondents agreed with statement that conformity of franchisees interests with interests of franchisor is an advantage (80%, N=76), also 61.1% (N=58) of them confirmed that possibility of not conformed interests is a disadvantage of franchising. Also weak correlation was observed between these factors (coef. 0.232, when  $p=0.05$ ). However, the respondents stated that they rely more on their business partners and suppliers (61%, N=58). Therefore, it can be stated that Lithuanian capital companies operating in catering sector do not lack trust for their business partners, but they understand how important the conformity between interests of franchising business partners is, because it can determine fluent development of particular business.

Even six out of seven assumptions were not confirmed, therefore it can be stated that before the investigation it was thought that business conditions and factors are worse among Lithuanian capital companies operating in catering sector than they really are.

#### **Knowledge level and opinion about franchising of Lithuanian capital companies operating in catering sector**

In order for businessmen to make decision to develop his business using franchising, he has to be introduced to this business form and evaluate it positively. Even 17% (N=16) of the respondents stated that they have expanded business using franchising. However, respondents who only were interested in possibility buying franchise of foreign company also could have answered positively, so this statement should be evaluated critically.

Only 25% (N=24) of the respondents stated that they are minded to expand their business using franchising and even 31% (N=29) of them neither agreed, nor disagreed with this statement, so it can be stated that either they have not made a decision yet or they are not aware about advantages and offered possibilities of this business development form. This statement can be confirmed by the answers of the respondents to another statement. Only 35% (N=33) of the respondents stated that they have enough information how to develop franchising business system, and even 41% (N=39) of them more disagreed with this statement. So it can be stated that approximately half of Lithuanian capital companies operating in catering sector lack information about franchising business development form, therefore do not consider using it for their business expansion. Although, it can be stated that franchising is considered as a perspective business development form, because the respondents agreed with this statement (4.78 points). In general, only 9% of the respondents disagreed with this statement. Answers to the question, in what market would the respondents expand their business if they were using franchising, divided equally (40%, N=38) between the options "Lithuania" and "Lithuania and foreign markets". Only 11% (N=10) of the respondents stated that they would expand their business starting from foreign markets. therefore, in general it can be stated that although some of the Lithuanian capital companies operating in catering sector think that franchising is perspective business development form, but due to lack of information and experience are not minded to use it for their business development (Fig. 3).



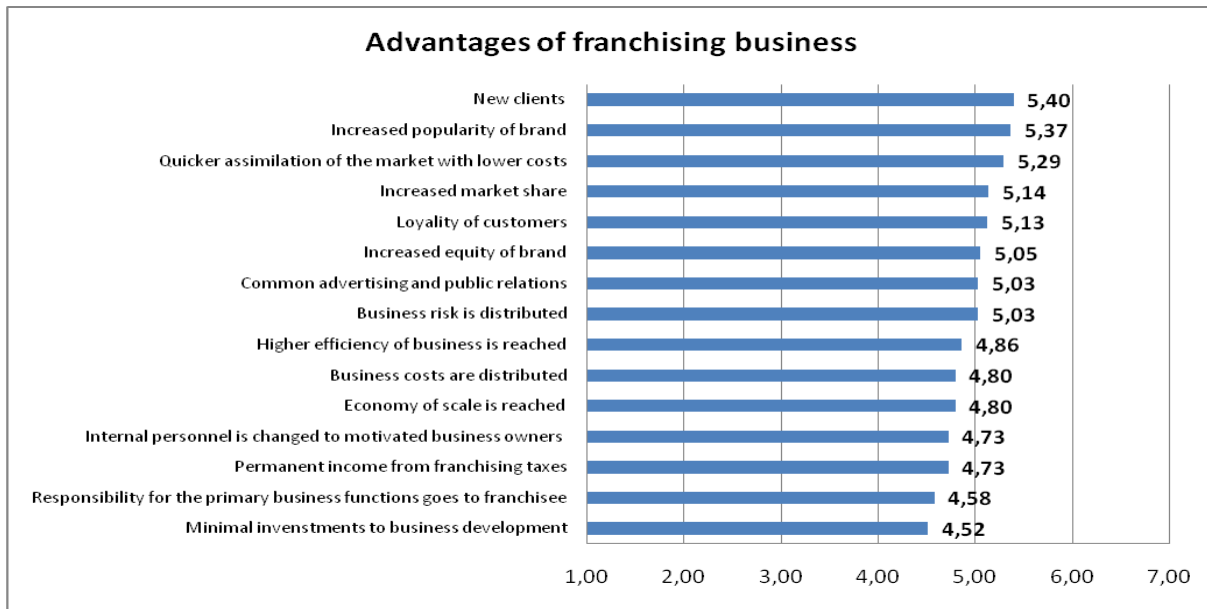
**Fig. 3 Opinion and experience of respondents about franchising (means)**

*(Prepared by the authors according to survey results)*

**Main advantages and disadvantages of franchising for Lithuanian capital companies operating in catering sector**

For the businessmen to decide to expand his business using franchising, he has to admit that franchising as business development form has more advantages than disadvantages and the existing advantages make it superior against other ways of business development. Therefore, it is very important to find out what advantages of franchising are marked by Lithuanian capital companies operating in catering sector. Respondents got fifteen advantages of franchising (Fig. 4), which they had to evaluate. In general, all of them were evaluated more positively than negatively.

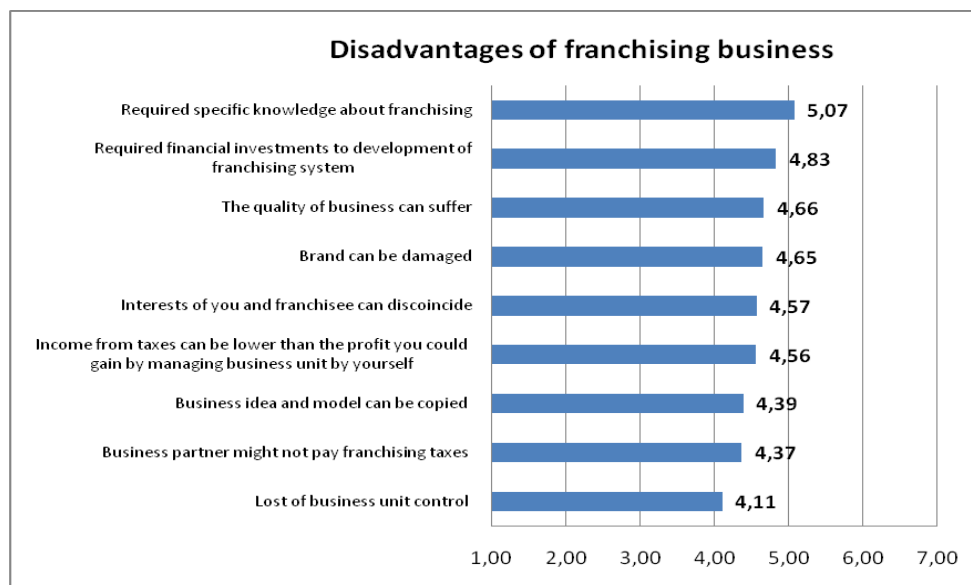
New clients and increased brand popularity were determined as the biggest advantages of franchising (respectively 5.4 and 5.37 points) by the respectively 79% (N=75) and 75.4% (N=72) of all respondents. This fact conforms to the main advantages of franchising determined in scientific literature. Further advantages rated by the respondents were ability to attract new clients much quicker and with fewer resources and to increase market share through the new business units of franchisee (respectively 5.29 and 5.14 points). Clients' loyalty (5.13 points) is also related to the mentioned advantages, as the loyalty increases when clients can find catering unit in a convenient place, as increases the popularity of brand they are loyal to, similarly as increased value of brand (5.05 points). Further, the respondents more agreed that unified advertising and public relations are advantage of franchising (5.03 points). Other advantages of franchising, like increased operating effectiveness (4.86 points), shared business costs (4.80 points), achieved economy of scale (4.80 points) were evaluated more moderate, as they can be achieved not only using franchising. And such specific factors as change of internal personnel to motivated business owners (4.73 points), permanent income from taxes (4.73 points), transfer of responsibility of primary business factors were evaluated the as average because lack of information about the advantages of franchising and its superiority against other business forms. By this fact also the lowest evaluated statement about required minimal investments into business development (4.52 points) can be explained, because investments depend on new business unit establishment place, size and other specific factors that might significantly differ in separate cases. Therefore, even 29.5% (N=28) of the respondents neither agreed, nor disagreed that this is advantage of franchising. However, in general it can be stated that Lithuanian capital companies operating in catering sector evaluate advantages of franchising positively and think that franchising is a perspective form for business expansion.



**Fig. 4 Advantages of franchising business (means)**

*(Prepared by the authors according survey results)*

Every business development form despite its advantages has some disadvantages, which can be the reason for not using it. Therefore, the respondents had to evaluate nine disadvantages of franchising as business development form (Fig. 5). Six of nine were evaluated as more or less important, but such factors as loss of business control, possibility that business partner might not pay franchising taxes and possibility that business idea might be copied were evaluated as neither important, nor unimportant (respectively 4.11, 4.37 and 4.39 points). However, both factors related with finance were allocated as more important. Almost half of the respondents (49.5 %, N=47) stated that possibility that income can be lower when acquired from taxes than when earned by themselves from the particular business unit (4.56 points) is disadvantage. And even 63.2% (N=60) stated that financial investments for the establishment of franchising system is also a disadvantage (4.83 points). It can be related to the fact that 39% (N=37) of the respondents stated that their financial resources are not sufficient for business development, therefore any financial investments or possibility to receive less money seem as a disadvantage for them. Respondents also stated that inadequacy of interests is a very important disadvantage of franchising (4.57 points). Also respondents were afraid that when business control is delegated to a different person, their business quality might suffer and some harm might be made to their brand (respectively 4.66 and 4.65 points). However, these losses might be avoided if suitable franchisee is selected and franchising agreement is appropriately made, as these are very important steps in the establishment of franchising system. Finally, as the biggest disadvantage of franchising, according to 66.2% (N=63) of the respondents is the required specific knowledge about franchising (5.07 points). It can be related to opinion of the respondents where 41% (N=39) of them disagreed with the statement that there is enough information about development of franchising.



*Fig. 5 Disadvantages of franchising business (means)  
(Prepared by the authors according survey results)*

## Conclusions

Lithuanian capital companies operating in catering sector have a strong potential to develop their businesses using franchising, because the business conditions are favoring and not hindering for it. These companies understand what kind of motivated person should franchisee be and how important it is that his interests conform to interests of franchisor. In addition, they positively evaluate almost all advantages of franchising business, especially when they are related with business development, popularity of brand and new clients. However, they objectively understand the disadvantages of franchising, especially when they are related to the financial side of business development and possibility to harm business. Nevertheless, as the main disadvantage they mention specific knowledge required for usage of franchising, as well as some other obstacles, like lack of knowledge about intellectual property protection and foreign markets, and lack of unique business ideas and strong brands. Therefore, not so much the business conditions have impact on franchising in Lithuania's catering sector, as the lack of education and information about franchising. Therefore, additional investments of education of Lithuanian capital companies operating in catering sector about development of franchising business could help in making this business development form much more popular.

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## LEARNING NETWORK FOR DEVELOPMENT: A THEORETICAL FRAMEWORK

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### Abstract

Learning is of strategic importance and this is confirmed by many researchers. But learning and development can be organized in a wide range of forms. Roughly, these can be categorized into three groups: a top-down planning strategy, a bottom-up driven activation strategy and a network-based learning strategy. Research has shown that learning in networks is more efficient than other types of learning, especially when the traditional forms of inward looking development concepts such as "Business Process Reengineering", "Total Quality Management", proved less successful.

In this paper we develop a theoretical framework for a research project in which we will study a learning network for development. The purpose of the project is to increase knowledge and understanding of how learning networks work and what is needed for a development oriented learning network. We also want to explore the possibilities and difficulties in working in a learning network. The issues underlying this study are the following:

- How does learning take place in a learning network?
- What makes a learning network function efficiently?
- What opportunities and difficulties are associated with work in a learning network?

The empirical basis for this investigation is a case study focusing on a learning network in Uddevalla, Sweden. In the study we use a number of complementary approaches for data collection.

**Keywords:** Learning, Network, Development, Learning Network, Inter organisational learning

### Introduction

We live in an ever changing and dynamic world. The changes are often very rapid and dramatic, which increases demands for development and change in all social institutions. Here, learning is of strategic importance and this is confirmed by many famous scientists.

Porter for example argues that price is no longer critical to business competitiveness, but the ability to create opportunities for learning and skills is important for the competitiveness of an organisation (Porter, 1990). Drucker believes that the importance of the traditional factors of production such as labor, land and capital for the welfare of a society has declined, and "the only - at least, the main - producer of wealth are information and knowledge" (Drucker, 1993). A number of Swedish researchers also show that learning is of great importance to innovation and development within companies, organizations, and regions (Svensson, Jakobsson & Åberg, 2001; Bergh, 2006; Holmquist, 2010).

But learning and development can be organized in a wide range of forms. Roughly, these can be categorized into three groups: a top-down planning strategy, a bottom-up driven activation strategy and a network-based learning strategy (Svensson & von Otter 2000). These strategies have been used in parallel, but we can also see an evolution over time, where the activation strategy has been popular for several decades. More recently, interest in the network-based learning approach has increased (Svensson, Jakobsson & Åberg 2001). Research has shown that learning in networks is more efficient than other types of learning, especially when the traditional forms of inward looking development concepts such as "Business Process Reengineering", "Total Quality Management", proved less successful (Holmquist, 2010).

The network based approach has proved to have a range of benefits and opportunities. It is flexible and facilitates development oriented learning of the actors. The approach provides the actors with a development competence which enable them to quickly respond to the increased demands of flexibility that society places on organizations. This does not mean that the network strategy is without difficulties. It is considered difficult to control, focus and to build broad participation. Furthermore the results of the strategy are difficult to measure (ibid). However, research has shown that the above mentioned problems can be overcome and that the strategy can be used successfully in development work. The network-based strategy significance has increased with time and it is used more and more. But for the network to function a development oriented creative learning is required (ibid). But what characterizes the development oriented learning?

Ellström distinguish development oriented learning and reproductive adaptation oriented learning from one another (Ellström, 2003). The adaptation oriented means that the individual learns things from given data, goals and conditions without questioning them. In the development oriented, creative learning, however, the individual is assumed to have a questioning, critical approach both to his own habitual behaviour, attitude, and knowledge to the task or situation that he or she faces. The task is thus to learn to deal with complex situations and problems. The first step here is not to develop and propose a solution, but rather to identify and define the situation, task or problem (ibid).

To enforce development requires an understanding of learning and the learning processes in the network and how learning leads to the development that the network, and the members of the network are aiming for (Svensson, Jakobsson & Åberg 2001). In order for a development-oriented learning to be implemented there must be a solid base - a "platform" - that the networking can rest on. Trust, equal relationships, time and resources, external support and feedback are mentioned as some important conditions for an effective learning process (ibid). Floren & Tell also mention three conditions (Prerequisites) for learning in a network (Floren & Tell, 2004). These are: reciprocity, the receptive and confronting capacity of learning actors and transparency in the dialogue among the learning actors.

Erschammar (2000) also mentions a number of factors that he believes are crucial for the effectiveness when a partnership is built, for example the vision, knowledge transfer, and continuity of the network.

The above description shows the importance of development in today's society and the importance of learning networks. It also shows that learning networks are associated with opportunities, but also a number of difficulties. To make the most out of the opportunities the learning networks can provide us with we need to have development oriented learning networks.

### **Purpose and research questions**

The purpose of this study is to increase knowledge and understanding of how learning networks work and what is needed for a development oriented learning network to operate. We also want to explore the possibilities and difficulties in working in a learning network. The questions underlying this study are therefore the following:

- How does learning take place in a learning network?
- What makes a learning network function efficiently?
- What opportunities and difficulties are associated with work in a learning network?

### **Methodology**

The empirical basis for this investigation is a case study focusing on a learning network in Uddevalla city in Sweden. In the study we use two complementary approaches for data collection. We use a combination of interviews and participation in various scheduled network meetings as the basis of our data collection. The method is based on a hermeneutic approach in which discussions with the interviewees are subject to interpretation.

The research approach behind this paper can be described as "abductive" (Alvesson & Skoldberg 1998). One way to do a case study with an abductive approach is called "systematic combining" (Dubois & Gadde, 2002). Systematic combining can be described as a non-linear, path dependent process of combining efforts with the ultimate objective of matching theory and reality. The case and the theoretical framework concurrently evolved through a process

where new empirical findings directed the search for theoretical concepts, and where the use of new theoretical concepts conversely directed the empirical field work (Dubois & Gadde, 2001).

### **Network-based learning strategy**

In today's society there is an increasing need for development and renewal of all organizations and regions as a result of the changes occurring in all parts of the society. A change that we cannot stop, but we can manage and influence. The literature suggests a number of strategies for development and renewal.

Angelöw distinguishes between three different strategies of development. In the top-down approach management defines the problem, initiate change and implement it. In the representative approach representatives for the groups concerned, together with the built upon that all participants are involved in all phases of strategic planning. (Angelöw, 1991).

Svensson & von Otter also mention three different strategies: a top-down planning approach, a bottom-up driven activation strategy and a network-based learning approach (Svensson & von Otter, 2000). The network-based learning strategy is a combination of the activation strategy and a broad voluntary collaboration between different entities with common interests. Here the governance is horizontal and the management consists of the coordinator. The strategy is used when projects are more open, when the target and the expected outcome is not as clear as in for example the planning strategy. The objectives can be different for instance various forms of cooperation between enterprises, to improve the climate for innovation or to contribute to regional and local development, etc (Svensson & von Otter, 2000).

The driving forces of the social institutions of today suggest that the network strategy has some advantages, when compared with the other two strategies. The strategy can offer a range of possibilities (ibid):

- It is flexible, which means that the working arrangements and activities quickly can adapt to external changes and internal needs.
- Development and distribution are process oriented and handled in parallel. The spread of experience is facilitated by that the participants early come into contact with each other.
- When many actors cooperate economies of scale are provided, increasing the development capacity and reducing vulnerability.
- The cooperation is demand driven, thus it is based on the perceived problems and actual situation of the participants, which makes networking concrete and result oriented.
- It stimulates development oriented learning. The open and flexible way of working facilitates creativity and innovation.

- The cooperation is horizontal and is based on voluntary participation, equal relationships and exchange of experience.

- The potential to exploit external knowledge is increased and it is easier to organize cooperation on an equal footing.

- The ability to achieve more fundamental change is increasing. A network-based approach involving key stakeholders can have greater impact.

But there are also a number of difficulties with a network approach. Awareness of how these can be handled is important for a network to function effectively. The literature mentions the following difficulties (ibid):

- It is often argued that the network is an effective method to strengthen the development capability, but it is difficult to show that this is the case, and show concrete results.

- One difficulty is the vagueness and ambiguity about the purpose, methods and results.

- The division of responsibility is unclear. Ideas and proposals are arising - but who implement them?

- A major weakness is the representativeness. A few participate. There is no broad-based participation.

- The feedback is hard and difficult to control and focus. There is also a risk that the network is limited to confirmation, namely that the network participants make up a closed club, and thus the risk that the development to stop at the personal level increases.

But despite the above mentioned difficulties, the network approach has proved to have the advantage that the actors involved acquire a development expertise. This is resource building and provides an organizational learning, which gives a network the ability to respond quickly to growing demands for adjustment and renewal (Svensson , Jakobsson & Åberg 2001). But to utilize the potential of the network strategy and to understand the learning process, we need to bring clarity to the concepts of networks and learning networks.

## **Networks and Networking**

Network is not a new word. Today it is used in many contexts and can have different meanings. Earlier there was much talk about collaboration, but in the early 1990's the word network became more commonly used. Some claim that the reason for this was the changes in the laws of competition in the United States made during the 1980s making it easier for firms to cooperate (Utbult, 2000).

But there are those who argue that the concept dates back to 1950, then used in particular treatment contexts to develop supportive relationships between vulnerable individuals. (Svensson, Jakobsson & Åberg, 2001).

Despite this long history, the network remains a vague and ambiguous concept. The word can be used to describe relationships within the family or neighbourhood as well as within grand organisations or between states. This multi clarity and vagueness of the term implies, as mentioned above, problems for both practitioners and researchers.

Some argue that the concept expresses a perspective rather than a well defined concept. But whereas Gustavsson & Hofmaeir claim there is no idea to attempt to define the concept or to try find a general definition of the term (Gustavsson & Hofmaeir, 1997). Svensson, Jakobsson & Åbery recommend that the concept in different contexts at least should be made clear. (Svensson, Jakobsson & Åbery, 2001).

Utbult refers to Axelsson and distinguish between synthetic and organic networks. The former is considered to be organized and consists of a group of actors coming together to achieve a certain goal. The latter however, is disorganized, spontaneously emerging and difficult to identify. The boundaries of the exchange are not always clear, and those covered by the network may not even be aware of or understand that they are a part of a network structure (Utbult, 2000).

Lind categorizes network in four different areas or perspective (Lind, 2002):

- Network as a perspective
- Network as a specific social phenomenon
- Network as a research method
- Network as an organizational development strategy

It is the last of the above perspectives we are interested in this investigation and we are therefore trying to see how this area is treated in the literature. Network development approach is a conscious strategy or technique, which aims to change something. Here, the participants set mutual goals, or perhaps a policy regarding how a development project will be implemented and there is an emphasis on learning. Here we can distinguish between different directions: those who study networks within and between large organizations (Gustavsen & Hofmaier, 1997), those who study networking small businesses (Utbult, 2000; Svensson, Jakobsson & Atkins, 2001) and the literature that attempts to provide practical advice and tips of how networks can be formed (Network of Education and Development, Swedish National Quality and Development, 2003).

The view of networks as a strategy for development and skills is therefore an approach which seeks to develop everything from individuals, organizations and regions (Lind, 2002). The growth of this perspective is mainly due to the increased need for enterprise development. Here the network form is seen as a process that promotes this. The actors can join together in networks to support and develop skills. In this perspective, the networks are a number of autonomous organizations that together can help each other to achieve a

development or an objective that would not be possible for each one separately (Smith, Jakobsson and Åberg 2001). Dalsgaard & Bendix mean that many companies and organizations are working in a network model without having put a label on their work processes and identify sex characteristics for the network organization (Dalsgaard & Bendix 1998).

- Shared values, ie. common values (norms, morals, ethics)
- Decentralization, which means that small units are built up and will have responsibility and influence.
- Complex leadership roles, where for example a person can be a manager of a colleague, but in another context, the roles are reversed.
- Flexible organizational boundaries. The players use each other's knowledge as well that of external partners to benefit from such a large information and knowledge flow as possible.
- High degree of interdependence. Employees must admit the mutual dependent to each other both inside and outside the organization to promote both cooperation and competition.
- Transparency. Transparency about who takes care of the financial resources, objectives and results.

There is a wide range of literature which discusses what networking is and what the differences are between networks and non networks . There is no need to go further in this discussion. We therefore provides one example of such literature (Network of Education and Development, National Quality and Development, 2003) and end the debate on the network here and go over to the other central concept namely learning and learning processes in network.



### Network and project group - differences

#### Network:

- Controlled on the basis of the members common professional aspirations, the members set the agenda
- Self-Organized, based on relationships between individuals
- Voluntary membership
- The group evaluates its own activities
- The group will choose who / which ones to take leadership tasks (leadership may rotate among the leaders and spread over several people)

#### project group

- Controlled on the basis of a formal mission, a mission that someone from the outside ordered the group
- Is part of the formal organization structure, part of the rules of procedure
- Membership is included in the individual's work (and the individual cannot always choose whether you want to participate or not)
- The group is evaluated against the objectives that have been decided in the formal organization
- The formal organization appoints the leader and give him / her authority and responsibilities

*Source: Nätverk för lärande och utveckling, Statens kvalitets- och kompetensråd, 2003*

Above, we had a discussion regarding network-based development strategy in which learning had an important role in the development of the network. But what is learning, and what distinguishes learning from the education?

### Learning and Learning Network

Education is often used to achieve development, but it has been shown that development cannot be organized by education and with top-driven methods, but it can be stimulated by developing targeted learning processes. It is therefore more appropriate to talk about learning and learning process instead of education (Svensson, Jakobsson & Åberg 2001).

In development processes learning precedes the change itself. Thoughts, beliefs and values change leading to new activities and actions. But learning can involve a variety of things and aspects (Holmquist, 2010). It can be seen as a part of the activities we engage in, which means that the behavior is the focus of learning. Learning and action are two sides of the same thing. Learning will thus depend on the actions we perform (Svensson, Jakobsson & Åberg, 2001; Holmquist, 2010).

The literature distinguishes between a development-oriented and an adjustment-oriented learning (Svensson, Jakobsson and Åberg). The development-oriented learning means that

individuals themselves take responsibility for identifying, interpreting, formulating and challenging the task, and the feasibility for this (ibid.)

But how does learning in a network work and how does the learning process look? In an article Louise Knight distinguishes between learning network and network learning. She believes that this distinction is important for the understanding of the learning process in an inter-organizational context. She describes these two concepts as follows (Knight, 2002):

“Network learning is learning by a group of organizations as group. If, through their interaction, a group of firms change the group’s behavior or cognitive structures, then it is the group of organizations that is the learner, not just individual organizations within the group. In such a case, the network can be said to have learnt.”

“The second subject closely associated with network learning is learning networks- groups of organizations that interact with the express purpose of learning together, from another and through their interaction”.

To describe the learning process in 14 network projects Svensson, Jakobsson and Åberg used the American philosopher John Dewey's model of development and learning. The focus of the model is the individual's learning, but Svensson et al used the model for describing learning in a number of networks. In the model, learning is perceived as a movement forward, from habitual behavior through problem definition, analysis and understanding into action. It is the behavior which is the focus of the model. Learning and action are seen as two sides of the same thing. Learning will depend on the actions we perform. The behavior of an organization in a network promotes learning and thereby innovation and development.

Svensson, Jakobsson and Åberg mean that the networking project that they have examined could be described in terms of Dewey's model. But they mean that some of the networks had more than others a learning process that consisted with the model. Nevertheless they argue that the model provided a framework to structure the description of the learning process in the different learning networks. What they mean is that learning occurs more effectively in an unstructured manner which may not necessarily conform to the model. They also feel that the learning processes as they attempted to portray worked in several different ways, the starting point might be different, many learning processes was going in parallel, and that some process was interrupted. Despite these differences they mean that the model on the whole worked well.

During the last decade researchers have developed different models to study the learning process in a learning network (Bergh, 2006; Holmquist, 2010). In order to understand the learning process in this study we will use all of these models as a ground for our study

### **Prerequisites for learning**

As we mentioned above learning is a process consisting of a number of steps. But a development oriented learning process requires a solid foundation, a platform that

networking can rest on. Svensson, Jakobsson & Åberg identify four building blocks: trust, equal relationships, time and resources and external aid (Svensson, Jakobsson & Atkins, 2001). But in a study of 14 network projects they find that there is need for additional building blocks. These are ; motivation and curiosity, clear objectives and performance criteria. They also find that structuring the first meetings provide security and support (Svensson, Jakobsson & Aberg, 2001).

Floren & Tell also believe that there must be a number of prerequisites for learning in a network (Floren & Tell, 2004). They also emphasize the importance of trust for learning especially in the so-called "higher-level learning, development-oriented learning, or what Argyris & Schore calls for double-loop learning.

Holmquist particularly stresses the importance of two concepts in terms of knowledge sharing in learning networks. One is the strategy and the other is absorption. He argues that network participation is needed as an important condition to be put in a larger strategic context in order not to be a temporary activity. He also emphasized that the absorption is a key issue. Without a good absorption capacity the network performance could not be maximised to its full potential . He also mentions that there are a number of factors that influence this ability. Ershammar also mentions a number of factors that he believes are essential for an effective collaboration (Ershammar, 2000). These are; the network's vision, knowledge transfer, tempo and continuity, communication within the network and reward methods

Bergh gives the following recommendations to those involved in inter-organizational learning networks (Brgh, 2006)

- Be prepared to invest time and energy in the participation in the network
- Try to get others involved
- Be active when the program for the network is formulated

## Conclusions

The purpose of this paper was to develop a theoretical framework to study a learning network. The framework shows that a network-based development approach has proved to have a range of benefits and opportunities. It is flexible and facilitates development oriented learning of the actors. The approach provides the actors with a development competence which enable them to quickly respond to the increased demands of flexibility that society places on organizations. But the network strategy is not without difficulties. It is considered difficult to control, focus and to build broad participation. Furthermore the results of the strategy are difficult to measure. However, research has shown that the above mentioned problems can be overcome and that the strategy can be used successfully in development work. All this according to literature and research in the area. In the continuous reserach we

want to use these theories as a base to see how a learning network for development in the city of Uddevalla, Sweden works.

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## INTEGRATION OF RUSSIAN BUSINESSES INTO THE WORLD ECONOMY

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### Abstract

The article contains analysis of Russian companies expansion to global markets and integration into the World economy. It shows major Russian players in international business, identifies some important problems which limit opportunities for Russian companies for efficient development overseas, compares Russian companies' expansion overseas to the same activity of companies from BRIC countries. Shows how important is state regulation for successful integration of domestic companies into international environment – country image, taxation, political and legal support, development of financial system, including securing bank sector. The authors underline that in order to increase capitalisation and risk diversification, and to expand geographical sales of goods and services, acquisition of the new resources, to gain access to new technologies and operational methods, Russian companies undertake dynamic expansion in the world markets.

**Keywords:** Russian companies, World economy, integration, international expansion, acquisition, business-government relations

### Introduction

World globalisation continues involving more and more countries. After having passed the period of destruction of the old economic system and implementation of a market management approach, Russia also strives to integrate into the World economic environment. Large Russian companies have achieved success on the domestic market and expand internationally, looking for new opportunities and resources. Depending on strategic objectives, each company selects its proprietary way of international expansion. One expansion option more appropriate in the contemporary environment involves transformation from a national business to a full-scale transnational corporation (TNC).

According to research by the Russian World Economy and International Relations Institute (IMEMO), at the end of 2008 there were 20 companies which could be included in a list

of the leading Russian non-financial TNC by the size of their overseas assets. See the diagram below.

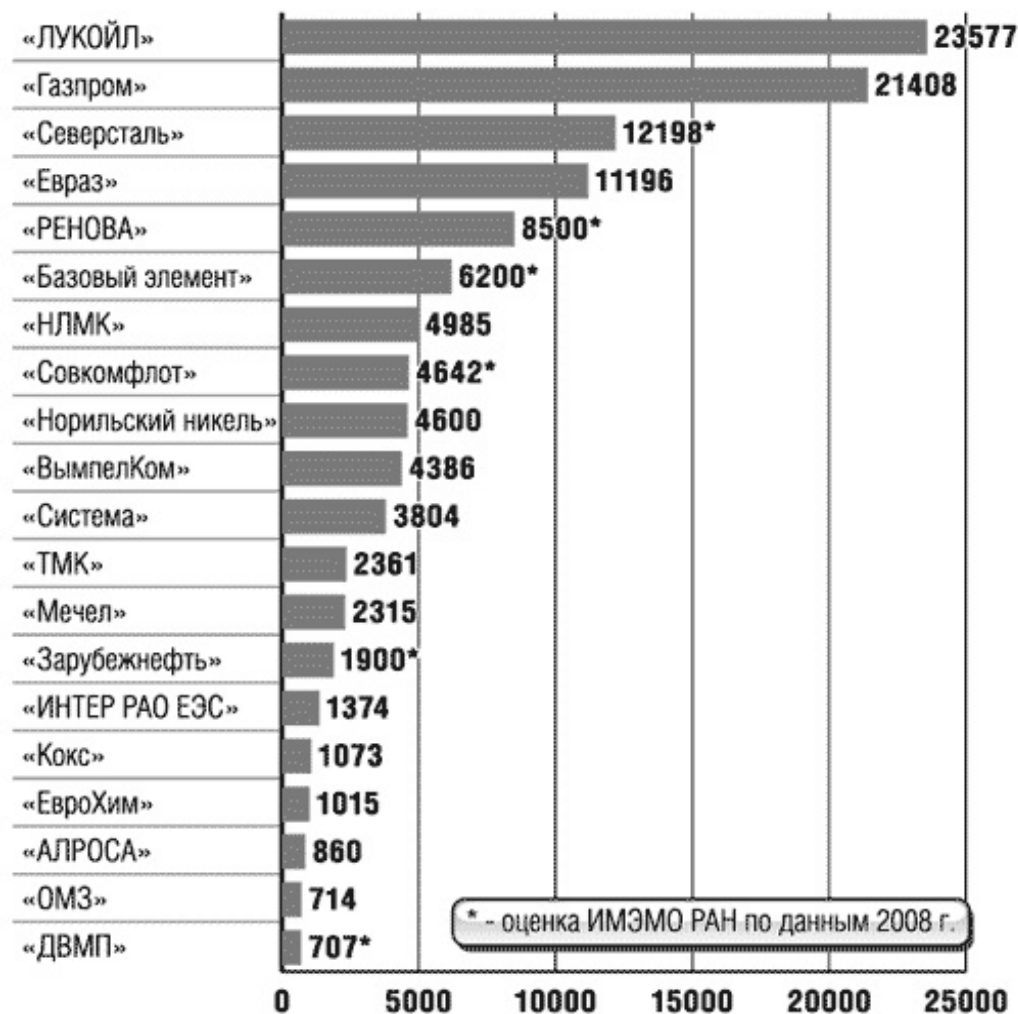


Figure 1. Twenty largest Russian non-financial TNC by the size of overseas assets, \$ US mln.

However, in this article we will deal with the Russian companies featuring on the UN Trade and Development Conference (UNCTAD) 2008 Top-100 Non-financial Developing and Transition Economy Countries TNCs Rated by Overseas Assets List published by UNCTAD in 2010 Annual Investment Report. Therefore only 8 leading Russian TNCs will be taken into account since they comply with the criteria of overseas assets amounting to at least 10% of the capital.

As can be seen from the table, the list is dominated by companies operating in the natural resources area: steel, mining and oil. However the rating also features telecoms companies. This is a positive sign that Russia moves towards expansion of sector diversification and high-tech development.

Russian TNCs featuring on the list are private companies and their controlling shares are concentrated in the same or several hands, while the rest are vastly dispersed. It should be noted that the capital has also foreign participation.

Private companies are more competitive and show more dynamic development compared to cumbersome state corporations. Making comparison with other countries from the same group of emerging economies, the so called BRIC, (Russia, Brazil, India and China), we note that international expansion, in China for instance, is vastly instigated by state corporations with strong support from the local government. Indian TNC list by the size of overseas assets is also headed by state companies, but major share is taken by private companies.

Table 1. Top 100 non-financial TNCs from developing and transition economies, ranked by overseas assets, 2008, \$m

Corporation	Industry	Assets	
		Foreign	Total
Lukoil	Petroleum and natural gas	21 515	71 461
Evrast	Metal and metal products	11 196	19 448
Severstal	Metal and metal products	8 066	22 480
JSFC Sistema	Telecommunications	5 698	29 159
MMC Norilsk Nickel		4 389	20 823
VimpelCom	Telecommunications	3 726	15 725
Mechel	Metal and metal products	2 911	12 010
TMK	Metal and metal products	2 361	7 071

Resource: UNCTAD

It should be noted that there are some extra risks common for private ownership: such companies are more exposed to business environment fluctuation and can fall victim to larger TNCs. The Russian Government still has a weak system of supporting businesses striving to expand to international markets, the legal system is immature, there is no proper information, technological and economic support, and this complicates the operations of corporations.

China presents a bright example of cooperation between the state and businesses. For example, the Chinese Government realised serious problems existing in the country in the area of energy security and the need for new resources and subsequently loosened investment outflow while eliminating the red tape for international expansion this way supporting the operations of Chinese companies abroad. As a result, the outbound investments have grown several times, Chinese companies expanded their geographical presence and their capitalisation has increased.

Although the Russian companies are leaders on the domestic market, their capitalisation is still at a low level compared with foreign competitors. In the Financial

Times Global 500 2010 UNCTAD List, which reflects the market value of companies, Lukoil could only reach position 140 with capitalisation of US\$ 48,29 bln., Norilsk Nickel took 203rd position with US\$35,18 bln., and Vypelcom 493rd with US\$16,26 bln.. At the same time, all three transnational Brazilian companies from the UNCTAD list made their way into the Financial Times rating: Petroleo Brasileiro S.A. – Petrobras is 13th with capitalisation US\$186,24 bln., followed by Vale S.A at 22nd with US\$162,83 bln., and finally Metalurgica Gerdau S.A. at 371st place with US\$21,26 bln.. This very clearly shows that the Russian companies have a goal to achieve.

It should also be noted that, in the Global 500 2010 list, Chinese companies mainly come from banking, which indicates successful and efficient economic growth in general. The unstable position of the Russian banks does not promote active international expansion of Russian companies. Financial capabilities of the Russian companies could not be compared with those of the world leaders, and little can be achieved without robust support from the banking sector.

At this stage Russian companies are able to integrate into the World economy only through cross-border acquisitions and mergers of assets with relatively low market value. In most cases their acquisition targets are operating factories and companies. Because development of a new property “from scratch” requires substantial capital investment and may be rather risky. Facing tough competition companies cannot afford to invest in inefficient and unprofitable projects. From this point of view Russian businesses lag behind foreign investors. However there are exceptions: Russian state company Rosneft, together with Chinese national company CNPC, will build an oil refinery in Lingshan Industrial Zone, and this is to become the first oil refinery built by a Russian company abroad.

According to FSC report, in 2010 total volume of cross-border deals involving Russian companies was US\$24,6 bln., while acquisitions of foreign assets by the Russian companies amounted to US\$3,64 bln. High merger and acquisition activity in 2010 was demonstrated by Mechel Group operating in the metals and metal products sector. As a result, during the year it acquired two companies: Romanian Donau Commodities, owner of Laminorul steel plant (acquisition value US\$12,4 mln.), and Turkish steel services company Ramateks (acquisition value US\$3 mln. In addition, Mechel has undertaken the liability of the company at US\$13,8 mln.), as well as assets of Cosipar in the Brazilian steel sector.

Lukoil, Russian leader by foreign assets, in 2009 bought the 46% share of BP in their joint venture Lukarco for US\$1,6 bln. and gained ownership of the company. In the same year Lukoil signed a contract for the acquisition of a 45% share in the Dutch Total Raffinatory Netherlands Oil Refinery from the French Total. The refinery also holds a share in the Rotterdam Maassvlakte Olie Terminal.



In Europe, Lukoil is primarily concentrated on the sale of their own products. Since the most efficient way of achieving this objective lies through proprietary gas stations, Lukoil runs expansion of their sales network, which spans over Finland, Czech Republic, Poland, Slovakia, Romania, Bulgaria, Ukraine and Cyprus. The company does not look at the European market only. In North America the company also owns a network of 2100 gas stations. Apart from sales the company also conducts exploration and extraction in Columbia, Venezuela, Ghana, Egypt, Azerbaijan, Kazakhstan, Uzbekistan, Saudi Arabia and the Gulf of Guinea. In 2009, Lukoil won a contract for the development of Iraqi oil field West Kourna-2 in partnership with Norwegian Statoil. In 2011 the company commenced operations in Vietnam. It is evident that Russian companies are becoming global players.

Other Russian transnational companies invest in the same regions: Europe, Latin America, North America and Africa. Regretfully, the Asian market is hardly accessible to the Russian companies. This is due to tough competition with the national companies and lack of sufficient capital experienced by the Russian companies. In any event, the Asian Pacific Region holds high potential and is very attractive for investors.

Here are some examples of geographical the expanse of international business by the Russian TNCs.

Fully integrated steel and mining company Evraz Group conducts operations in the USA, Canada, Italy, Czech Republic, South Africa and Ukraine. The company holds second position in North America in terms of steel sheet production capacity and is one of the North American leaders in pipe production, primarily referring to large diameter pipes and oil pipes.

Sistema Financial Public Limited Company subsidiaries operate in the telecoms sector in the CIS, Central and Eastern Europe and India. The business of the corporation subsidiaries is mainly focused on the implementation of state of the art technologies facilitating advanced development of participated sectors and the improvement of lifestyle.

Norilsk Nickel, the world's largest producer of nickel and palladium, one of the biggest platinum, copper and residual metals manufacturers. Production facilities of the Group are located on three continents and in four countries: Australia, Botswana, Finland and South Africa.

VympelCom Plc is a member of VympelCom Ltd. Group, one of the world's largest operators incorporating companies doing business in Russia, Ukraine, Kazakhstan, Uzbekistan, Tajikistan, Armenia, Georgia, Kyrgyzstan, Vietnam, Cambodia, Laos, Algiers, Bangladesh, Pakistan, Burundi, Zimbabwe, Namibia, Central African

Republic, Italy and holding indirect interest in the capital of Globalive Wireless Canada (Wind Mobile).

Chinese companies mainly undertake expansion in the Asian Pacific Region, Africa and the USA. A regional approach is evident. Brazilian companies also direct their investments into neighbouring countries. However the common feature for the 3 countries is that the bulk capital export is channelled through offshore zones: BVI, Cayman Islands and so on. Historically, big Russian capitals are concentrated in Cyprus. This gives rise to an obvious question how to differentiate real investment from simple capital diversion. For instance, Cyprus is one of the biggest investors into the Russian economy. In other words, to minimise the risks, Russian capital flows into Russia as foreign investment.

Political situation is one of the major factors in the choice of domiciliation. Tested positive and friendly relations between the countries facilitate privileged treatment for Russian companies.

International operations of the Russian companies are greatly affected by the image of the country. Widespread negative perception of Russia is an obstacle to desired development of corporations. Significant number of deals were cancelled because of negative opinion of investors, society and governments. Extensive variety of research and reports were dedicated to this subject. Such attitude stems from past stereotypes and practical acts of the Russians. Usually the society makes no differentiation between the activities of the state and the companies, therefore the attitude towards Russia expands to the Russian companies too. Lack of economic and ownership transparency, impact of informal connections and nepotism on the business, unstable legal system, unreliability, human rights issues, corrupt society, aggressive foreign policy all constitute conditions resulting in negative perception of foreign countries towards Russian business. Due to cultural differences, customary attitudes and stereotypes common misunderstanding occur regularly, and this is a direct cause for sometimes biased reflection of Russian governmental and business activities in the foreign mass media. This also adds fuel to the fire.

In order to achieve positive results, the companies and the state must act together. Primarily corporations need to improve transparency, pay more attention to the social and environmental projects and maintain the good reputations of their executives. At the same time, the state needs to procure legal protection of the companies, restrict excessive involvement in the operations of the companies, implement the policy of support to the Russian corporations in their international expansion.

Solution of these issues will inevitably open new horizons to Russia and its companies.

Finally, the following conclusions can be made. In order to increase capitalisation and risk diversification, and to expand geographical sales of goods and services, acquisition of the new resources, to gain access to new technologies and operational methods, Russian companies undertake dynamic expansion in the world markets. This is mainly attributable to private companies with modest capitalisation, which acquire foreign assets through cross-border merger and acquisition deals. The main destinations of corporate internationalisation are Europe, USA and Africa, while the Asian Region still remains the closest perspective goal. In order to be successful in business ventures abroad, Russia and Russian companies need to resolve a number of issues, overcome negative perception of Russia and Russian businesses.

Overall, Russian TNCs successfully integrate into the World economic arena and Russia can be definitely considered as a member of the globalisation process.

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## CSR CONTRIBUTION AND COMPETITIVENESS: THE CYPRIOT EXPERIENCE

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### Abstract

Corporate Social Responsibility has been a term used for the last decade and has been asserted that by contributing to CSR a firm becomes competitive. Whilst it has been argued that CSR contribution does increase a company's profit there has been little work to develop a tool in assessing the CSR contributions made and the impact on competitiveness.

The current paper is identifying the areas SMEs in Cyprus concentrate their CSR contribution, the barriers and enablers making CSR possible as well as the tools used to evaluate the CSR contributions.

The purpose is to identify the components so as to enable the research team of seven euro-Mediterranean countries to develop a tool on CSR competitiveness. This project is funded by the European Union.

Since Cypriot SMES operate in a small country with the idiosyncrasies and needs of a small country tend to emphasise the community rather than the market needs. Given the financial crisis at the moment the barriers are not only lack of resources but also lack of knowhow. The owners of the companies tend to be the major enablers which is a strong point and the government is making every effort to assist them.

**Keywords:** CSR Competitiveness, Cyprus, SMEs

### Introduction

Corporate Social Responsibility relates to how the "companies integrate social and environmental concerns in their business operations and in their interactions with their stakeholders on a voluntary basis" (European Commission, 2001). The Commission extended this expectation on CSR and in the Lisbon Strategy in 2005, the Commission stated that CSR "can play a key role in contributing to sustainable development while enhancing Europe's innovative potential and competitiveness" (European Commission, 2005). The Commission went even a step further and in their Integrated Guidelines for Growth and jobs "recommend to Member States to encourage enterprises in developing their corporate Social Responsibility" (European Competitiveness Report, 2008:106).

Corporations, as argued by Porter and Kramer (2006:80), “will discover that CSR can be much more than a cost, a constraint, or a charitable deed- it can be a source of opportunity, innovation, and competitive advantage”. To do this however they need to embed in their strategic plan, the CSR actions and address the needs of the stakeholders by taking a long term perspective. CSR is an investment that will pay up in the long run, one does not rip the benefits in the short run. In this report the author will illustrate that whilst the literature has demonstrated that CSR does exist, its linkage to actual improvement in competitiveness has not been achieved. However, companies have realised the benefits and are persisting to contribute towards CSR.

## **Literature Review**

As Vilanova et al. (2009:57) states, CSR has become one of the “central issues on the agenda of organisations today, but is still a long way from being a centre stage on corporate strategy”. As stated in the Cosmic Project (2009) in order for benefits to be derived from CSR, an organisation should try to achieve long-term internal stability and competitiveness. From an internal perspective an organisation ought to address the following areas: Mission, vision and leadership; Workforce activities; Marketplace activities; Supply chain activities; Stakeholder engagement; Community activities and Environmental activities (Cosmic, 2009).

It was asserted in the European Competitiveness Report (2008:5) that “CSR is not so much about what enterprises do with their profit, but how they make that profit”. CSR is approached from different perspectives. It is approached from social performance (Carroll, 1999), business ethics (Solomon, 1993), corporate governance (Freeman and Evan, 1990), social contract (Donaldson and Dunfee, 2002), stakeholder management (Donaldson and Preston, 1995).

Vilanova et al. (2009) has grouped CSR into five dimensions, these being: (a) Community relations, (b) Workplace, (c) Accountability, (d) Marketplace and (e) Vision. However many obstacles are placed on corporations that prohibit or at least do not encourage them to proceed with CSR. There are however a number of obstacles (Reich, 1998; O’Brien, 2001) placed which make companies hesitate to contribute towards CSR.

In this day and age reputation of a product or an organisation plays a major role in its survival. Stakeholder groups are becoming more sensitive to CSR issues and reputation “is a factor which affects the market value of companies” (Carlisle and Faulkner, 2005:413). Good CSR “enhances reputation”, makes a company more attractive as an employer, staffs are more innovative and creative and this will lead to differentiation advantages over the competitor.

The European Commission (European Competitiveness Report, 2008) states that the concept of competitiveness can be applied at different levels, from “the firm (micro) level, to the sectorial, regional and national (macro) level. At macro-economic level, competitiveness is taken to mean rise in the standards of living, whereas at micro level refers to the performance of a given

industry in a given country or region relative to the same industry in other countries or regions. Francis (1989) states that “a firm is competitive if it can produce products or services of superior quality or lower costs than its domestic and international competitors”.

Considering the European Commission’s (European Competitiveness Report, 2008) and Francis (1989) it is argued that in order for an organisation to achieve competitiveness at micro-economic level through CSR the following six parameters need to be considered:

- Cost structure- achieving cost savings with the use of CSR e.g., applying energy saving methods.
- Human resources- attracting, motivating and retaining employees, thus employee turnover rate is low.
- Customer perspective- find methods to drive customer loyalty and demand e.g. encourage customers to pay premium price for environmental or social products or impose social procurement on suppliers.
- Innovation- Using CSR to find new ways of working, new products, services, processes and new market space.
- Risk and reputation management- enterprises are now under greater pressure and more scrutiny to embedded CSR practices. When organisations are forced to deal with transparency, human rights, supply chain management they are therefore forced to discover additional impacts of CSR
- Financial markets- Investors analysts, creditors are now looking for corporate social investments, for information on intangibles and firms that look after their employees, customers etc because that would mean lower litigations.

Whilst some authors have argued that CSR is a “cosmetic effort on the part of the companies to respond to societal demands” (Vilanova, 2009:59; Porter and Kramer, 2006), others have found that CSR affects competitiveness (Chand and Fraser, 2006), and some have suggested that competitiveness is one of the key drivers for adopting a CSR approach (Bansal and Roth, 2000).

Assessing the degree of competitiveness is not an easy task. Murths and Lenway (1998) have described competitiveness as the strength of an organisation in comparison to its competitors, and of course productivity was assumed to be a good indicator of competitiveness at a firm level (Porter, 1985). More recently, Lowell (2007) has argued that tangible performance is inadequate as it does not take into account key competitiveness generating resources in the form of intangible capital as knowledge, relationships, reputation or talent.

As an alternative to the above and in an effort to use a framework taking into consideration flexibility, adaptability, quality as well as the dimensions asserted (Kay, 1993; Mintzber, 1993; Porter, 1985; Barney, 1991; Hamel and Prahalad, 1989) Vilanova et al. (2008) proposed a model of competitiveness to address the following dimensions:

- Performance, including standard financial measures such as earnings, growth or profitability
- Quality, not only for products and services, but also the capacity to satisfy customer expectations
- Productivity, in terms of higher production and lower use of resources
- Innovation, including products and services as well as management process
- Image, including corporate branding in terms of building trust and reputation

#### **Applying CSR in a way to achieve competitiveness and ensure stakeholders' needs**

O'Brien (2001) has developed a model which he refers to it as the socially anchored competency model, whereby the company's core business competencies are examined to determine the potential impact on stakeholders. The core competencies serve as the primary input into the stakeholder analysis. "This allows managers to determine not only whether stakeholders are negatively affected by the company's core businesses, but how competencies can be leveraged in innovative ways that maximize social benefits as well as benefits to the company's business... it does require managers to define the core competencies, identify and assess any negative affect on key stakeholders, and determine ways competencies can be used to benefit the company's stakeholders and businesses." (p. 9)

The model is presented below in figure 2 and it does indicate that in order for companies to integrate CSR and achieve competencies they need to identify their core competencies, the expectations of the stakeholders and build those together with strategic alliances in a integrated model to achieve both business and social benefits.

#### **Stakeholders**

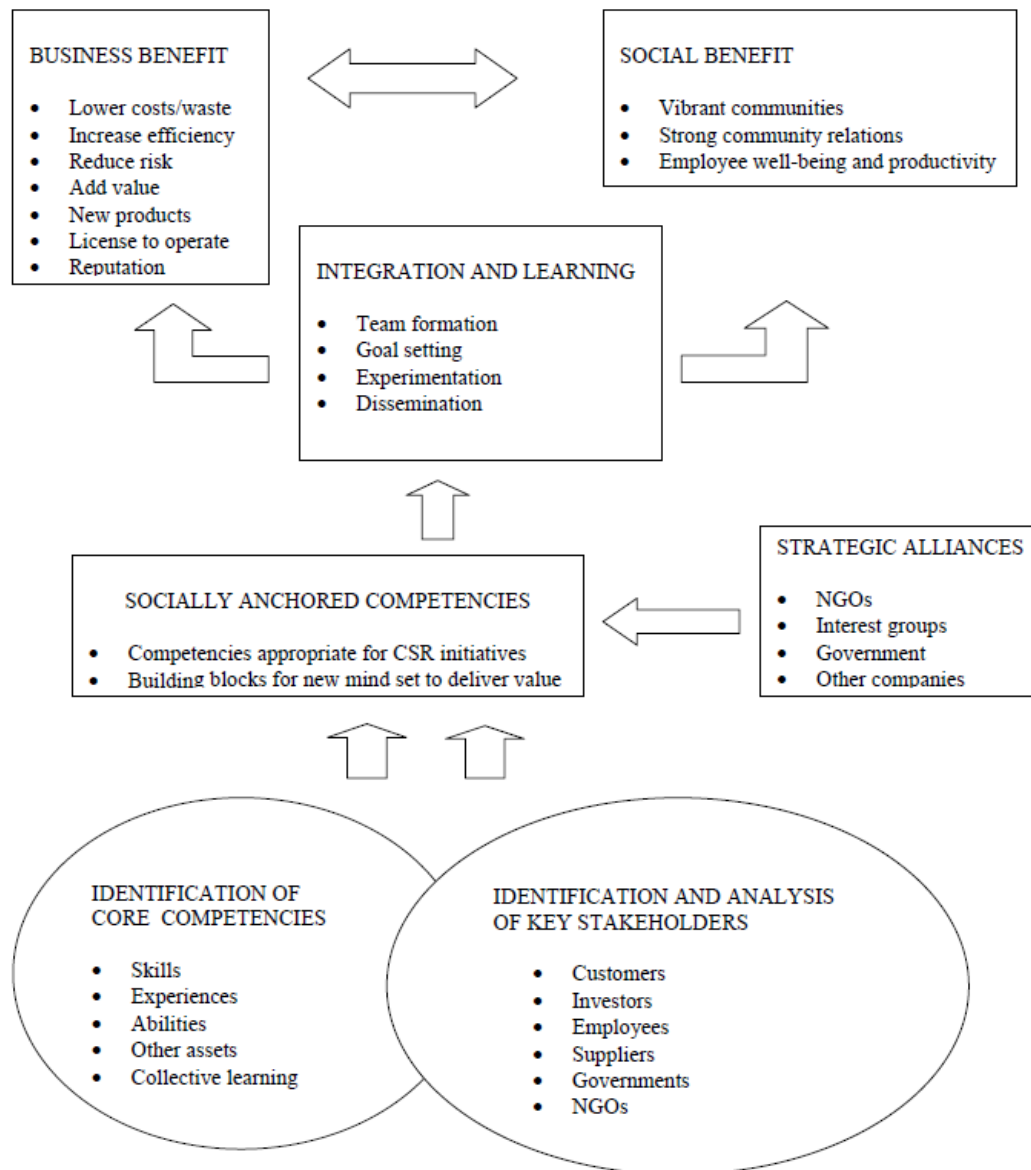
Porter and Kramer (2006:78), argue that "governments, activists, and the media have become adept at holding companies to account for the social consequences of their activities". O'Brien (2001:3) has argued that stakeholders are requiring companies to go beyond the notion of strategic philanthropy and international codes of conduct". Investors want to see not only profit but they want to see these financial gains from the firm's investments in CSR initiatives.

Companies can no longer be content to monitor only the obvious social impacts of today and ignore the social effects of tomorrow because if they do they risk their survival. Corporations

need to address the needs of the human resources they use if they do not want to be left without workers, they need to ensure they not only comply with the rules and regulations imposed by the authorities but go beyond that and address social issues eg. not only are they providing safe products but they ensure these products are environment friendly etc. Of course no business can solve all of society's problems or bear the cost of projects that the authorities should have carried out but society expects of organisations to be given something back in return for the profits being made. A case that comes to mind is a few years back when one of the semi government organisations in telecommunications (CYTA) was criticised because it made huge profits and the government imposed a penalty on them. There was a public outcry for the profits made and as a result the organisation build a bridge on the main road where many school children crossed everyday on their way to school, offered money for research, gave free telephone cards to soldiers etc.



### SOCIALLY ANCHORED COMPETENCY MODEL



Source: O'Brien (2001:7)

Porter and Kramer (2006) have argued that corporations need to prioritise the social issues into generic social issues, value chain social impacts and social dimensions of competitive context. (see diagram 3 below). It is about identifying the particular set of societal problems that a corporation is best equipped to help resolve and from “which it can gain the greatest competitive benefit” (92) By creating such a corporate social agenda a corporation will look beyond community expectations to opportunities to achieve social and economic benefits simultaneously. Corporations need to “move from mitigating harm to finding ways to reinforce corporate

strategy by advancing social conditions” (p. 85). In other words corporations need to apply responsive CSR i.e. acting as a good corporate citizen, “attuned to the evolving social concerns of stakeholders, and mitigating existing or anticipated adverse effects from business activities”(p. 85). Good corporate citizenship goes beyond merely writing a cheque, it is about doing business differently from competitors and in a way that will lower costs or serve better customers.

Prioritizing Social Issues		
Generic Social Issues	Value Chain Social Impacts	Social Dimensions of Competitive Context
Social issues that are not significantly affected by a company's operations nor materially affect its long-term competitiveness.	Social issues that are significantly affected by a company's activities in the ordinary course of business.	Social issues in the external environment that significantly affect the underlying drivers of a company's competitiveness in the locations where it operates.

Source : Porter (2006)

An idea proposed by Porter (1998) has been the development of Clusters. Clusters promote “both competition and cooperation. Rivals compete intensely to win and retain customers” (p.79) Corporations can also cooperate to have better access to employees and suppliers, access specialised information, one organisation complements another (eg. in the tourism industry is not enough for a tourist to be satisfied with a hotel facility but be disappointed with the restaurant or leisure activities around the hotel). Clusters not only provide opportunities for innovation but also provide capacity and flexibility. Thus in small or developing economies if clusters are developed then CSR strategic plans could be introduced and benefit all the companies in the clusters.

#### CSR in Cyprus: Legislative and other framework

As stated in the European Commission (2010) report many countries do not have a strategic document in place. This does not mean that they have not adopted an advanced approach to CSR. In Cyprus “the Planning Bureau is currently developing a National Plan on CSR. The government has prepared the terms of reference, which consist of two priorities. First, Cyprus wants to promote CSR as an aspect of the sustainable development of business and to develop measures to promote socially responsible investment, comprising interventions that contribute to social, environmental and economic responsibility by acting as a point of reference for the relevant policies. Particular emphasis will be given to further promoting socially responsible purchasing and investment by the government, enhancing transparency, promoting corporate

governance and human resources development, energy saving and environmental protection, and combating poverty and social exclusion (p.13).

More specifically several initiatives (Bakalouris 2011) have already been undertaken by the Public Sector, either at an ad hoc basis in view of the crisis, or more permanent ones.

Such measures include: (a) the “In-company/On the job training programme” (b) Schemes Providing Incentives for Hiring Disadvantaged Individuals and Individuals with Disabilities (c) a Project co-financed by the European Social Fund, which aims at reducing the gender pay gap between men and women, (d) The Department of Labour Inspection promotes CSR in the sector of Occupational Safety and Health.

“In order to promote sustainable production and consumption patterns the Cypriot government continues to provide grants to support the introduction of EMAS. The aim is to improve the environmental performance of organisations in all sectors through the implementation of the scheme. The initiative, among other things, covers the costs of consultancy for establishing EMAS that result from the verification and validation of the system. Cyprus also continues to financially support the promotion of the EU Ecolabel” (European Commission, 2010:35). Furthermore, in order for Cyprus to promote emission reductions by businesses, Cyprus launched a comprehensive initiative in 2009. A Charter of Climate Change was launched and in addition an IT tool has at the time of writing launched to enable companies to trace all energy savings activities they have undertaken and to measure the amount of emission reductions they have achieved. It measures the decrease of their carbon footprint (in tons of Co<sup>2</sup>).

As far as reporting of CSR, Cyprus does not have any specific requirements. It does however indirectly through its Corporate Governance Code 2002 has a requirement that listed companies should disclose in their annual report a corporate governance report.

Based on an earlier research Doukakis et al. 2005; Krambia-Kapardis, 2007) 95% of businesses who responded to the survey were contributing towards CSR and 82% of those believed that there is a direct connection between profit and CSR’ (p. 271). Most respondents expressed the view that CSR in Cyprus began between 1981-1990, even though they did not think it was CSR at the time. The emphasis of CSR in Cyprus appeared to be towards the employees (35%) , consumers (26%) and community (10%), environment (6%), investors (5%), suppliers (4%) and other 14%. Like other European companies however, the Cypriot companies contributing towards CSR lack strategic planning and do not measure the benefits derived from CSR. It is evident therefore that companies in Cyprus have been contributing to CSR for almost a decade.

## Methodology

Seven Euro-Mediterranean countries including Cyprus are currently funded by the Med programs of the EU to identify a tool in testing CSR contributions and determining their competitiveness. In order to develop the tool the researchers had to carry field work in each country to answer a number of research questions. Thus in this paper the research findings are those relating to Cypriot SMEs. A questionnaire was developed and pilot tested by the research team and then each country had to identify 20 SMEs and 3 institutions and carry out interviews.

Cypriot companies have begun in recent years to take CSR more seriously and to realise that CSR is not simply helping out the poor, the orphans and the government when they needed to build a bridge or a park but to form strategic plans, appoint an employee responsible for CSR and prove that they are ethical. Two Charters were set up one following a European project and the other being an initiative of the Cyprus Chamber of Commerce and Industry. The former, the European Road Safety Charter was signed by 63 companies and the latter, the Climate Change signed by 55 companies.

In reference to Companies (SMEs) in Cyprus who are active on CSR the following research questions are to be answered:

- What are the objectives in the implementation of the companies of their CSR actions and policies?
- What motivates the companies to contribute towards CSR?
- Are there any supports for the companies in implementing CSR policies?
- Are there any links between CSR and competitiveness?
- Are there any evaluation tools used in the implementation?
- What are the barriers and the enablers of CSR policies and actions?
- What are the lessons learned by the companies?

Once the State of Art and State of Practice was completed by each partner, a questionnaire was developed to be used on companies and organisations. The research team, had the questionnaire pilot tested and then distributed to 20 organisations and 3 public institutions. In order for the research team in Cyprus to identify which SMEs would be interested to participate the assistance of Cyprus Chamber of Commerce (CCC) was sought. The Chamber emailed all the companies in their database asking them to respond to an email and provide their details if they wanted to participate in the study. A total of 23 companies responded. Some of those were excluded because they were not SMEs and smaller one were excluded because they did not contribute towards CSR but wanted to find out what this tool is all about.

The questionnaire was then emailed to the 20 companies wishing to participate and a face to face interview was organised March of 2011.

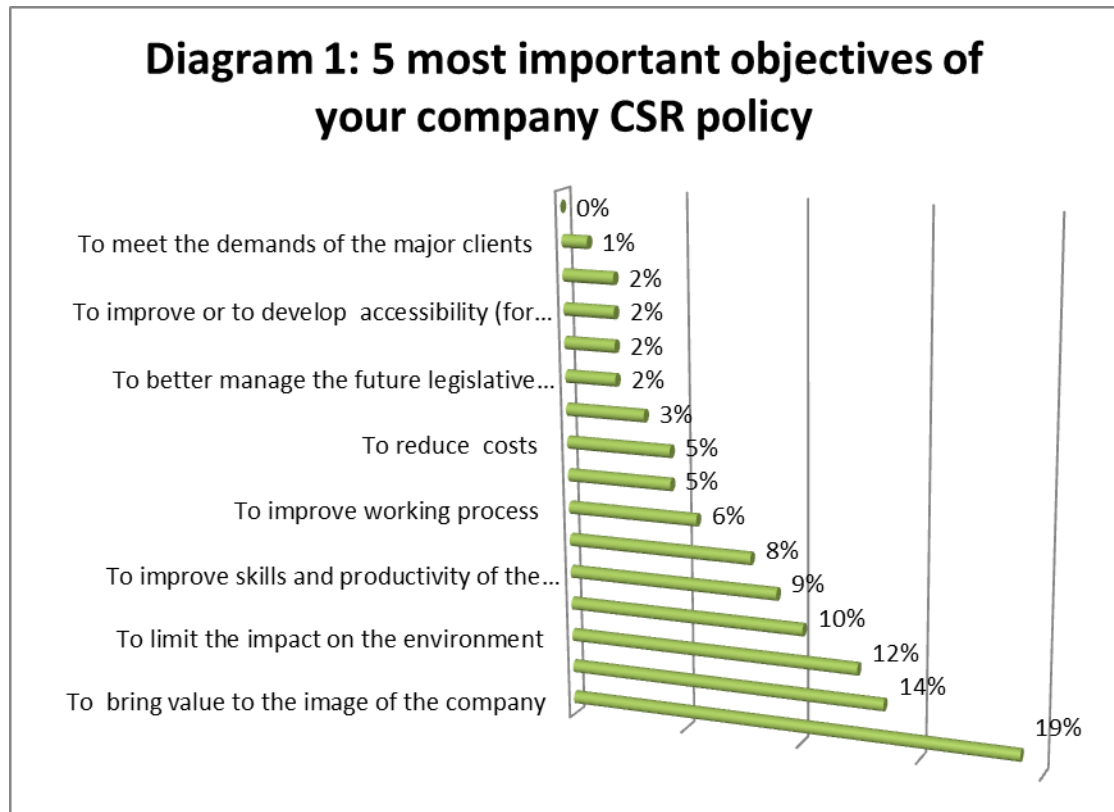
## **Survey Findings**

### **Demographics**

The 20 companies that took part in the survey were from the service industry (6), wholesale and trade (3), Agriculture and forestry (2), manufacturing (2), accommodation and food service (2), information and communication (2), financial and insurance activities (1), education (1), construction (1). For the 14 companies there is a person responsible for CSR and that person is in Marketing, Human Resources, Management, or Ownership position. For the majority (17) CSR is integrated in the company's strategy.

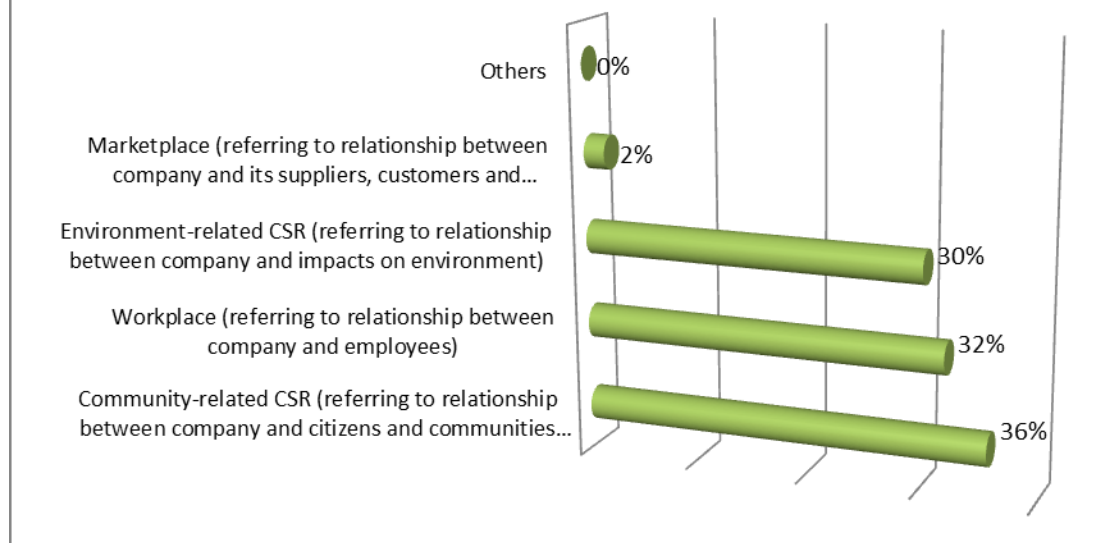
Research findings for the companies (#20) and institutions (#3) that responded to the questionnaire.

- What are the objectives in the implementation of the CSR actions and policies?  
The main objectives in implementing CSR actions for the companies are to: (a) bring value to the image of the company, (b) improve social relationships in the company, (c) to limit the impact on the environment, (d) to gain market share, (e) to improve skills and productivity of the employees, (f) to improve the intensity and quality of relationships with their stakeholders. (see Diagram 1)  
For the institutions the objectives are centred around economic performances, improvement to the environment and opportunities to support the youth.



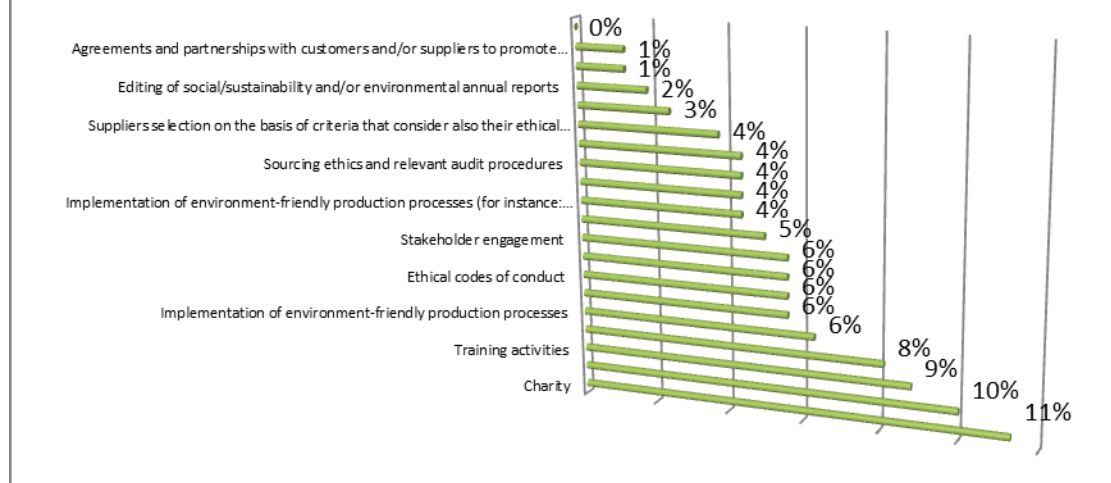
The companies tend to place a lot of emphasis in community related CSR, secondly on workplace CSR, environment and the least in the marketplace. This is in line with the Doukakis et al. (2005) survey. Indicating that the CSR idea has not changed much in six years' time. (see Diagram 2)

For the institutions the most important category is the market place

**Diagram 2: Categories of CSR policy**

This is further reinforced because they place their CSR actions and policies in initiatives that favour the local communities, equal opportunities, and training activities. (see Diagram 3)

The institutions placed their CSR actions and policies on creating and endorsing partnerships.

**Diagram 3: Kind of CSR actions constitute CSR policy**

- What motivates the companies to contribute towards CSR?  
The companies appear to be motivated primarily by internal rather than external motivations. The internal motivations of major influence are the Directors, the Board and of course the owner. Whilst the external motivations are mainly the national authority, and citizens. This is consistent with the fact that CSR policies are community

driven rather than market driven. The institutions are motivated by their own strategic goals and funding. In addition stakeholders and pressure groups for one of them appear to have a major role in motivate a local authority to be active in CSR.

- Is there any support for the companies in implementing CSR policies? Cypriot companies are provided with limited support for the implementation of CSR policy. Those that were supported, the assistance were mainly from a research department or expert or an associated company. The assistance provided was not financial. Those that were assisted by public organisations it appears that local authorities had a major role to play. Again this is consistent with earlier findings since Cypriot companies tend to focus on the community needs. Non-Financial Assistance as support was granted to the institutions. The support varied from advice, training, promotion of social and green procurement
- Are there any links between CSR and competitiveness? The companies appear to contribute most in initiatives in favour of local communities, charities, ethical codes of conduct and equal opportunity in this order.



	<i>Very strong contributions</i>	<i>Least contributions</i>
<i>Labour Contribution Policy</i>	<i>Increase in commitment, loyalty, motivation, morale Increase in productivity</i>	<i>Participation in R&amp;D projects Entrance in new markets</i>
<i>Health contribution Policy</i>	<i>Increase in commitment, loyalty, motivation, morale Increase in productivity</i>	<i>Participation in R&amp;D projects Entrance in new markets</i>
<i>Training contribution policy</i>	<i>Increase in commitment, loyalty, motivation, morale Increase in productivity</i>	<i>Better recognition by society Strengthening of community ties</i>
<i>Equal contribution policy</i>	<i>Increase in productivity Improvement of image</i>	<i>Entrance in new markets Participation on R&amp;D projects</i>
<i>Adoption of Environmental Management Systems</i>	<i>Improvement of image Anticipation of new regulations</i>	<i>Entrance in new markets Improved response to tender requirements</i>
<i>Environmental friendly production process</i>	<i>Improvement of image Modification of internal values</i>	<i>Entrance in new markets Increase in innovation</i>
<i>Ethical codes of conduct</i>	<i>Improvement of image Modification of internal values</i>	<i>Participation on R&amp;D projects Entrance in new markets</i>
<i>Sourcing ethics</i>	<i>Modification of internal values Increase of commitment loyalty, motivation, morale</i>	<i>Participation in R&amp;D projects Entrance in new markets</i>
<i>Environmental protection</i>	<i>Improvement of image Modification of internal values</i>	<i>Entrance in new markets Improvement of product quality</i>
<i>Charity contribution</i>	<i>Strengthening of community ties Improvement of image</i>	<i>Increase in innovation Participation in R&amp;D projects</i>
<i>Initiatives in favour of local communities</i>	<i>Improvement of image Better recognition by society</i>	<i>In crease in innovation Anticipation of new regulations</i>
<i>Fair Trade</i>	<i>Better recognition by society Improvement of image</i>	<i>In crease in innovation Participation in R&amp;D projects</i>

- Are there any evaluation tools used in the implementation?  
The majority of the respondents do evaluate their CSR policies. The performance measure used relates to brand reputation, product quality, market position, and cost savings. To evaluate their CSR policies they use questionnaires, mainly qualitative

performance measures. The evaluation process is predominately internal. For those who use external evaluation procession they use an evaluation agency.

The majority of the respondents do not use any guide, website or book to help them start CSR. For those who do use tools, the tools used to assist in intensifying their CSR development are: EU manuals on road safety, GRI, AA1000, ISO 26000, EMAS or guidelines set up the Head Office.

The tools that could be used to intensify CSR are:

- A CSR forum or a local panel for CSR
- A management tool in measuring and monitoring performance
- A tool that evaluates and measures the effectiveness of CSR actions
- CSR handbook, consultation or a person in Charge of CSR
- Personnel training for CSR
- Training, Seminars, a local forum for promoting CSR

- What are the barriers and the enablers of CSR policies and actions?  
The barriers encountered by the respondents were mainly lack of expertise, and lack of financial resources. In addition the government bureaucracy appeared to be a major barrier for the Cypriot companies. The enablers appeared to be the Board, the owner's ideology and the local authorities. Barriers were faced by some institutions from opposing interests, public opinion, financial crisis, and internal politics. Enablers were the vision and planning of the organisation, the interests by SMEs to invest in CSR and assist the local authority to do so and the well versed employees.

- What are the lessons learned by the companies?  
The lessons learned from the implementation of CSR are:

- Any contribution to CSR programs is always beneficial
- By implementing CSR one gains awareness, satisfaction, appreciation and value
- CSR actions are appreciated.
- CSR increases the brand value of the bank. It also bring better recognition by society
- CSR programs get a positive response from the public
- Commitment from Top Management is crucial

- It gives great satisfaction
- It helps to get feedback from their Associates and the Society: Having a CSR strategy is necessary.
- It is a good Public Relations tool.
- It is always deeply appreciated.
- It is always helpful to be involved in such activities
- It is never enough
- It is something that can be easily implemented
- The company learned to communicate with young people
- There is not yet enough interest in CSR
- You have to communicate your policy

In addition to the quantitative study a qualitative study was carried out to identify good practices that perhaps other companies can replicate or get ideas from.

## **Conclusion**

It can be concluded that in Cyprus the SMEs that are active in CSR place emphasis on the community and the workplace. This is understandable given the size of the country. It is part of the culture of the enterprises that you need to help out the local community and this will add value to the company. However the institutions tend to be driven by economic performances and the environment, which is quite understandable since the Board of a local authority or a public body is appointed on actions implemented.

The SMEs' main objectives in implementing CSR actions are focused on bringing value to the image of the company, improving social relationships in the company and attempting to limit the impact to the environment. The SMEs are motivated by internal rather than external factors such as Board and owners' decisions whereas the institutions are driven by the pressure groups and stakeholders.

Unfortunately no financial support is provided to either the SMEs or the institutions and there is lack of training on how they can be active in CSR actions. If an SME has the resources and knowhow as well as top management who are sensitive on CSR issues it will proceed to create CSR actions, otherwise it will not. The institutions do not have any tools that are currently being

used to evaluate their CSR actions whereas the companies appear to be in somewhat informed on tools that can be used.

As Vilanova et al (2009:65) argues “CSR will become a truly strategic business issue when the financial sector in general and financial analysts in particular broadly use CSR criteria to evaluate firms”. Until that is done SMEs and institutions will do the bare minimum.

*“Successful corporations need a healthy society. Education, health care, and equal opportunity are essential to a productive workforce. Safe products and working conditions not only attract customers but lower the internal costs of accidents. Efficient utilization of land, water, energy, and other natural resources makes business more productive. Good government, the rule of law, and property rights are essential for efficiency and innovation. Strong regulatory standards protect both consumers and competitive companies from exploitation. Ultimately, a healthy society creates expanding demand for business, as more human needs are met and aspirations grow. Any business that pursues its ends at the expense of the society in which it operates will find its success to be illusory and ultimately temporary”* (Porter and Kramer, 2006:83)

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## STRUCTURAL CORRELATES OF ENVIRONMENTAL BEHAVIOUR: THE CASE OF BIO-FUELS

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### Abstract

The study explores the interrelationships between environmental concern knowledge, beliefs about and behavioral intention for bio-fuels. Data was collected from 1,695 respondents. Hypotheses were based on literature, and a conceptual model was tested through SEM. Results show that environmental concern has a positive and direct impact on knowledge, beliefs and intention. Demographics determine levels of concern and knowledge. All constructs associate with each other positively. Future research should validate results using cross-cultural samples. By examining the effect and interrelationships of environmental concern, knowledge and beliefs on behavioral intention for bio-fuels the study adds to the evolving literature on green consumer behavior.

**Keywords:** Bio-fuels, green consumer, concern, knowledge, beliefs, intention

### Introduction

“Bio-fuels” are environmentally friendly liquid fuels that can be used in the transportation sector and substitute for conventional petroleum-based oil fuels; they usually have fewer emissions and are produced in an environmentally sustainable manner. The term bio-fuels includes: bio-diesel produced from oil bearing seeds, animal fats and recycled greases; bio-ethanol produced from various grains and sugar components of various plants; and bio-gas produced from the biological breakdown of organic matter in the absence of oxygen. Bio-fuels will account for approximately 20% of the fuels used in the EU in the next 20 years (EBTP, 2010). Bio-fuels are the only sustainable energy resource that can most prominently reduce dependence on traditional oil reserves. In both EU and US’s environmental policies bio-fuels play an important role in the effort for cleaner development. In the EU, the importance of bio-fuels is apparent also from the relevant market indices. In 2009, bio-fuels represented 4% of the total road travel fuel consumption, while the market grew to 12,092 million tons of oil equivalent, an exceptional +18.7% from 2008 (EurObser’ER, 2010).

As long as sustainable consumption remains top priority, understanding the behavior of green, ecology-sensitive consumers is a key issue. Given the high growth conditions of the bio-fuels market (which to a large degree is still fueled by the existence of relevant tax exemptions

and not by the marketability of the end-product) understanding the antecedents of consumer behavior is crucial to operate under unconstrained competitive conditions. The aim of the present study thus is to explore the observed inter-relationships among determinants of green consumer behavior, as described in the literature. Especially, how does consumer environmental concern relate to knowledge of environmental issues, the shaping of environmental beliefs, and the intention to behave in an environmentally sustainable way?

Environmental concern can possibly influence various green consumer behaviors, such as willingness to pay (WTP) for renewable energy (Bang et al, 2000) and usage intentions (Alwitt and Berger, 1993). Nevertheless, the results of different studies remain confounded. Environmental knowledge represents what consumers know about the environment and about fundamental relationships that lead to different environmental views and have significant ecological effects (Mostafa, 2007). Earlier literature suggests that the kind of knowledge that correlates strongly with green consumer behavior is not clear (Mostafa, 2007; Tilikidou and Delistavrou, 2006). Environmental knowledge can be distinguished broadly between objective knowledge and perceived or subjective knowledge about concrete environmentally friendly actions (e.g. use of bio-fuels). Objective knowledge separates further in knowledge regarding the reasons of environmental problems (abstract / factual / declarative knowledge) and knowledge regarding the possible actions consumers can take to counteract these problems (concrete / procedural / action-related knowledge). Abstract knowledge is positively correlated with green purchasing behavior (Mostafa, 2007), while other examples from literature suggest concrete knowledge (Tanner et al, 2004), and yet other research (Ellen, 1994) suggests that objective knowledge has a much smaller impact on green consumption behavior compared to subjective knowledge.

Beliefs have been used widely in green behavior research (e.g. Bang et al, 2000; Kalafatis et al, 1999). Literature (De Groot and Steg, 2007; Mostafa, 2007; Bang et al, 2000) uses beliefs as significant influencers of attitudes and intention to use or purchase environmental products. Beliefs may be behavior- / product-specific or general. The relationship between beliefs and green behavior is essential since beliefs affect a wide range of green behaviors and can shed light on the variables on which is best to focus (De Groot and Steg, 2007).

All the aforementioned research is captured in the hypothesized, estimated structural model (c.f. Figure 1), as follows: environmental concern is treated as a general attitude construct that influences subjective knowledge, product-specific beliefs and behavioral

intentions, as reflected through hypotheses H1a-c respectively. Then, the model explores the relationship among these three constructs by hypothesizing a hierarchical set of relationships from knowledge through beliefs (or directly) to intentions (hypotheses H2a-b respectively), and

then from beliefs to intentions (H3). Testing and statistically validating the model satisfies the overall aim of the work as described above.

## Data and method

The survey uses a random sample of 1,695 Greek consumers. The data were gathered in June 2008 by a professional research agency. Sample's mean age is 41.04 years. The sample is nationally representative in terms of education, income, and geographical distribution.

The questionnaire used in the survey comprised four multi-item questions following the postulated model. The first question examines consumers' concern about the environment measured on a scale with end-points 1: "Very unconcerned" to 7: "Very concerned" (5 items); the second question measures consumers' knowledge of renewable energy and bio-fuels on a scale with end-points 1: "Non Knowledgeable" to 7: "Very Knowledgeable" (3 items); the third question relates to consumer beliefs about bio-fuels on a scale with end-points 1: "Strongly agree" to 7: "Strongly disagree" (5 items); finally, the fourth question includes consumers' behavioral intention, namely their willingness to use and pay (a premium) for bio-fuels measured on a scale with choices 1: "Very unwilling" to 7: "Very willing" (5 items).

All scales were constructed following the accepted methods of item generation and scale construction (Churchill, 1979), thus after surveying the literature (see previous section) a preliminary questionnaire was created, which was then submitted to a panel of 5 experts requesting feedback on wording, relevance, presentation and validity of the items included. After the proposed changes, the amended questionnaire was pilot tested with a sample of 150 consumers. The results of the pilot test showed no significant changes to be necessary.

The scores on each of the 4 constructs are computed by averaging item ratings per factor. Descriptive analyses were employed in order to check the properties of the data and determine their suitability for the intended analyses. Internal consistency of the various constructs is assessed by computing Cronbach alpha coefficients. (Mean/SD & Cronbach alphas: Concern: 5.5/1.52 & 0.93; Knowledge: 2.8/1.60 & 0.92; Beliefs: 4.7/1.39 & 0.92; Intention: 4.1/1.54 & 0.93; All items to total correlations were > 0.60; Results available upon request).

To investigate the interrelationships between different constructs and test the hypotheses put forth previously two kinds of analyses were used. Initially, the median of the summation scores of the relevant variables was used to classify respondents in two groups, either high or low, with respect to concern, knowledge and beliefs. Then, t-tests were run to examine the existence of significant differences between group means.

After running the t-tests and in order to gain a more robust understanding of the interrelationships among the various constructs, the proposed model was tested using SEM.



Initially, the measurement model containing all latent constructs and indicators was analyzed; then, the hypothesized structural model was estimated afterwards. Given that the observed variables were slightly non-normal, the method of estimation was Maximum Likelihood (LISREL 8.80) with its correction for non-normality (Robust ML; Satorra and Bentler, 1994).

## **Analysis and results**

The slight non-normality of the data is due to a specific, readily recognizable pattern in the respondents' ratings of the concern and knowledge items. That is, responses in the concern items exhibited a high concentration around 6-7, while responses in the knowledge items exhibited high concentration around 1-3. In line with previous research (Bang et al, 2000), the present sample comprises respondents with very high concern regarding environmental issues, who nevertheless exhibit a low level of (subjective) knowledge regarding bio-fuels (mean scores "Knowledge": 2.82 and "Concern": 5.54). In this respect, Gärling et al. (2003) claim that questions on environmental issues evoke skewed response distributions due to the difficulty of consumers to clearly distinguish among the constructs and social desirability response bias. Tilikidou and Delistavrou (2006) confirm that Greek consumers exhibit low objective environmental knowledge (both specific and general) .

T-tests results confirm all hypothesized relationships (Table 1). As in previous studies (Bang et al, 2000), consumers with low environmental concern are underrepresented, since those classified in the low environmental concern group (984 consumers scoring less than 31 in a 5-35 potential score range) actually have moderate to high absolute levels of concern. Comparing between those more concerned and those less concerned, a statistically significant difference emerges regarding knowledge about bio-fuels (t-value: 6.214,  $p < 0.001$ ; mean scores: 2.61 and 3.11 for the low and high concerned respectively), their willingness to use and pay for bio-fuels (t-value: 12.578  $p < 0.001$ ; mean scores: 3.60 and 4.50 for the low and high concerned respectively), as well as their beliefs towards bio-fuels (t-value: 11.811,  $p < 0.001$ ; mean scores: 4.42 and 5.17 for the low and high concerned respectively). The findings support hypotheses H1a-H1c.

*Table 1. T-tests of Construct Mean Differences per Sub-group*

		Mean	SD	t	p
<i>Knowledge X Concern</i>	<i>Low concern</i>	2.6	1.47	6.214	0.000
	<i>High concern</i>	3.1	1.73		
<i>Willingness to Use &amp; Pay more X Concern</i>	<i>Low concern</i>	3.6	1.50	12.578	0.000
	<i>High concern</i>	4.5	1.49		
<i>Beliefs X Concern</i>	<i>Low concern</i>	4.4	1.47	11.811	0.000
	<i>High concern</i>	5.2	1.14		
<i>Beliefs X Knowledge</i>	<i>Low knowledge</i>	4.6	1.45	6.233	0.000
	<i>High knowledge</i>	5.0	1.28		
<i>Willingness to Use &amp; Pay more X Knowledge</i>	<i>Low knowledge</i>	3.6	1.58	11.433	0.000
	<i>High knowledge</i>	4.5	1.42		
<i>Willingness to Use &amp; Pay more X Beliefs</i>	<i>Low beliefs</i>	3.5	1.47	18.008	0.000
	<i>High beliefs</i>	4.7	1.40		

The median summed response for environmental knowledge is 8.00 on a 3 – 21 potential score range. Thus, 940 and 755 respondents are classified in the low and high knowledge group respectively. Regarding beliefs towards the positive environmental consequences of bio-fuels, those less knowledgeable exhibit statistically less positive beliefs (t-value: 6.233,  $p < 0.001$ ) than those more knowledgeable (mean scores: 4.55 and 4.97 respectively), supporting hypothesis H2a. Similarly, results for willingness to use and pay yield a statistically significant relationship (t-value: 11.433,  $p < 0.001$ ) between the less and more knowledgeable (mean scores: 3.60 and 4.50 respectively), supporting hypothesis H2b.

Finally, the median summed response for beliefs is 25 on a 5 – 35 potential score range. Thus, 941 and 754 respondents are classified in the less positive and more positive beliefs group respectively. Those with less positive beliefs exhibit reduced willingness to use and pay for bio-fuels compared to those with more positive beliefs (t-value: 18.008,  $p < 0.001$ ; mean scores: 3.50 and 4.70 respectively), supporting hypothesis H3.

Following, in order to gain a more robust understanding of the interdependent relationships between the various constructs, a SEM procedure tested the proposed model. The measurement model showed that all items load significantly on their corresponding latent variables ( $p < 0.01$ ). All indicators load only on one latent variable while error terms were not allowed to co-vary. Overall, the goodness-of-fit indices indicate a good fit of the measurement model: SBS chi-square 572.88 [df.118],  $p < 0.01$ , RMSEA 0.048 [0.044 - 0.0525], GFI 0.95, AGFI 0.93, TLI- NNFI 0.99, CFI 0.99, PNFI 0.76. The estimated structural model can be found in Figure 1. Model estimation

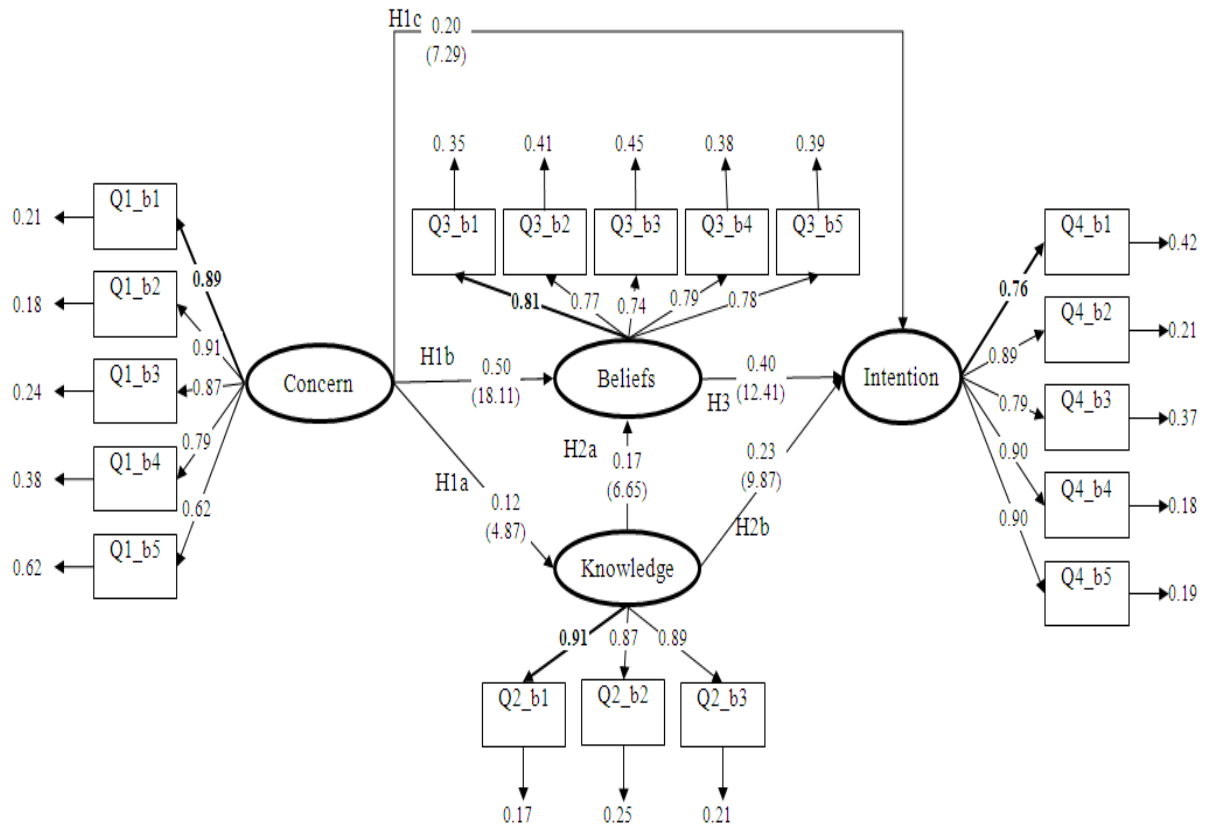
enabled empirical testing of the hypotheses posed. All estimated coefficients were significant at  $p < 0.05$ , with the hypothesized direction of effect.

Table 2 presents the relevant correlations, average variance extracted, covariances and reliability for all latent constructs of the structural model. The estimated model covers all assumptions pertaining to convergent and discriminant validity, as well as a re-confirmation of the constructs' reliability. Convergent validity is assessed through the Average Variance Extracted (AVE; all estimates  $> 0.50$ ) while discriminant validity is assessed by comparing the AVE of each construct to the squared correlation of every other construct (Garson, 2010). Finally, construct (or composite) reliability is a measure of internal consistency different than Cronbach alpha with a common cut-off level of 0.70, which all of the constructs superseded.

## **Discussion and conclusions**

The findings of this study offer implications for both marketers and public policy makers.

Results suggest that concern for the environment, subjective knowledge about environment related behaviors, and beliefs towards bio-fuels have direct and indirect effects on environmental behavioral intention (i.e. use and pay premiums for bio-fuels), albeit some of the inter-relationships are rather weak.

**Figure 1:** Overall Fit of the Proposed Model & Path Coefficients of the Relationship

SBS Chi-square=572.88, df=118, P-value=0.000, RMSEA=0.048

Note: Standardized parameter estimates significant ( $p < 0.05$ ); t-values in parentheses

**Table 2.** Correlations, Average Variance Extracted, Covariances, and Construct Reliabilities, Latent Constructs

	Concern	Knowledge	Beliefs	Intentions
Concern	<b>0.68</b>	0.27	0.98	0.82
Knowledge	0.12	<b>0.79</b>	0.48	0.71
Beliefs	0.52	0.23	<b>0.60</b>	0.94
Intentions	0.44	0.35	0.56	<b>0.73</b>
CR	0.91	0.92	0.88	0.93

Note :

Average Variance Extracted is bold on the diagonal.

Correlations are in the lower triangle and covariances are in the upper triangle.

Average variance extracted =  $\sum(\text{standardized loadings})^2 / \sum(\text{standardized loadings})^2 + \sum \epsilon_{ij}$

Construct Reliability =  $\sum(\text{standardized loadings})^2 / \sum(\text{standardized loadings})^2 + \sum \epsilon_{ij}$

Convergent validity AVE > 0.50; Discriminant validity AVE > Corr<sup>2</sup> (between the latent and all other variables)

The weak impact of concern on knowledge and the weak effect of knowledge on beliefs partially agree with previous research (Bang et al, 2000) and support the literature that questions the effect that both general attitudes (i.e. concern) and knowledge have on purchasing behaviors and behavior-specific attitudes. Past research suggests that environmental concern may not have any effect on knowledge or green behavior. The present study points more to the direction of existent relationships, which however may be rendered insignificant in the presence of other stronger explanatory factors, such as consumers' personal values (Mostafa, 2007), and situation specific cognitions (Bamberg, 2003).

Concern impacts on intention directly as well as indirectly, through both beliefs and knowledge. As hypothesized, concern is a very strong antecedent of green consumer behavior that may not be left out from future studies. Following, the strongest structural relationships form the path "Concern – Beliefs - Intentions" and secondarily with knowledge and concern bearing directly on intentions. This finding suggests that "concern for the environment" and "environmental-subjective knowledge" remain important antecedents of green consumption behavior. As in earlier research (Bamberg, 2003) "concern" has a strong direct impact on bio-fuel-related beliefs, pointing to its effect as an underlying mechanism in shaping belief-regulated situation-specific perceptions that frame consumers' attitudes towards bio-fuels. Furthermore, the direct, positive impact of both "concern" and "knowledge" on behavioral intention (in particular WTP) confirms previous research (Mostafa, 2007; Bang et al, 2000) and suggests that consumers possessing higher concern for the environment and higher bio-fuel specific knowledge may be more inclined to behave in a way that reflects these elevated levels of knowledge and concern. Results suggest that enhancing consumer awareness of environmental issues may lead to an important shift in their beliefs towards various aspects of green consumer behavior thus increasing their intention to behave accordingly. The more intensive cognitive reflections on the ramifications of certain behaviors may lead to enhancing personal beliefs and attitudes towards the behaviors themselves, thus offering a chance to drive motivation for action.

Knowing the profile of the green consumer is important, since such information allows marketers to construct specific strategies to target especially this segment. For bio-fuels, but also for renewable energy sources in general, both consumers' knowledge and beliefs should be strengthened in order to change their consumption behaviors. Practically, marketers have to communicate to the consumers the effects and costs for relying on traditional energy sources, as well as the fundamental benefits and consequences from using renewable energy sources. Such communication efforts should find increasing support by the government as well as local policy makers. In the present study, a substantial number of consumers show increased willingness to use and – most importantly – pay premiums for bio-fuels. The extent to which people would actually prefer a slightly more expensive fuel source be that such fuel is actually available in the

market still remains unclear, especially in times of economic turmoil. Nevertheless, the present results suggest that the market for bio-fuels has, in general, a lot of potential for growth and expansion. Given the fact that the European bio-fuels market and consumption thereof is still evolving (albeit with a different rate across the different countries), understanding the interplay of the various motivators of bio-fuel consumption is important if the various EU states are to move in an effective and efficient way towards the design and putting in place environmental policies and actions that will give rise and strengthen green consumption, especially bio-fuels consumption.

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## A COMPARATIVE EVALUATION OF CUSTOMER PERCEPTION AND SATISFACTION OF M-BANKING & I-BANKING

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### Introduction

Information technology is an imperative for organizations to remain competitive and grow in the present environment. Electronic banking is the latest delivery channel for banking services. The definition of e-banking varies amongst researches because electronic banking refers to several types of services through which bank customers can request information and carry out most retail banking services via computer, television or mobile phone (Daniel, 1999; Mols, 1998; Sathye, 1999). Burr (1996), for example, describes it as an electronic connection between bank and customer in order to prepare, manage and control financial transactions. Electronic banking can also be defined as a variety of following platforms: (a) Internet banking (or online banking), (b) telephone banking, (c) TV-based banking, (d) mobile phone banking, and (e) PC banking (or offline banking). Among these Internet banking and mobile banking are considered to be the fastest developing areas.

The use of technology in banking has direct relationship with the profitability of the service providers also. *Ceteris paribus*, investment in electronic banking increase the profit margin of banks by reducing costs and increase in non-interest income, which will increase the ROA and ROE (Sinkney, 1998). Scott (1999) commented the integration of the banking services with e-commerce and emergence of e-cash would positively affect the efficiency scores of the banks. Implementation of IT opens the floodgates to a whole set of new policies for development (Howkins and Valantin, 1997). The diffusion of new technologies with user-friendly service models is expected to improve the banking services (Akinci, Aksoy, and Atilgan, 2004). Technology Acceptance Model (TAM) proposed by Davis et al (1989) suggests that use of technology depends on ease of use and its perceived usefulness by the consumers. In the study on online banking drivers Aladwani (2001) has found, that providing faster, easier and more reliable services to customers were amongst the top drivers of e-banking development. Consumer's preferences, attitudes and motives are governing factors for developing service delivery options (Byers, Lederer, 2001). Moreover, technology helps in standardizing banking services (Quinn, 1996) and reducing operating costs (Hewer, Howcroft, Durkin, 2003). Technology has improved the service quality and encounters (Beatson, Lee, Coote, 2007) and

consumers can have direct access to online banking from home, workplace, or any other place at their leisure (Suominen, 2001). Low penetration level of ICT in many developing countries hinders efforts to harness the technologies for development (Akpan, 2003).

The advent of Internet changed banking in India though the process of technology adaptation has been slow in India over the last several years. It was a silent revolution and became prevalent in only a few years. During the 1990's banks started offering rudimentary banking services via Internet sites and early in the 2000 decade this feature was being widely used. Basically, the emergence of new private-sector banks in the country in the mid-nineties has changed the scenario drastically, as the business model of these new banks revolved around a strong IT backbone. The volume of transactions and the monetary value grew dramatically to a point where i-banking is probably the biggest source of electronic banking transactions.

Internet penetration is rising appreciably in India today. Urban India which accounts for about 28% of the total population, has witnessed the bulk of this growth. On the other hand, as per the latest round of research conducted by IMRB International with ICube 2010, as per all India estimates, rural India is projected to have 10.6 Mn claimed Internet users and 8.5 Mn active Internet users in June 2010 and 15.2 Mn claimed Internet users and 12.1 Mn active Internet users in December 2010. This shows an over 40% growth in both claimed as well as active Internet users. Only 5% of the rural population is accessing Internet using mobile phones. However, the mobile medium presents an exciting medium for the Internet in the near future. Cost effective and feature laden mobile phones are increasingly available and Internet data plans become cheaper. With the launch of 3G services, there will be a greater number of people using these services in urban India at first, and with time will trickle down to the rural parts as well. 6% of the rural population is using Internet for Financial products, online banking, and insurance. (IAMAI Internet in Rural India, 2010)

On the other hand mobile phones as a delivery channel for extending banking services have off-late been attaining greater significance. The rapid growth in users and wider coverage of mobile phone networks have made this channel an important platform for extending banking services to customers. With the rapid growth in the number of mobile phone subscribers in India (about 261 million as at the end of March 2008 and growing at about 8 million a month), banks have been exploring the feasibility of using mobile phones as an alternative channel of delivery of banking services. Some banks have started offering information based services like balance enquiry, stop payment instruction of cheques, transactions enquiry, and location of the nearest ATM/branch etc. This is the most basic type of m-banking. Acceptance of transfer of funds instruction for credit to beneficiaries of same/or another bank in favor of pre-registered beneficiaries have also commenced in a few banks. Some banks offer only the option of text alerts, which are messages sent to cell phone that alert the customer regarding the activity on his /



her account such as deposits, withdrawals, and ATM or credit card use. A more involved type of m-banking allows the user to log into his or her account from a cell phone, and then use the phone to make payments, check balances, transfer money between accounts, notify the bank of a lost or stolen credit card, stop payment on a check, receive a new PIN, or view a monthly statement, among other transactions. With m-banking facilities, one can bank from anywhere, at anytime and in any condition or anyhow. The system is either through SMS or through WAP. In several countries (like Korea) two SIM Cards are used in mobile phones; one for the telephonic purpose and the other for banking.

It is expected that the adoption of m-banking will be fueled by two primary factors: consumers' increasing preference for real time, self-service transactions; and their growing adoption of mobile data services and applications.

TowerGroup estimates that up to 30 percent of online banking users will adopt the mobile channel in the next five years. However, m-banking is also likely to appeal to a segment of the banking population that accesses services via ATMs, but is not willing to use or comfortable with online banking. TowerGroup expects that by 2012, approximately one-fourth of all m-banking users will come from outside the online banking channel. It also estimates that m-banking usage will grow from 10 million active users in 2009 to over 53 million active users in 2013, representing a compound annual growth rate of 51.8%. Two factors that have helped the rapid growth of m-banking are the lower cost of mobile calls and the rapidly growing mobile penetration.<sup>64</sup>

### **Objective of the study**

m-banking is seen as an alternate delivery channel of i-banking as banking services provided by the m-banking and i-banking are more or less same. Various literatures are talking about the superiority of m-banking over i-banking in terms of its easy access, cost effectiveness, strong network, and security issues etc. This research paper tries to find out for which specific banking services customers prefer to use m-banking over i-banking and vice versa. It will be done by evaluating the customer perception and satisfaction related to use of i-banking and m-banking. In doing so the research work contributes to the literature on the relationship between perception and satisfaction of electronic delivery channel of banking in a number of ways.

First, this study examines the perception and satisfaction level of i-banking and m-banking customers of Indian PSBs.

Second, it provides a comparative analysis of i-banking and m-banking on some selected parameters of perception and satisfaction.

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<sup>64</sup>Feature – Mobile banking in India, June 14, 2009 – 5:23 pm by Shalini Amarnani

Third, this paper makes a more general theoretical contribution towards adaptation of delivery channels by the Indian PSBs in a segmented service delivery context.

## **Literature review**

As Internet banking is a relatively new concept in banking service delivery, not many studies are available in Indian context. The major distinction between the electronic and mobile business transaction prefixed as "e" and "m" is that the electronic medium offers "anytime access", while mobile medium offers "anytime and anywhere access" to business processes respectively (Tiwari et al, 2006).

### **i-banking**

Internet banking can be defined as the use of technology to communicate instructions and receive information from a financial institution where an account is held. Internet banking includes the system that enables financial institution customers, individuals or business to access accounts, transact business, or obtain information on financial products and services through a public or private network, including the Internet. Sournata, Mattila and Munnukka (2005), Al-Sabbagh and Molla (2004)- all explore the various inhibitors and drivers of electronic banking adoption. They believe there are relatively few empirical analyses of the impact of electronic banking on customers.

According to Wheri, Internet banking was used mainly as an information presentation medium in which banks marketed their products and services on their Web sites. With the development of asynchronous technologies and secured electronic transaction technologies, however, more banks have come forward to use Internet banking as transactional as well as an informational medium.

Gender is one of the relevant issues in the adoption of Internet banking. Shergill and Li's (2005) study of Internet banking consumers found that women regarded privacy protection and ethical standards more seriously than men did. The desire for control of service delivery was found important by Ramsay and Smith (1999) while habit may also play a role (Wan et al., 2005). The information provided on the banking web site may help provide needed knowledge and thus helps to motivate adoption (Waite and Harrison, 2004).

Consumer concerns about Internet security, privacy and trust have also been noted by many experts (Miyazaki and Fernandez, 2001; Gefen et al., 2003; Nissenbaum, 2004). Survey by Chung and Paynter (2002) identified consumer fears regarding transaction security as an inhibitor to the adoption of Internet banking. Security has also been identified as a key consumer concern in other Internet banking adoption studies (Black et al., 2002; Siu and Mou, 2005). In the context of consumer attitudes toward Internet banking systems, trust may be related to consumer judgment on security and privacy issues (Wang et al., 2003).

**m-banking**

Mobile banking, or m-banking, is the term we use to describe financial services delivered via mobile networks using mobile phones. Mobile business (m-Business) can be defined as electronic business interactions/transactions enabled at least in part by mobile technology that may target businesses and consumers alike (Coursaris and Hassanein, 2002). M-banking is separated into two categories; additive and transformational, where the additive model uses M-banking as an extra access channel for existing clients Porteous (2006).

M-banking has increasingly been heralded as the tool for bringing financial services to the largely unbanked population. Its potential to transform the livelihood of people – who previously have been outside the formal financial sector – is the key rationale put forward (Dr. Lennart Bångens and Björn Söderberg, 2008).

Charles et al. (2007) conducted a study on the M-commerce in the banking sector of Nigeria - it deals with the issue of adoption of ICT in the banking sector using SWOT analysis. It was found out that all banks in Nigeria offer e-banking and around 52% of them also offer some form of M-banking services. The paper reflected that the potential is great for M-Commerce but due to lack of infrastructure support the implementation is not smooth.

Coursaris & Khaled (2003) has done an analysis of the Canadian Mobile market with respect to both E-Commerce and M-Commerce focusing on the issue of wireless privacy. Needs and concerns of the mobile customers has been highlighted in their research.

Tiwari, Buse, and Herstatt (2007), in their study titled, "Mobile Services in Banking Sector: The Role of Innovative Business in Generating Competitive Advantages" have empirically assessed the customer acceptance of the M-Commerce in Germany. The study found that the highest users of mobiles are the top management of the corporate, self employed, salaried persons, students and others. It was found that Government employees were found not supporting mobile banking. Some of the reasons that came in favor of mobile banking is its ubiquity, overview of bank account and immediacy. However the concerns of the users were mainly regarding the insecurity and high cost.

Much of the attraction of the mobile banking channel lies in the "do-it-yourself" mindset it enables. Consumers can cash their own checks and transfer money-without visiting the branch or picking up the phone. In today's world, digital transactions equal dollars saved (Vemuri, 2010).

The results of a recent global survey by KPMG indicate that 91% of U.S. consumers have not tried banking through a mobile device, but 85% would like to try if offered free. Of the respondents that haven't tried mobile banking, 48% cited security and privacy concerns as the reason for not going for it. And while nearly 20% expected to break down and give it a try within

the next year, 66% found financial transactions on mobile devices to be more daunting of a proposition. Again 68% of KPMG's respondents said their current bank does not offer transactions through a mobile device - or if it did, they haven't been made aware of it.

Vital Analytics Team has done a survey based on data gathered in April 2009 for Feb/March m-banking in urban Indian the result of which is shown in the figure below:

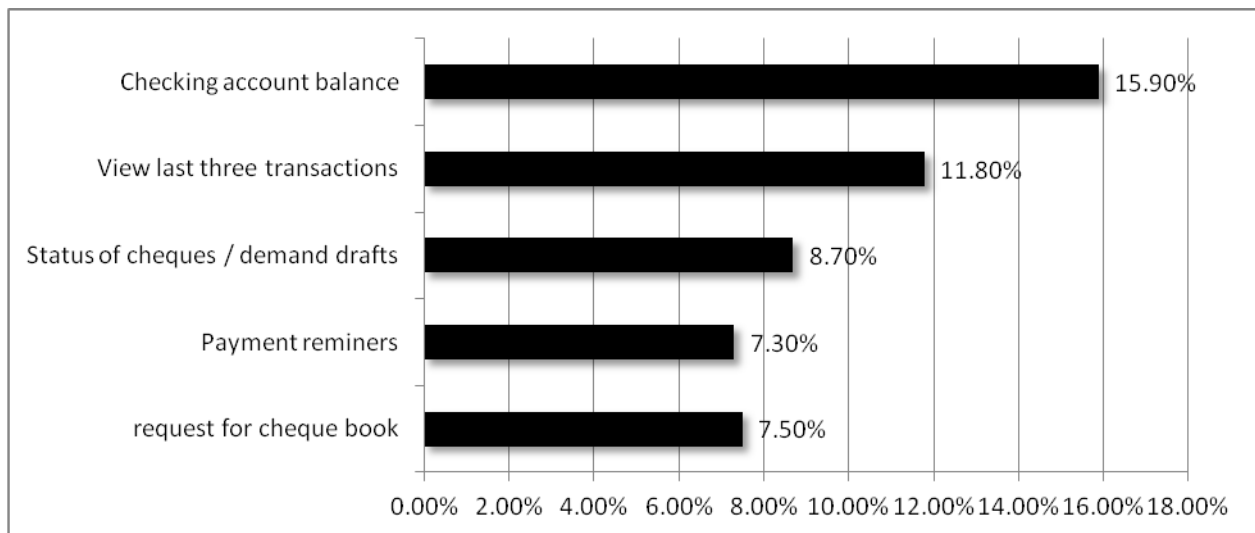


Figure1 : Statistics on most popular m-banking services

Filtering the data further, we can try to understand which of the income groups in urban India use m-banking more. m-banking is most used by subscribers falling in Rs. 1 Lakh to Rs. 2.99 Lakhs income bracket followed by less than Rs 1 Lakh income bracket. Therefore it is observed, m-banking is more popular among low income group of mobile users than higher income group of mobile users.<sup>65</sup>

However, the growth of m-banking still faces cultural, technical and business challenges. Chief among the technical challenges are information security and consumer privacy. Charul Vyas, an analyst in the Emerging Technologies research service said "Beyond technology, broad participation in m-banking will be most encouraged by maximizing and improving the customer experience," "Banks must invest substantial marketing dollars to increase consumer awareness about m-banking, as well as remain vigilant regarding privacy and data security in this area."

<sup>65</sup>Mobile banking report: "Most popular services and income profile" (Two month ended March 2009, Urban Indian Mobile Phone Users).

The mobile payments market is still at its infancy in India and it is estimated that the current daily transaction volumes today will be in the range of Rs 5-10 Million. Even if 5% of mobile bill payment and recharge shifts onto mobile payments platform the industry can grow to at a size of Rs200 Million a day.

## **Methodology**

This work was done mainly as an exploratory research to do a comparative analysis on i-banking and m-banking on some selected service areas.

### **Questionnaire**

This research paper evaluates the Customer Psyche i.e, it finds out customer perception and satisfaction level of i-banking and m-banking focusing on the different services provided by these two delivery channels. This research study has found out nine such service attributes and has measured how the perception and satisfaction level of these services differs with the channels of delivery. Primary data has been gathered on the perception and satisfaction level of i-banking and m-banking from the customers of Indian PSBs.

For this purpose customer of Indian banks which have implemented i-banking and m-banking has been surveyed. There were 36 questions altogether divided under four subheadings:

- Customer perception on i-banking services provided by Indian PSBs
- Customer perception on m-banking services provided by Indian PSBs
- Customer satisfaction with the present service level of i-banking
- Customer satisfaction with the present service level of m-banking

### **Scaling Technique**

We have used Likert-type Scales, consisting of a number of statements which express either a favourable or unfavourable attitude towards the given object to which the respondent is asked to

react. The respondent indicated his agreement or disagreement with each statement in the instrument. Each response is given a numerical score, indicating its favourableness or unfavourableness, and the scores are totaled to measure the respondent's attitude. In other words, the overall score represents the respondent's position on the continuum of favourableness or unfavourableness towards an issue.

### **Sampling**

Users of i-banking and m-banking services as offered by Indian Public Sector banks forms the population to evaluate the perception and present satisfaction level of these two delivery channels. The banks which have a high rating in the usage of electronic payment systems

(volume and value of transaction wise) were chosen for this study. Three PSBs has been selected which have high value and volume of Internet banking transactions, namely State Bank of India, Punjab National Bank, Bank of Baroda. Major cities are considered as subgroups here as the customers of the major metro cities are the main users of i-banking and m-banking. Among these subgroups the four major metro cities are selected for collecting the sample. To decide the sample to be taken for each of these three banks and again each of the four cities within these three selected PSBs, number of ATM outlets of the banks in four metro cities have been collected. The assumption was ATM users are the prospective user of i-banking and m-banking.

Percentage has been worked out to find out the ranking of the banks in terms of no. of ATM outlets in these three banks and four cities within in each of the three banks. Accordingly 131 customers from SBI, 65 from PNB and 86 customers from BOB were selected. The banks were not willing to share the list of Internet banking and m-banking users due to security reason. Therefore quota sampling method was applied to select the customers of i-banking and m-banking. A total of 282 customers were given the questionnaires out of which 240 were usable the average response rate being 85%.

### **Statistical Techniques Used**

The data collected through questionnaire were analyzed using the following statistical techniques:

- Univariate statistical technique: the measures of central tendency, namely, mean were used for determining customer satisfaction on various dimensions of Indian retail banking sector.
- Multivariate statistical techniques: factor analysis was carried out to identify the different dimensions of Indian retail banking industry, and the variables that impact the dimensions.

The above analysis was carried out using SPSS version 17.0 software.

### **Analysis**

The data collected were analyzed and tested under two categories :

- Category I : Customer's perception on different services provided by i-banking and m-banking
- Category II : Customer's satisfaction on different services provided by i-banking and m-banking

The table 1 given below shows the variables and their description on which data has been collected and analyzed.

<i>Sly no.</i>	<i>Variable name</i>	<i>Description</i>
1	<i>perception_fundtransfer_ibank</i>	<i>Fund transfer (RTGS, NEFT) can be done easily though i-banking</i>
2	<i>perception_balanceenquiry_ibank</i>	<i>Balance enquiry can be done easily through i-banking</i>
3	<i>perception_billpayment_ibank</i>	<i>Bill payment (Electric, Telephone, Mobile) can be done easily though i-banking</i>
4	<i>perception_taxpayment_ibank</i>	<i>Tax payment can be done easily though i-banking</i>
5	<i>perception_tktbooking_ibank</i>	<i>Ticket purchase (Train, Air, Bus ) can be done easily though i-banking</i>
6	<i>perception_onlinetrading_ibank</i>	<i>Online trading can be done easily though i-banking</i>
7	<i>perception_eshopping_ibank</i>	<i>e-shopping can be done easily though i-banking</i>
8	<i>perception_movieticket_ibanktibank</i>	<i>Cinema ticket booking can be done easily though i-banking</i>
9	<i>perception_servicerequest_ibank</i>	<i>Online service request (a/c opening, dd issue, cheque book issue, loan application, Stop payment of cheque , Cheque status ATM / branch locator, new a/c or fixed deposit) are easy to handle through i-banking</i>
10	<i>perception_fundtransfer_mbank</i>	<i>Fund transfer (RTGS, NEFT) can be done easily though m-banking</i>
11	<i>perception_balanceenquiry_mbank</i>	<i>Balance enquiry can be done easily through m-banking</i>
12	<i>perception_billpayment_mbank</i>	<i>Bill payment (Electric, Telephone, Mobile) can be done easily though m-banking</i>
13	<i>perception_taxpayment_mbank</i>	<i>Tax payment can be done easily though m-banking</i>
14	<i>perception_tktbooking_mbank</i>	<i>Ticket purchase (Train, Air, Bus ) can be done easily though m-banking</i>
15	<i>perception_onlinetrading_mbank</i>	<i>Online trading can be done easily though m-banking</i>
16	<i>perception_eshopping_mbank</i>	<i>e-shopping can be done easily though m-banking</i>
17	<i>perception_movieticket_mbankctibank</i>	<i>Cinema ticket booking can be done easily though m-banking</i>
18	<i>perception_servicerequest_mbank</i>	<i>Online service request (a/c opening, dd issue, cheque book issue, loan application, Stop payment of cheque , Cheque status ATM / branch locator, new a/c or fixed deposit) are easy to handle through i-banking</i>
19	<i>satisfaction_fundtransfer_ibank</i>	<i>Satisfaction level with fund transfer (RTGS, NEFT) mechanism through i-banking</i>
20	<i>satisfaction_balanceenquiry_ibank</i>	<i>Satisfaction level with balance enquiry through i-banking</i>
21	<i>satisfaction_billpayment_ibank</i>	<i>Satisfaction level with different bill payment (Electric, Telephone, Mobile) through i-banking</i>
22	<i>satisfaction_taxpayment_ibank</i>	<i>Satisfaction level with tax payment though i-banking</i>
23	<i>satisfaction_tktbooking_ibank</i>	<i>Satisfaction level with ticket purchase (Train, Air, Bus ) through i-banking</i>
24	<i>satisfaction_onlinetrading_ibank</i>	<i>Satisfaction level with online trading through i-banking</i>
25	<i>satisfaction_eshopping_ibank</i>	<i>Satisfaction level with e-shopping through i-banking</i>
26	<i>satisfaction_movieticket_ibankctibank</i>	<i>Satisfaction level with cinema ticket booking through i-banking</i>
27	<i>satisfaction_servicerequest_ibank</i>	<i>Satisfaction level with online service request (a/c opening, dd issue, cheque book issue, loan application, Stop payment of cheque , Cheque status ATM / branch locator, new a/c or fixed deposit) through i-banking</i>
28	<i>satisfaction_fundtransfer_mbank</i>	<i>Satisfaction level with fund transfer (RTGS, NEFT) mechanism through m-banking</i>

<i>Sly no.</i>	<i>Variable name</i>	<i>Description</i>
29	<i>satisfaction_balanceenquiry_mbank</i>	<i>Satisfaction level with balance enquiry through m-banking</i>
30	<i>satisfaction_billpayment_mbank</i>	<i>Satisfaction level with different bill payment (Electric, Telephone, Mobile) through m-banking</i>
31	<i>satisfaction_taxpayment_mbank</i>	<i>Satisfaction level with tax payment though m-banking</i>
32	<i>satisfaction_tktbooking_mbank</i>	<i>Satisfaction level with ticket purchase (Train, Air, Bus ) through m-banking</i>
33	<i>satisfaction_onlinetrading_mbank</i>	<i>Satisfaction level with online trading through m-banking</i>
34	<i>satisfaction_eshopping_mbank</i>	<i>Satisfaction level with e-shopping through m-banking</i>
35	<i>satisfaction_movieticket_mbankctibank</i>	<i>Satisfaction level with cinema ticket booking through m-banking</i>
36	<i>satisfaction_servicerequest_mbank</i>	<i>Satisfaction level with Online service request (a/c opening, dd issue, cheque book issue, loan application, Stop payment of cheque , Cheque status ATM / branch locator, new a/c or fixed deposit) through m-banking</i>

Table 2: Name and description of the variables used in SPSS ver 17.0

### Findings on category I :customer's perception on different services provided by i-banking and m-banking

#### Mean value analysis

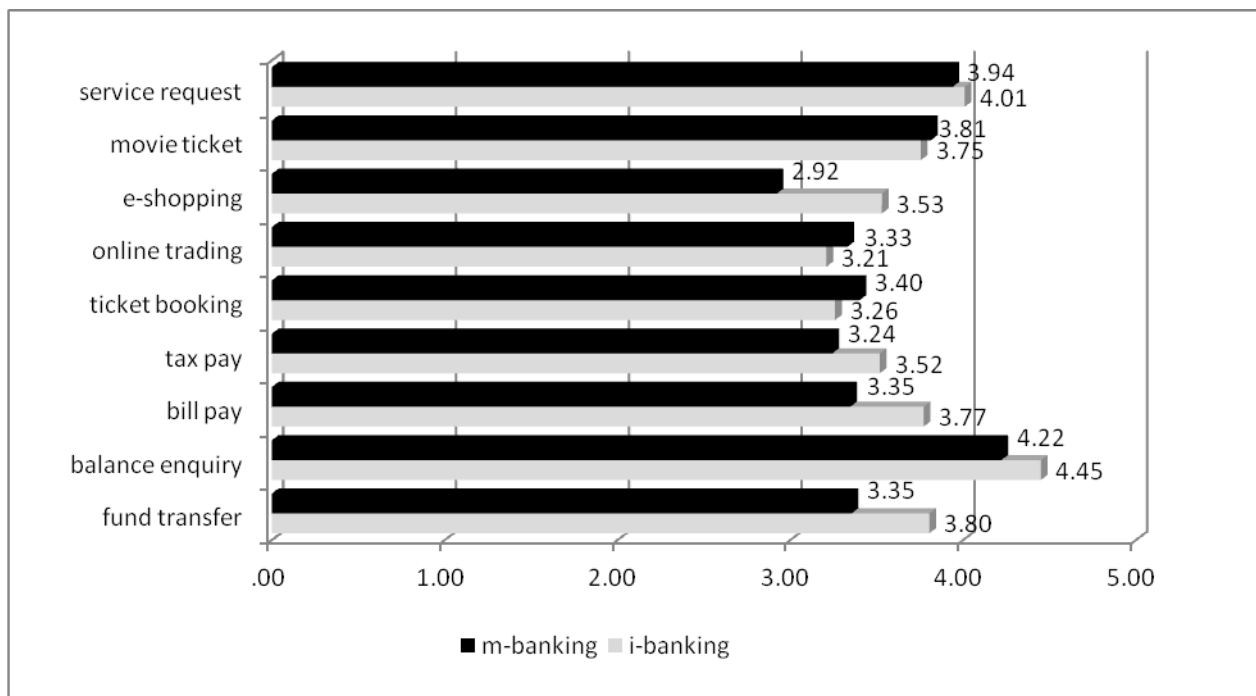


Figure 3:Comparative mean value analysis of customer perception regarding i-banking and m-banking services



Figure 3 gives a comparative mean value analysis of the user perception regarding m-banking and i-banking. Customers prefer i-banking over m-banking in the services like fund transfer, balance enquiry, bill payment, tax payment, e-shopping and online service request. Nevertheless the intensity of the preference varies from service to service. m-banking is a preferred channel over i-banking for the services like ticket booking, movie ticket booking and online trading.

### Factor analysis

Factor analysis has been performed separately on i-banking and m-banking related to perceptual attributes.

*Rotated Component Matrix<sup>a</sup>*

	<i>Component</i>	
	<i>1</i>	<i>2</i>
<i>Perception_fundtransfer_ibank</i>		.841
<i>Perception_balanceenquiry_ibank</i>	.884	
<i>Perception_billpayment_ibank</i>		.862
<i>Perception_taxpayment_ibank</i>	.834	
<i>Perception_eshopping_ibank</i>	.480	-.817
<i>Perception_movieticket_ibank</i>	-.858	

*Extraction Method: Principal Component Analysis.*

*Rotation Method: Varimax with Kaiser Normalization.*

*a. Rotation converged in 3 iterations.*

*Table 3: Factor analysis of customer perception regarding i-banking services*

There were 9 items related to perception of i-banking services. The significance values in the correlation matrix were scanned and the variable for which majority of the significance value is greater than 0.05 were noted. We also identified correlation coefficients which had greater than 0.9. Accordingly three variables were eliminated. The KMO measure of sampling adequacy gives a value of 0.658 which is mediocre. Barlett's Test of sphericity is highly significant ( $p < 0.001$ ) and therefore factor analysis is appropriate.

Two factors were extracted through varimax with Kaiser Normalization rotation method, having

eigen value more than 1. Rotation converged in 3 iterations. Variables which had factor loadings lesser than .40 were deleted from the analysis.

Factor 1 includes variable Perception\_balanceenquiry\_ibank, Perception\_taxpayment\_ibank, Perception\_movieticket\_ibank indicating the time dimension.

Factor 2 comprises of the variables Perception\_fundtransfer\_ibank, Perception\_billpayment\_ibank and Perception\_eshopping\_ibank indicating transaction-intensive dimension because they generally involve a considerable amount of transaction.

*Rotated Component Matrix<sup>a</sup>*

	Component	
	1	2
Perception_fundtransfer_mbank	.758	
Perception_balanceenquiry_mbbank	.593	
Perception_billpayment_mbank	.774	
Perception_taxpayment_mbank		.647
Perception_ticketbooking_mbbank		-.533
Perception_eshopping_mbank		.542
Perception_movieticket_mbbank	-.630	.568

*Extraction Method: Principal Component Analysis.*

*Rotation Method: Varimax with Kaiser Normalization.*

*a. Rotation converged in 3 iterations.*

*Table 4: Factor analysis of customer perception regarding m-banking services*

There were 9 items related to perception of m-banking services also. The significance values in the correlation matrix were scanned and the variable for which majority of the significance value is greater than 0.05 were noted. Accordingly two the variables were eliminated. The KMO measure of sampling adequacy gives a value of 0.724 which is considered good. Barlett's Test of sphericity is highly significant ( $p < 0.001$ ) and therefore factor analysis is appropriate.

Two factors were extracted through varimax with Kaiser Normalization rotation method, having

eigen value more than 1. Rotation converged in 3 iterations. We also eliminated from the analysis those variables which had factor loadings lesser than 0.40 .

The first dimension comprises of the factors Perception\_fundtransfer\_mbank, Perception\_balanceenquiry\_mbank, Perception\_billpayment\_mbank and Perception\_movieticket\_mbank indicating *frequent service dimension*.

The second dimension indicating *occasional service dimension* consists of three parameters - Perception\_taxpayment\_mbank, Perception\_ticketbooking\_mbank and Perception\_eshopping\_mbank.

### Findings on category II: customer's satisfaction on different services provided by i-banking and m-banking

#### Mean value analysis

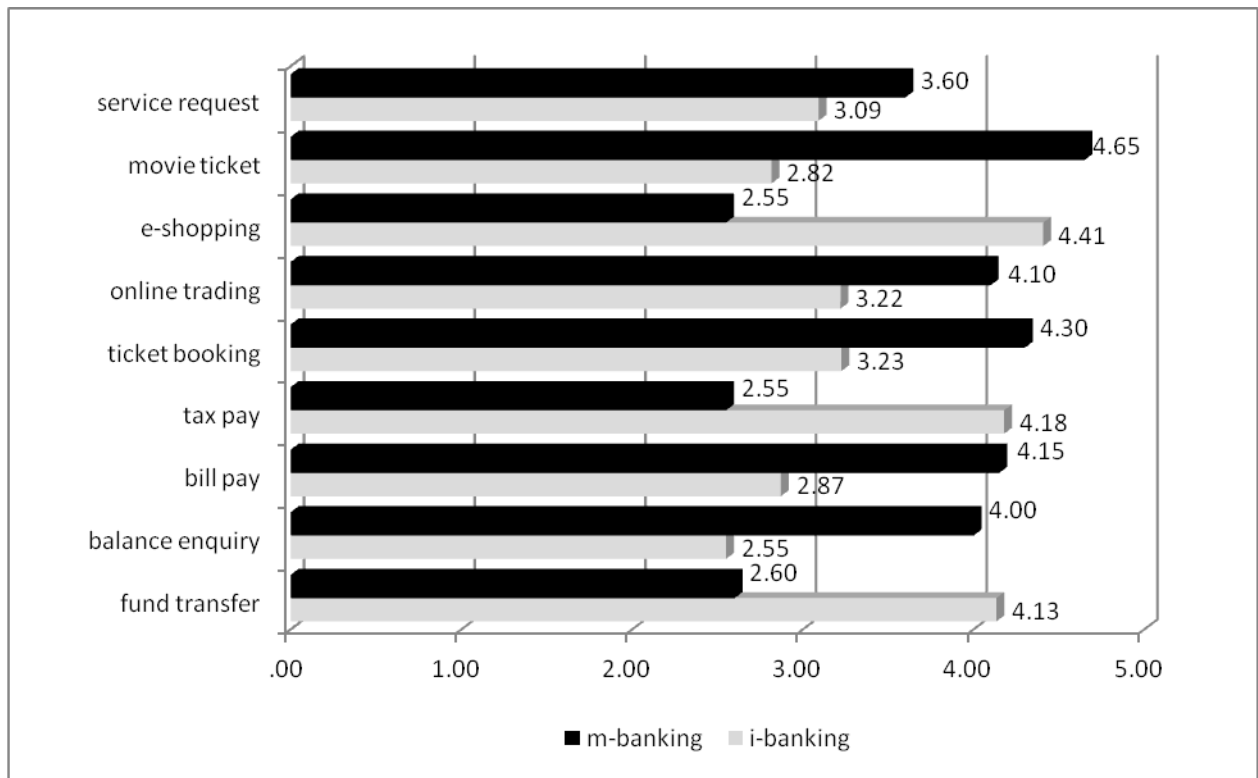


Figure6 : Comparative mean value analysis of customer satisfaction regarding i-banking and m-banking services

Here again figure 6 gives a comparative mean value analysis of the user satisfaction regarding m-banking and i-banking. The analysis indicates:

- Customer has a much high satisfaction level for shopping electronically using i-banking than m-banking.
- Customers are more satisfied with m-banking for movie ticket booking.
- For tax payment customers are having higher satisfaction level with i-banking
- customers are more satisfied with balance enquiry service of m-banking

- Customer satisfaction is again higher in i-banking than m-banking for fund transfer (RTGS, NEFT).
- On the other hand for issues like balance enquiry, bill payment (Electric, Telephone, Mobile), ticket booking, online trading and online service requests (a/c opening, dd issue, cheque book issue, loan application, stop payment of cheque, cheque status ATM / branch locator, new a/c or fixed deposit) customers are showing a higher satisfaction level with m-banking delivery channel as compared to i-banking.

### Factor analysis

*Rotated Component Matrix<sup>a</sup>*

	Component	
	1	2
<i>Satisfaction_fundtransfer</i>		-.594
<i>Satisfaction_balanceenquiry</i>	-.606	
<i>Satisfaction_billpayment</i>	-.620	.572
<i>Satisfaction_taxpayment</i>	.734	
<i>Satisfaction_onlinetrading</i>	.631	
<i>Satisfaction_eshopping</i>	.820	
<i>Satisfaction_servicerequest</i>		.848

*Extraction Method: Principal Component Analysis.*

*Rotation Method: Varimax with Kaiser Normalization.*

*a. Rotation converged in 3 iterations.*

*Table 5: Factor analysis of customer satisfaction regarding i-banking services*

There were nine items related to perception of m-banking services also. Measure of sampling adequacy (MSA) measures the magnitude of observed correlation coefficients to the magnitude of partial correlation coefficients (Agarwal, 2008). Values of MSA above .50 for entire matrix and for individual variable indicate appropriateness for factor analysis (Hair et al., 2009). Accordingly two variables were dropped. The KMO measure of sampling adequacy gives a value of 0.749 which is considered good. Barlett's Test of sphericity is highly significant ( $p < 0.001$ ) and therefore factor analysis appropriate.

Factor analysis on the satisfaction of i-banking brings out twodimensions. The first factor consists of Satisfaction\_eshopping\_ibank, Satisfaction\_taxpayment\_ibank, Satisfaction\_onlinetrading\_ibank, Satisfaction\_billpayment\_ibank and Satisfaction\_balanceenquiry\_ibank indicating value-added service dimension.

The second factor consists of Satisfaction\_fundtransfer\_ibank and Satisfaction\_servicerequest\_ibank indicating core service dimension.

*Rotated Component Matrix<sup>a</sup>*

	Component		
	1	2	3
Satisfaction_fundtransfer	-.812		
Satisfaction_balanceenquiry			.898
Satisfaction_billpayment	.492	.593	
Satisfaction_taxpayment		-.587	.593
Satisfaction_ticketbooking		.677	.418
Satisfaction_onlinetrading		-.743	
Satisfaction_eshopping	.626		-.662
Satisfaction_movieticket	-.531	.754	
Satisfaction_servicerequest	.866		

*Extraction Method: Principal Component Analysis.*

*Rotation Method: Varimax with Kaiser Normalization.*

*a. Rotation converged in 5 iterations.*

*Table 6: Factor analysis of customer satisfaction regarding m-banking services*

Factor analysis on the satisfaction level of the m-banking again brings our three dimensions.

Factor 1 consists of Satisfaction\_fundtransfer and Satisfaction\_servicerequest indicating *core service dimension*.

Factor 2 consisting of Satisfaction\_movieticket\_mbank, Satisfaction\_onlinetrading\_mbank, Satisfaction\_ticketbooking\_mbank, and Satisfaction\_billpayment\_mbank indicates the *value-added service dimension*.

Factor 3 consists of Satisfaction\_balanceenquiry\_mbank, Satisfaction\_eshopping\_mbank and Satisfaction\_taxpayment\_mbank and indicates *time dimension*.

## Findings and conclusion

From the above analysis on the customer perception and satisfaction regarding nine identified i-banking and m-banking service attributes some major findings are coming out. The mean value analysis of customer perception shows services like e-shopping, electronic fund transfer, utility bill payments, tax payments and balance enquiry i-banking is more suitable as a channel of delivery. While shopping people generally like to see the product physically. None of the

electronic channel can serve the purpose. However, a computer screen is a preferred medium than a mobile screen as it can give a larger and more detailed image with higher precision. May be due to this reason the customer perception is more favourable towards i-banking for e-shopping. There is a limitation of 5000 rupees for each and every transaction using m-banking. Whereas there is no limit on NEFT transaction and the minimum amount to be remitted through RTGS is Rs.1 lakh. For this reason probably customers are still reluctant to perceive m-banking as a suitable delivery channel for fund transfer. For rest of the issues like utility bill payments, tax payments and especially for balance enquiry, may be the low adaptation of m-banking is the cause for lower preference. It is expected that more and more people will get accustomed to m-banking the more they will rely on this delivery channel.

Coming to the satisfaction level of the i-banking and m-banking customers of Indian PSBs it has been found that they are more satisfied with i-banking when the issue of e-shopping arises, which actually echoes customer perception. Those who have experienced m-banking have shown a clear inclination towards m-banking for value-added services like movie ticket booking. For issues like tax payment which have to be done once in every year people are having high satisfaction level with i-banking. For more frequent issues like balance enquiry, bill payment (Electric, Telephone, Mobile), ticket booking, online trading and online service requests (a/c opening, DD issue, cheque book issue, loan application, stop payment of cheque, cheque status ATM / branch locator, new a/c or fixed deposit) customers are showing a higher satisfaction level with m-banking delivery channel as compared to i-banking. However as depicted in the perception analysis also people still rely more on i-banking for issues like fund transfer where dealing with a lump sum amount is concerned.

The factors identified from the perceptual analysis of i-banking indicates people like to use i-banking mainly for two reasons a) for reducing the lead-time of operation and b) for transaction intensive services. The analysis on the satisfaction level clearly brings out two factors core service dimension and value added service dimension both for i-banking and m-banking. The core services of banking are fund transfer and various service requests of banking. Bill payment, tax payment, ticket booking (train, air, and bus), online trading, electronic shopping and movie ticket booking has been identified as value added services. This implies the customers of Indian PSBs measure the performance of core banking services and value-added banking services separately. The difference of factor loadings within the factor for i-banking and m-banking bears that, both the channels are suitable to offer the various banking services and customers expect to receive these services through these two channels because of the respective advantages of the channels. Therefore i-banking and m-banking, these two delivery channels can be regarded as complementary to each other. May be the perception and the satisfaction level will be more

inclined towards m-banking in coming days with more adaptation of m-banking as a delivery channel and less stringent rules by the government.

### Limitations

Only nine service types have been selected for comparison m-banking and i-banking. There are many more services that can be taken into consideration and if added to this analysis may open up separate dimension related to this research area.

Only 240 samples have been collected for this research study. More related data can provide with more valuable findings in this regards.

Very few Indian PSBs are practicing m-banking though most of them are providing i-banking facilities. It is believed that when all of the PSBs will come up with m-banking facilities in its full flair this will add more dimension to this kind of research work.

No demographic analysis has been provided in this research paper though as specified in the literature review various demographic analyses has already been done regarding the adaptation of m-banking services.

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## ORGANISATIONAL LEARNING AND SERVICE QUALITY FOR HEALTH AND FITNESS ENTREPRENEURS

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### Abstract

This paper presents a study of learning, entrepreneurship and service quality in the health and fitness sector. The purpose is to outline the theoretical framework and to propose a methodological approach for the study. The theoretical basis for the project lies in the field of service dominant logic of marketing. One aim is to develop this field by integrating knowledge from organisational learning, entrepreneurship and quality management. Theories from those fields are presented and their relevance is discussed. On this basis, a methodology for an empirical study is proposed.

**Keywords:** Organisational learning, service dominant logic of marketing, service quality, entrepreneurship, health and fitness

### Introduction and Purpose

Systematised methods for quality management started to form around the last turn of the century (Lagrosen and Lagrosen, 2009). During recent decades they have also been thoroughly researched in many different sectors. One of the sectors that have attracted substantial research is the health sector. Nevertheless, virtually all research has concentrated on traditional health care, e.g. hospitals. On the other hand the recreational health sector which includes activities such as SPA, fitness and wellness is insufficiently researched.

Traditional quality management theories focused on industrial manufacturing companies and were developed by researchers from the technical disciplines. About 25 years ago theories specifically concerning quality in services started to appear. This coincided with the rapid expansion of the field of services marketing (Brown et al., 1994). In developing theories for services management the scholars realised that quality issues needed to be included. As no such theories existed at that time, service quality came to be a field within services marketing.

Later, services marketing has matured as a research field with vast amounts of research being produced and numerous scientific journals having this focus. Nevertheless, the last few years have seen interesting developments in the field. Leading scholars have begun to question the relevance of services marketing as a field focusing solely on marketing of services. Rather, they

claim that there is a certain service logic that can be applied to any offering. This new way of regarding service marketing, called the service dominant logic of marketing, SDL, is promoted as a completely new logic for all marketing activities (Lusch and Vargo, 2006). The approach has gained considerable ground and is becoming more and more established.

There is, however, room for further theoretical development of SDL. The connection between SDL and quality, both traditional quality management and service quality, is in no way clear and need to be investigated further. Ideally, lessons learned in the quality field should be incorporated into SDL. Since it is relationship oriented and based on co-production by the customer (Vargo and Lusch, 2004a), the success of SDL hinges on the ability of organisations to uphold balanced and trustful relationships internally as well as with networks of external customers and other stakeholders (Gummesson, 2008). Developing such ability requires profound and sustainable learning touching on values and culture. Ways of achieving this are studied in the field of organisational learning (Senge, 2006). Therefore, organisational learning theories should be integrated in SDL for it to have a profound base needed for real changes to take place.

Moreover, the technical progress in information and communication technology, ICT, has to a large extent altered the conditions for conducting marketing activities and will probably continue doing so (Hair and Money, 2006). The advent of the Internet has changed the way people and companies communicate providing companies with novel approaches for marketing communications. In particular, the recent upsurge in the use of social media (Facebook, Twitter etc.) is rapidly changing the ground for marketing activities (Scott, 2010). This new development remains to be included in SDL. In particular, entrepreneurs have been quick to adopt the social media in their marketing activities. The health and fitness sector mainly consists of small and medium sized companies. Furthermore, the sector is characterised by fast changes in the output and demand for various health offers. Thus, successful actors need to have entrepreneurial skills.

The overall scientific purpose for the project is twofold:

- To investigate service quality based on the service dominant logic of marketing in the health and fitness industry, an empirical area which has so far attracted far less research than its importance merits.
- To develop means of integrating knowledge from the fields of quality management, organisational learning, social informatics and entrepreneurship into the framework of the service dominant logic of marketing.

The research contribution from the project will be a development of the service dominant logic, SDL, framework into a more complete system for generating quality and marketing success in the modern business context. Another contribution will be additional understanding of service

quality and marketing in the health and fitness industry. The purpose for this paper is to outline the theoretical framework and propose a methodological approach for the study.

The main basis for the project is found in the newly developed field of service dominant logic of marketing. In order to further develop this field, we will also include theories from quality management, organisational learning and entrepreneurship. In the following sections, we will briefly review some relevant aspects of those areas.

## **Quality Management**

Management of quality has been an issue for all organised human activity since time immemorial. However, systematised quality management methods were first employed around of the turn of the last century (late 19th and early 20th century). The early quality management approaches focused mainly on inspection (Lagrosen and Lagrosen, 2009). Next stage came to be the development of statistical tools for quality control. After the Second World War the development was led by Japan with the aid of the American scholars W. Edwards Deming and Joseph J. Juran. This resulted in quality management being developed into an advanced framework for continuous improvement, employee motivation and leadership (Deming, 1986; Ishikawa, 1985; Juran, 1989). Today, quality management can be viewed as an integrated system consisting of managerial values, techniques and tools (Hellsten and Klefsjö, 2000). Research has found that the methods included, and in particular the values, are effective for achieving a well-functioning quality management in companies from all sectors (Lagrosen and Lagrosen, 2005).

Traditional quality management was developed in the industrial manufacturing sector. In a separate development marketing emerged as an academic discipline. It started as an offspring of economics but advanced into a number of different schools during the first half of the 19th century. From the early 1960s, the discipline came to be dominated by the managerial school containing practical and concrete methods for marketing management (Lagrosen and Svensson, 2006). Starting from the late 1970s this dominance came to be challenged by two different strands: industrial marketing and services marketing. The latter came from the realisation that marketing services was different from traditional marketing which made the managerial school of marketing lack relevance. The field expanded rapidly during the 1980s and 1990s aided by the fact that global deregulation led to substantial changes taking place in many service sectors. Some general models for service quality that were presented quite early had a large impact and they are still referred to (see e.g. Grönroos, 1990; Parasuraman et al., 1985). In addition, related methods for quality measurement such as the SERVQUAL (Zeithaml et al., 1990) has continued to be popular in spite of later criticism. More recently service quality has expanded its scope in different directions, coming to include important aspects such as the role of feelings (Edvardsson, 2005). In addition, the importance of relationships has been emphasised. In this way, service

marketing together with industrial marketing formed a basis for the emergence of relationship marketing (Gummesson, 1999).

### **The Service Dominant Logic of Marketing**

In recent years, a new way of approaching marketing related to services has come to light – the service dominant logic of marketing, SDL, (Vargo and Lusch, 2004a). Its originators claim that this is a completely new paradigm of marketing thought and that it will change the way marketing is viewed in the same way that traditional physics was revolutionised by the advent of quantum mechanics (Lusch and Vargo, 2006). The novelty lies in the fact that it does not focus on services as such. Services marketing is usually seen as a way of conducting marketing for a certain kind of products i.e. services. Therefore, much effort has been wasted on identifying differences between goods and services while still departing from a goods-based perspective (Vargo and Lusch, 2004b). SDL in contrast regards service marketing as an approach, a way of conducting marketing for any kind of products in which the focus is on providing value for the customer. SDL builds on a number of fundamental premises which were originally formulated as follows (Vargo and Lusch, 2004a):

- The application of specialised skills and knowledge is the fundamental unit of exchange
- Indirect exchange masks the fundamental unit of exchange
- Goods are distribution mechanisms for service provision
- Knowledge is the fundamental source of competitive advantage
- All economies are service economies
- The customer is always a coproducer
- The enterprise can only make value propositions
- A service-centered view is customer oriented and relational

SDL has had a large impact on marketing thought and the framework is evolving. In a later paper (Vargo and Lusch, 2008) the authors have revised the premises and added two additional:

- All social and economic actors are resource integrators
- Value is always uniquely and phenomenologically determined by the beneficiary

Despite its impact, critics hold that SDL need further development (Brookes, 2007) and particularly that more empirical research is needed (Winklhofer et al., 2007). One area that needs further development is the connection between SDL and branding (Brodie et al., 2006). Interestingly, SDL may lead to branding being extended into wider communication modes

(Ballantyne and Aitken, 2007). For this reason, we will also include studies of the branding situation in the companies and we will examine their use of social media (see below).

## **Organisational Learning**

Organisational learning is a theoretical field that has been formed based on the ambition to promote sustainable success in organisations. Thus, it is meant to counter reductionist approaches and provide a more holistic view. Its basis lies in systems thinking and consequently it draws its roots to general systems thinking as formulated by von Bertalanffy (1950) and its later developments in organisational theory. Seeing organisations as systems implies that shifts in processes, strategies, practices and systems must be based on inner shifts in people's values, aspirations and behaviour (Senge, 1999). This resembles the view of quality management as a system of different components presented above. Thus, quality initiatives, in order to be effective must be based on profound organisational learning, which is often not the case (Argyris, 1999).

Another interesting aspect on learning is the difference between knowledge of individual actors and knowledge documented in routines, policies, information systems, documents etc. Both forms influence individual possibilities for learning and development (Giddens, 1984)

Profound learning in an organisation requires an influence on its core values (Argyris, 1993; Argyris and Schön, 1996). Often organisational change is attempted through changes in organisational structure, ways of working, technology, communication etc. However, these changes will only be effective if they are related to changes in principles and values of the employees (Schneider et al., 1996). Often, there is a difference between the values that an organisation officially promotes, the espoused values (Schein, 1992) and what it actually does, the theories in use. Although much research has indicated inconsistencies between these two, not enough is known about how to handle these inconsistencies (Argyris, 1999). There are often hidden attitudes that need to be brought to surface for continuous learning to be possible (Senge, 1999).

Learning in organisations often involves tacit knowledge (Polanyi, 1967) and actions that are skilful are usually based on tacit knowledge that have been transformed into manageable routines (Argyris, 1999). Hence, methods for transforming tacit knowledge to explicit knowledge and vice versa are particularly useful (Nonaka and Takeuchi, 1995). Therefore, our studies will contain qualitative methodologies aimed at understanding subtle aspects such as values and tacit knowledge. Organisational learning theories tend to emphasise collaboration, decentralised structures and multi-disciplinary work-teams (Beeby & Booth, 2000). Consequently, the experience of studying teams that the research group has (see e.g. Berlin & Carlström) will be beneficial for understanding these learning processes.

Although, organisational learning usually deals with separate organisations its scope should go beyond the individual organisation. Current business is becoming ever more interconnected and value is usually created in networks. Ideally, learning networks can be created (Garcia, 2006). One ambition for the proposed project is to create a learning network in the Swedish health and fitness industry.

## Entrepreneurship

The term entrepreneurship derives from the French words "entre" (between) and "prendre" (to take). Thus, literally, an entrepreneur is someone who takes a position between a supplier and a customer. According to the French economist JB Say, an entrepreneur is a person who "shifts economic resources from an area of low productivity into an area of higher productivity and greater yield" (Chaston, 2000). This definition would probably cover most activities of business but entrepreneurship has developed into a concept including elements of risk taking and innovation. Entrepreneurial marketing is different from traditional marketing management, business marketers act differently, and thus their behaviour enriches the understanding of the possibilities of marketing (Hills and Hultman, 2006). In many cases, entrepreneurship is used to describe the activities of smaller firms. Yet not all small businesses are entrepreneurial. On the contrary, many conduct marketing in a very traditional way. For them to be considered entrepreneurial there must also be some novelty and creativity in the way they act. In addition, entrepreneurial marketing, may also be applicable in large firms, given the turbulence, risks and uncertainties surrounding today's markets (Hills and Hultman, 2006).

Moreover, entrepreneurial thinking is making its way into other areas than the industry. For example, social entrepreneurship is used to describe business activity in the social field as a complement or alternative to traditional welfare systems (Thompson et al., 2000). Similarly, cultural entrepreneurs are individuals or companies who act in an entrepreneurial way in the cultural sphere (Wilson and Stokes, 2002)

Several researchers have noted characteristics or personal tendencies that are common among entrepreneurs, that distinguishes them from other managers. Some examples of such properties that are particularly relevant in this case are (Lamping and Kuehl, 1997):

- *A passion for business.* This should include both personal and emotional commitment. Many professionals in the health and fitness sector are themselves passionate about their own training, fitness and general health.
- *Confidence.* Entrepreneurs often have profound knowledge of their products and markets which makes them confident in themselves. Managers in the health and fitness sector are often personally engaged in health and fitness activities as well as having

substantial theoretical knowledge of anatomy, nutrition etc. This gives them a firm knowledge base for their management.

- *Management of risk.* Entrepreneurial activities usually contain an element of risk taking. Nevertheless, many entrepreneurs manage risks very carefully. Several activities in the health and fitness sector require substantial investment which contributes to an element of risk.
- *Changes are opportunities.* Entrepreneurs are not frightened by change. Rather, they search for it and exploit it. They have a capacity to master change to their own advantage. The health and fitness sector is characterised by fast changes in that new treatments and training methods quickly come in and out of fashion. Handling this requires entrepreneurial ability.

### **Previous Research Regarding Quality in Health and Fitness**

Studies connecting health and quality have almost exclusively concerned traditional health care such as hospitals (see e.g. Arcelay et al., 1999; Wagar and Rondeau, 1998; Yasin and Alavi, 1999).

On the other hand, organisations focusing on promotive health care such as the fitness, SPA and wellness sectors have received surprisingly little attention from the research community (Mueller and Kaufmann, 2001). This is even more surprising since some of the studies made have indicated that the sector suffers from quality problems (e.g. Hurley, 2004).

As service operations in the fitness sector are especially complex (Chelladurai et al., 1987) and distinctive (Chang and Chelladurai, 2003) often including bundling of different services (Woolf, 2008), research into this field could contribute to the general development of service quality theory and the development of the service dominant logic of marketing. Some previous studies into quality dimensions in the sector exist (Afthinos et al., 2005; Athanasopoulou, 2008; Chang and Chelladurai, 2003; Chelladurai et al., 1987; Lagrosen and Lagrosen, 2007; Papadimitriou and Karteroliotis, 2000; Tawse and Keogh, 1998) as well as their relationship to branding (Alexandris et al., 2008). However, the research is rather disparate and no consensus regarding the dimensions of quality in the area has been reached (Lam and Ocker, 2004).

Consequently, studying marketing and quality management in this field based on the new SDL framework should be of substantial scientific interest.

### **Methodology**

We have seen the relevance of the theoretical fields described above. In order to integrate them an empirical study will be carried out. As the research is explorative to its character, the empirical research will mainly be of qualitative character. The research process will consist of co-

production involving the researchers as well as staff from the participating companies. Together, we will carry out case studies at each company and the results will be integrated into a larger whole as a learning network is formed.

The following methods will be used:

- *The quality café*. This is a method for analysing quality problems and possibilities for improvement. Having the method “The world café” (Brown, 2005) as its basis, quality management analysis tools have been integrated so as to make it suitable for analysing quality issues. In an interactive seminar consisting of a systematised number of phases engaging employees as well as customers, creative solutions and novel opportunities are often found. By allowing the space in-between the participants speak, even tacit knowledge can be expressed.
- *Definition and measurement of quality dimensions*. This is another method developed by Stefan and Yvonne Lagrosen which has been used successfully in a number of studies (e.g. Lagrosen, 1997; Lagrosen, 2000). The method is based on qualitative interviewing and analysis inspired by the grounded theory-approach (Glaser, 1992; Glaser and Strauss, 1967; Strauss and Corbin, 1990). The aim is to gain profound understanding regarding the meaning of quality for customers and staff. Based on the quality dimensions and the service context model (Gummesson, 1993), matrices are formed describing the quality dimensions in relation to modes of interaction. On this basis questionnaires of high validity are constructed and delivered to customers and staff.
- *Analysis using the MOA-model*. The MOA-model especially focuses consequences of implementation and use of information- and communication technology (ICT) in the organization for different interest groups such as employers (work process), employees (work situations) and customers (quality of the service produced) (Grundén 2009c). The model has been used in several studies (e.g. Grundén 2009a,b). The model will be used in workshop activities with each organization, both as a scenario model and as an evaluation model.

The data from the research methodologies will be immediately useful for the companies and they will be continuously implemented into their operations. Furthermore, they will bring ample possibilities for theoretical development. An in-depth understanding of vital aspects regarding quality, organisational learning and entrepreneurship in the health and fitness sector will result from the data collection and the direct analysis of the data. This knowledge will be used for development of the theories regarding the service dominant logic of marketing so as to make them more complete and valid.



## Conclusions

We have seen how the new service dominant logic of marketing has developed and that it should have relevance for the health and fitness industry. Moreover, we have found that quality management, organisational learning and entrepreneurship all are vital fields both theoretically and in practice for the health and fitness industry. In addition, there is a theoretical value of integrating these fields in the service dominant logic of marketing theories. It is our ambition to contribute to this development with the proposed study.

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## SOCIAL MEDIA MARKETING AS AN ENTREPRENEURIAL LEARNING PROCESS

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### Abstract

The purpose for this paper is to explore social media marketing from the perspective of entrepreneurial learning. The theoretical basis consists of contributions from the fields of organisational learning and entrepreneurship. An empirical study involving ten companies has been carried out. The data were analysed with methods inspired by grounded theory. Categories describing the companies' social media presence from an entrepreneurial learning perspective are provided. Thus, the paper presents a novel way of studying social media activities which should contribute to the theoretical fields of organisational learning and entrepreneurship as well as to the understanding of social media marketing. For practitioners, the findings provide additional knowledge that should be useful for their own social media activities.

**Keywords:** Social media, Entrepreneurship, Organisational learning, Marketing communication

### Introduction and purpose

The advent of social media has changed the marketing landscape in a profound way. Conducting marketing in social media carries many opportunities but it may also entail many difficulties. As developments in the social media are very fast, many companies are uncertain as to how they should act. A major difference between many traditional marketing communication tools and social media is that the latter builds on interaction. Consequently, an ability to handle relationships is vital. In general, relationship marketing builds on factors such as trust, commitment and attraction (Gummesson, 1999). These factors become even more vital when companies can be in constant interaction with their customers while the customers have ample opportunities to interact between themselves.

Interaction between companies and customers can be seen as a mutual learning process. Companies have excellent opportunities for learning about their customers' needs and wants as well as providing useful information for their customers. If companies pay attention on this, a more profound learning may take place in which the organisation as a whole is developed. This in turn may be a basis for entrepreneurial activities. Successful entrepreneurship requires an

ability to find new opportunities in the market or even create a new value balance in the market (Hills and Hultman, 2006). An in-depth learning about customers' needs and wants can enable them entrepreneurs to develop offers that better satisfy customers, thus leading to marketing success. Profound learning in organisations is studied in the field of organisational learning. By applying this theoretical field to the field of entrepreneurship a vantage point for studying entrepreneurial learning could be created.

The purpose for this paper is to explore social media marketing from the perspective of entrepreneurial learning. An empirical study, involving ten companies of different size and industry has been carried out. The findings are analysed from an entrepreneurial learning perspective.

The rest of this paper is structured as follows. First, we present the theoretical bases for the study i.e. social media marketing, organisational learning and entrepreneurial learning. Second, our methodology and the findings that it generated are described. Third, the analysis is made and conclusions are drawn.

### **Social media and marketing**

Social media in itself is a widely described term, and there are many who try to define it. In general, social media is considered to include a new layer to information. The technologies associated with social media offering services such as, search functions, analytics and social networking (O'Reilly and Battelle, 2009). These services described in social media is said to have revolutionized our social contacts not only in every-day life.

The use of social media has also become more and more popular as a marketing tool for the establishment and management of customer relationships as it offers for an example marketing principles as to influence a specific target of audience, based on voluntarily acceptance as well possibilities for addressing social issues (Kotler et al., 2002). According to the traditional marketing paradigm, marketing is seen according to the one-way interaction model, where the producer is the sender and the customer is the receiver. In contrast, the use of social media in marketing is based on a multi-way interaction approach, in which the roles of sender and receiver are mixed (Ström, 2010). A pull marketing strategy is more efficient for the use of social media than the traditional push-marketing approach. This means that the producer uses social media for the communication of information, knowledge, values and ethics related to the service or product, in order to entice the customer to interact. When the customer is interested in taking part in the interaction, valuable information about interests, preferences and values could be interchanged in an informal process and affect the further customer relationship and marketing activities in order to make the product or service more attractive. Ethics and values are important aspect of the interaction, as they could contribute to mutual trust in the relationship building

(Brown, 2005). The combination of the use of different social media could also reinforce the marketing effects. Social media can be an economic alternative especially for entrepreneurs and smaller businesses, as low costs are needed, apart from working hours.

### Organisational learning

In order to survive in a competitive context organisations need to constantly develop. Thus processes of learning throughout the organisation are necessary. Organisational learning theories have been developed in order to provide a more sustainable perspective on organisational success. One aspect that is of particular importance for organisational learning is the learning of leaders and their learning is related to their emotional intelligence (Goleman et al., 2002; Grewal and Salovey, 2005). Emotional intelligence has been defined as the ability to conduct emotional self-leadership and it is related to intra-psychic and intra-personal function (Mayer et al., 1991). The learning of the leaders will be more effective if their emotional self-awareness, one of the dimensions of emotional intelligence, is high (Goleman et al., 2002).

A learning organisation is characterised by people learning together and thereby developing new and expansive patterns of thought which in turn leads to better results (Senge, 1990). Achieving this is related to values such as trust and common visions being present in the organisation (Senge et al., 2005; Senge, 2006). From a social constructivist perspective organisations are seen as having no objective existence; rather they are enacted constructions of the interacting organising parties (Weick, 1979). Assuming this line of thought organisational learning becomes a way of actually constructing organisations.

Moreover, Senge et al. (2005) define different levels of learning. The more profound levels require awareness of a greater wholeness. In order for learning to be profound, the organisational values must be influenced (Argyris, 1993; Argyris and Schön, 1996).

Perhaps, the most influential framework in organisational learning theory is the five disciplines presented by Senge (2006):

- *Personal mastery.* There are two aspects of personal mastery as a discipline:
  - Continually clarifying what is important to us. We need to approach our lives as creative work directed towards higher ideals.
  - Seeing current reality more clearly. Many organisations and people live in a self-made web of illusions. Breaking out of this trap is a process of learning.
- *Mental models.* Our behaviour is usually unconsciously controlled by deeply held internal images of the world around us. These images tend to limit our thoughts and actions to areas that are familiar. Therefore, clarifying these assumptions is a first step

towards change. This requires us to slow down our thinking processes so as to become aware of the mental models that they are built on.

- *Shared vision.* A shared vision is a vision that people throughout the organisation carry. Having impressive power, it can be viewed as a force in people's hearts. As such it provides focus and energy for learning. Achieving a shared vision may be difficult but it can lead to profound organisational learning.
- *Team learning.* If the energies of the members in a team are aligned, striving in the same direction, their effect is extremely powerful. However, the individual members often have different ambitions and priorities which leads to waste of energy. Aligning the team requires dialogue and deep listening between members.
- *Systems thinking.* This is the discipline which contains the main argument of Senge. It integrates and forms the basis for the other four disciplines, implying that organisations should be seen as open systems in which all parts constantly interact with each other and with the environment. This is a holistic viewpoint seeing deeper patterns which enable sustainable solutions. Moving away from the traditional reductionist linear way of analysis, the fifth discipline is built on a language of circles including feedback loops where all influences can be both causes and effects.

Consequently, systems thinking is the main basis for organisational learning. Systems thinking is an established feature of organisational theory, going back at least to the original theories regarding a general systems theory by von Bertalanffy (1950). The merits of Senge lies in establishing systems thinking in relation to organisational learning which should be particularly useful for studying organisational change.

### **Entrepreneurial learning**

Entrepreneurship has become popular as a solution to many of the world's current problems. One way of succeeding as an entrepreneur is by finding unexplored niches in markets where all actors have incomplete and often inaccurate information (Kirzner, 1979). Another way is to radically alter the balance of the market by inventing new products, processes, channels etc. This leads to what can be called creative destruction in that the old order is destroyed in the process that something new and more effective is created (Schumpeter, 1934). Both these processes have obvious implications for learning. Entrepreneurial learning needs to be active leading to the acquisition of entrepreneurial patterns rather than just experiences and skills (Wing Yan Man, 2006).

## Methodology

An empirical study has been carried out. Since the study is of an explorative character we chose to use qualitative methods for data collection. A multiple case study was chosen and ten companies were chosen for investigation. The selection was based on theoretical sampling (Glaser and Strauss, 1967). Accordingly, companies and respondents were selected based on their perceived ability to contribute to the theoretical understanding being developed. For this reason the range of companies is very diverse spanning many different industries and ranging from one-man companies to very large enterprises. A list of the companies is provided in table 1.

In-depth interviews (Patton, 1990), were carried out with managers responsible for marketing communications in the companies. In total, eleven interviews were carried out by students trained by the authors. The interviews were of a conversational character. No fixed questionnaire was used. Instead the respondents were encouraged to speak freely from their own hearts so as to not superimpose the presuppositions of the authors on the respondents. The data from the interviews was analysed by the authors based on methods inspired by the constant comparative technique from the grounded theory approach (Glaser and Strauss, 1967; Glaser, 1992).

## Findings

The analyses of the interviews revealed the following categories:

### Use

This category concerns the level to which they use social media and which media they use. Several companies use social media to a rather low extent. Some others use it much more. The varying degrees of use do not seem particularly related to the size of the organisation. The largest organisations are the most active users but some of the very small companies are also very active. From this small sample it seems to be the medium sized companies that lag behind. Regarding the choice of social media tools, all companies currently use Facebook (networking site) which seems to be the completely dominating tool. A few of the companies also use Twitter (microblog service), YouTube (video sharing site) and blogs. One company also uses Scribd (a publishing site) and LinkedIn (networking site). Interestingly, although all the companies use Facebook, they have adopted it lately. Thus, those companies that use Twitter began using it before they entered Facebook. Concerning the companies' use and adoption of microblogging, this application allows and meets a need of regular and fast communication, which requires less time investment from the user (Java et al., 2007; Naaman et al., 2010).



COMPANY	TYPE OF COMPANY	COMMENTS
<i>Anonymous</i>	<i>Photography and journalism</i>	<i>A free-lance photographer and journalist</i>
<i>Arena Älvhögsborg</i>	<i>Real estate, health care</i>	<i>A real estate company focusing on facilities for health care, fitness and sports</i>
<i>Fregatten Atletica</i>	<i>Fitness centre</i>	<i>A fitness centre offering gym facilities as well as a wide range of training classes</i>
<i>Kurortsstaden</i>	<i>SPA-company</i>	<i>A separate SPA-company that collaborates with a major hotel</i>
<i>Marknad Varberg</i>	<i>Networking company</i>	<i>A company aimed at developing the business and society in the town of Varberg</i>
<i>SATS</i>	<i>Fitness chain</i>	<i>The largest fitness chain in Scandinavia with 116 fully owned fitness centres</i>
<i>Sports international</i>	<i>Sports arrangements</i>	<i>A small company that arranges cups, voyages and other events</i>
<i>Statens järnvägar</i>	<i>Railway operator</i>	<i>Sweden's main railway operator. State owned but competes in a market with private actors.</i>
<i>Stena Fastigheter</i>	<i>Real estate</i>	<i>One of Sweden's largest real estate companies focusing on private tenants</i>
<i>Strömstads Badanstalt</i>	<i>Spa and fitness centre</i>	<i>A company offering baths, SPA-treatments and fitness activities.</i>

Table 1. The companies included in the study.

## Aims and results

The aim that most companies emphasise is providing information for their customers. The information can be of concrete nature informing current customers about changes in services, delays, problems or new procedures. Alternatively, the media are used for more traditional selling messages intended to push products. Nevertheless, some companies are eager to promote an active dialogue with the customers and in a few cases also between the customers. Certain companies have noticed a need from the customers to communicate between each other. In addition, such possibilities are believed to make the customers more committed to the companies and their products.

There seems to be an almost linear development in the ambitions of the companies, going from fairly traditional one-way communication to encouraging an active dialogue; and finally to aim for a community of interacting customers and prospects. Regarding the media, there is also a difference in that microblogging is seen more as a tool for one-way communication while social networking sites are perceived to be more interactive. Facebook for example is also regarded as more private and intimate whereas Twitter is thought to be more as a business like information media.

When this living dialogue is achieved, it is seen as a learning process in which feed-back from the customers is used for developing the companies' offers. In this way, companies can get fast and direct knowledge regarding developments in the market. It is also seen as a wider environmental analysis tool. Active response from customers is sometimes stimulated by contests and special offers for social media contacts.

The information giving is also seen as a kind of education process for the customers. In particular, one company uses YouTube as a channel for conveying knowledge about fitness activities and news in the health area. For this purpose, they have started their own YouTube channel. Moreover, the companies link Facebook visitors to their homepage on the web where they can provide more information.

By answering to criticism the companies are able to provide their view and explain their activities. They can react to critical tendencies very quickly. Sometimes satisfied customers "defend" the companies against criticism which is very valuable due to their much higher credibility. Moreover, they regard social media presence as a way as giving additional service to customers using it as an "online customer service centre".

### **The image factor**

From the interviews it was clear that several companies have more than just concrete aims for their social media presence. They see presence on social media as a way of seeming to be modern and up to date. Thus, social media presence in itself is viewed from a branding perspective. Nonetheless, they realise that their social media pages must be updated and active in order not to give an amateurish impression. In addition, companies that are active in company networks need to co-ordinate their different social media activities so as to not confuse customers and public.

### **Uncertainty**

There is a substantial uncertainty among the companies regarding their media presence. They have difficulties in assessing the costs. The direct costs are normally very low. On the other hand, the time it takes for employees to work with the social media presence entails substantial costs that are hard to gauge since the same employees often work with many different tasks at the

same time. Measuring the effects of the presence is even more difficult. Only a few very basic things, like the number of followers on Twitter or the number of likes on Facebook is immediately quantifiable. Sometimes they can also get a feeling for the power of the media by providing special offers only available through social media and measuring how many customers take advantage of them. In appreciating other effects, the companies usually have to be content with mere guesswork. This makes it problematic to decide how much to invest in social media presence and which activities to engage in. In addition, they are uncertain as to how they should handle criticism or abusive behaviour on the social media. All in all, this uncertainty was rather marked and troubling for the companies. The consequence is that most of the companies in this study do not have any specified aims for their social media presence and the activities are often the result of ad-hoc decisions.

### **Connection to organisational learning**

In order to assess the connection of these findings to organisational learning, we chose to relate them to the five disciplines framework of Senge (2006) presented above. This lead to the following inferences:

- *Personal mastery.* Used in a suitable manner social media should give organisations a possibility of seeing their reality more clearly. Many organisations have lacking understanding of the experiences, attitudes and feelings of their customers and other publics. By promoting interaction with and among social media users, as some of the respondents did, they may begin to see their organisation in a new light.
- *Mental models.* If a profound dialogue on social media is achieved the limits set by organisations' mental models may be widened. Nevertheless, this also requires slowing down the thinking process in order to reflect. The studied companies reported that working with social media can require substantial input of time from the employees. If this time is spent in too superficial information handling the opposite of this discipline might result.
- *Shared vision.* A shared vision need to be built on dialogue which is respectful and profoundly focuses on learning to understand other people's viewpoints. Interaction on social media could ameliorate such learning. Nevertheless, this again requires the social media interaction to be of a more profound nature than it was for most of the companies included in the study.
- *Team learning.* Aligning the team requires dialogue and deep listening between members. Is this deep listening possible on social media? If so this could be a way of forming aligned teams. This should be an important issue for further research to examine.

- *Systems thinking*. Based on the interviews, we can conclude that those companies that use social media most successfully have managed to integrate them into a larger system. This reduces the uncertainty that many companies experience. Using social media as a separate addition without connection to the other activities of the company will not lead to any useful results. Instead, their role in the greater open system, that includes the company, the customers and other stakeholders of importance, should be assessed. By utilising social media in this context as a means of gaining profound knowledge as noted above, they could become a very useful tool for entrepreneurial learning as well as for entrepreneurial success.

## Conclusions

We have seen that the use of social media varies substantially between the companies. Those who use them most successfully have managed to stimulate interactivity and put them into a larger context. Viewing the findings of the study through the lens of the five disciplines of the learning organisation (Senge, 2006) provided additional understanding. The importance of achieving a profound dialogue and handling social media in the context of the larger system became clearer.

## Suggestions for further research

This is a first, limited study of an explorative character involving a small number of companies. It provides some preliminary knowledge that can be used for more in-depth research. Larger studies involving many companies and going more into detail regarding success factors and hurdles should be welcome.

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## ASSESSING THE IMPACT OF WEBSITE QUALITY ON USER SATISFACTION: A STUDY OF WEBQUAL AND NET PROMOTER SCORE IN HOTELS

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### Abstract

The primary aim of this paper is firstly to investigate the relationship between customer satisfaction with e-service quality attributes and certain demographic and behavioral variables. The secondary aim is to identify detractors and non-detractors. Based on a convenience sample, the perceived e-quality and user satisfaction on a sample of three hotel sites was examined by using the instruments of WebQual 4.0 and Net Promoter Score (NPS) respectively. Multiple regression was applied to identify significant relations while discriminant analysis enabled the identification of the attributes which distinguish detractors and non-detractors. The important variables in determining satisfaction were found to be “attractive appearance”, the “ease of use” of the web-sites, and the age of the users. The former was found to be a key discriminator between detractors and non-detractors followed by “ease of use” and “accuracy of information”. Finally, this study by employing the Net Promoter Score offers practical help to researchers and practitioners in providing directions for e-quality improvement and produces a stimulus for further investigation and future research in a variety of areas and sectors.

**Keywords:** e-quality, e-services, customer satisfaction WEBQUAL, Net Promoter Score, hospitality sector

### Introduction

Quality of services and customer satisfaction has been for several years a wide research theme mainly due to its immense importance for commerce (Johnston, 2004; Caruana, 2002; Parasuraman et al., 1988). The higher the quality the more likely it is that the customer feels satisfied (Getty and Getty, 2003). Therefore, customer satisfaction leads to positive behaviours towards the interpreting the data. Net Promoter Score (NPS) creates a different way of measuring customer satisfaction by simplifying the procedure. Companies obtain their Net Promoter Score by asking customers a single question: “How likely is it that you would recommend this

company to a friend or colleague?" (Reichheld, 2003). Based on their responses, customers can be categorized into one of three groups: Promoters, Passives, and Detractors.

Over the last few years the introduction of the internet as a new powerful tool for service production gave completely different aspects to quality and its measurement. It is natural that this new technology opened up a new area for research to scholars who tried to provide new tools for measuring web-quality by trying to decode the new dimensions of e-commerce. It has been claimed by Zafiropoulos and Vrana (2006) that it is vital to examine users' perceptions about a website, because these views give general guidelines to manage a website effectively and determine its' eventual success. Researchers have come up with many dimensions and models that can define web-quality. An effective and well known instrument to measure user perceptions on quality of web-sites is WEBQUAL 4.0. It has evolved by means of a process of iterative refinement and consists of 22 items gathered up into three dimensions namely, usability, information and interaction (Barnes and Vidgen, 2001, 2002, 2003)

As far as tourism is concerned the internet has changed the traditional behaviour of the consumer in terms of searching, choosing and buying a tourism product.. Rocha and Victor (2010) assert that tourism is one of the sectors where the internet is heavily used. Therefore, it is obvious that the internet can promote the abundance of tourism choices that Greece has, especially due to the fact that it is a tool that has no geographical boundaries and which is highly connected to tourism itself.

The objectives of this study are twofold. The first is to investigate through regression analysis the relationship that might exist between WEBQUAL's measurement items and user satisfaction as expressed by NPS for 3 website hotel portals. The second is to identify through discriminant analysis which items are in a position to differentiate respondents who act as detractors from those who do not act as detractors. Furthermore, an attempt to connect the results with the demographic information will be made. The effects that socio-demographics have on customers satisfaction is an area that is very often neglected by the researchers (Tsai et al., 2002). For this purpose the relation of demographic factors, frequency of use and type of users in relation to overall quality and satisfaction will be also examined.

## **Theoretical background**

### **E-services' Qualities Dimensions and Measuring Models**

One of the earlier attempts were to measure the quality of web-sites came from Griffith and Krampf (1998). Their research was mainly based on the time needed to answer customer's e-mails and they suggested that the access and the responsiveness of a website were the main criteria for measuring quality in websites.

Voss (2000) claimed that the five dimensions of the SERVQUAL (SQ) model can be applied to measure e-quality if the empathy dimension that has to do with human interaction is excluded. For Voss assurance is highly connected to the extent to which a website can handle quickly, and accurately, the needs of the clients; credibility refers to the fast connection to the web-site, the correct and fast loading of the page and the accuracy of the commands, and also refers to the security and trustworthiness of a web-site.

An important effort to adapt the SQ model in e-services came from Kaynama and Black, (2000). After a subjective evaluation of the e-services of 23 traveling agencies seven dimensions of model SQ were extracted: Responsiveness, Content and purpose (reliability), Accessibility, Navigation, Design and presentation, both of which derive from the dimension of the material property of the company, tangibles, Background, (derive from assurance) and Empathy, personalization and customization. Zeithaml *et al.*, (2000) also presented a list of criteria in an effort to provide a revised model for the measuring of web-quality: Access, Assurance/trust, Ease of navigation, Efficiency, Flexibility, Personalization, Price knowledge, Reliability, Responsiveness, Security/privacy and Site aesthetics. The above characteristics more or less cover a wide range of the characteristics of web-quality.

Even if there are several pieces of research available and a variety of dimensions proposed, the research on complete models is relatively limited. Yoo and Donthu (2001) used a sample of students for the creation of a model named SITEQUAL, in order to measure the perceived quality of a web portal. This research concluded with nine basic points and four dimensions: ease of use, aesthetic design, processing speed and security. SITEQUAL was developed to evaluate the perceived quality provided by internet shopping sites (Yoo and Donthu, 2001) although Sohail and Shaikh, (2007) expressed the view that it does not capture the complete purchasing process. Wolfenbarger and Gilly (2003) created the eTailQ model for the quality of services in the web retail business. Their research proved that the designed model of the webspace and the dimension of credibility were immediately related to the overall quality, satisfaction and loyalty of the users of the webspace.

Zeithaml *et al.*, (2000, 2002) defined the electronic service quality as the degree to which a web space is efficiently aiding the purchase, the delivery and the shipping of goods and services. The e-SQ model was applied on focus groups and through this procedure they ended up in seven dimensions: efficiency, reliability, fulfillment, privacy, responsiveness, compensation and contact. From the seven dimensions the first four were considered important while the last three had a role only when a customer was dissatisfied. Parasuraman *et al.*, (2005) continued the research on the model and they renamed the dimension of 'reliability' to 'system availability'. Furthermore they gave a new name to the model, E – S – QUAL for the basic four dimensions and E – RecS – Qual for the second level dimensions.



Loiacono *et al.*, (2000, 2002) developed a scale with 12 core dimensions that fall into four major higher order factors: ease of use, usefulness, entertainment and complementary relationship, indicating the WebQual™ model. However this model's primary purpose is to generate information for web site designers as it examines the internet retailer's website, rather than to measure service quality as experienced by customers (Parasuraman *et al.*, 2005; Francis and White, 2002).

Mich *et al.*, (2003) developed a model called 2QCV3Q with seven dimensions: identity, content, services, location, maintenance, usability and feasibility, oriented as a quality model for web site development. Bauer *et al.*, (2006) based on E-S-QUAL proposed an instrument for measuring e-markets. The model added the factor of enjoyment as an important dimension, together with functionality/ design, process, reliability and responsiveness.

### **The development and progress of webqual (WQ)**

WQ's first version was developed at UK Business Schools (WebQual 1.0, Barnes and Vidgen, 2000) based on Quality Function Deployment (QFD). In their research 54 raw qualitative characteristics were gathered and structured into relational groups. From these characteristics, a questionnaire with 35 parts was created which was then filled out by respondents and used to enhance the initial questions. The first comment on the questionnaire was about its considerable size. Applying WQ to B2C websites, it was obvious that the interaction element, examined from a quality point of view, was absent from WQ 1.0. Barnes and Vidgen, (2002) suggested that the interaction quality is equally or even more important to the success of the web corporation, given the absence of human communication. In WQ v2.0, the interaction point of view was widened with the integration of previous research in service quality, with SQ as the predominant model. While WQ 1.0 aimed to information quality, it was less focused on the interaction aspect. Likewise, WQ 2.0 emphasized the interaction quality but lacked WQ's 1.0 abundance in information quality. Both tools included a width of quality characteristics about the website as a software project. Reconsidering the tools, Barnes and Vidgen, (2001) found out that all the qualitative characteristics could be categorized into 3 discernible categories: a) quality of website, b) information quality, and c) quality of interaction services. This reconsideration resulted in a new version of WQ (3.0) which was tested in web auctions.

In WQ v4.0, the focus on quality of websites was replaced by a focus on usability which emphasised the user and their perception, instead of focusing on the design and the website as a context free software artifact. The term Usability also mirrors the interaction of information and services. In WQ 4.0, the usability aspect is extracted from the human-computer interaction bibliography (Davis 1989, 1993; Nielsen 1993), and recently from the usability on the Web (Nielsen, 1999, 2000; Spool *et al.* 1999). Usability is related to the perception and interaction of the

user with a website, for instance; the ease of browsing if the design model is appropriate for the kind of website kind. The following Table 1 shows the actual structure of WEBQUAL 4.0 and its relevant dimensions where it is obvious that the model is influenced from many service quality models and especially from the SERVQUAL one.

**Table 1.** *WebQual 4.0*

<i>Description</i>
<i>Usability</i>
1. <i>I find the site easy to learn to operate</i> 2. <i>My interaction with the site is clear and understandable</i> 3. <i>I find the site easy to navigate</i> 4. <i>I find the site easy to use</i> 5. <i>The site has an attractive appearance</i> 6. <i>The design is appropriate to the type of site</i> 7. <i>The site conveys a sense of competency</i> 8. <i>The site creates a positive experience for me</i>
<i>Information</i>
9. <i>Provides accurate information</i> 10. <i>Provides believable information</i> 11. <i>Provides timely information</i> 12. <i>Provides relevant information</i> 13. <i>Provides easy to understand information</i> 14. <i>Provides information at the right level of detail</i> 15. <i>Presents the information in an appropriate format</i>
<i>Interaction</i>
16. <i>Has a good reputation</i> 17. <i>It feels safe to complete transactions</i> 18. <i>My personal information feels secure</i> 19. <i>Creates a sense of personalization</i> 20. <i>Conveys a sense of community</i> 21. <i>Makes it easy to communicate with the organization</i> 22. <i>I feel confident that goods/services will be delivered as promised</i>
<i>Overall Impression</i>
23. <i>My overall view of this Web-site</i>

Source: [www.webqual.co.uk](http://www.webqual.co.uk)

### **Net promoter score (NPS)**

According to Reichheld (2003, 2006) the best predictor of top-line growth can usually be captured in a single survey question: Would you recommend this company to a friend? Reichheld arrived at the “recommend to a friend” question by testing around 20 customer

satisfaction and retention questions among a sample of customers across a range of products and industries and then correlating their responses with future purchase or referral behavior. The NPS question was found to have the best correlation out of the 20 questions tested, 80% of the time (Satmetrix, 2004). According to this research there are the answers between 1-6 belong to a group that was called “detractors” while answers between 9 and 10 are called “promoters” and are the ones that will actually promote the company to a friend. It is also worth mentioning that 7s and 8s are called “passives” and they do not take part to the equation at all. The equation to calculate the NPS is:  $NPS = \% \text{ of Promoters} - \% \text{ Detractors}$ .

NPS also echoes the veracity of word of mouth in the sense that Promoters offer positive word of mouth, and Detractors hold a negative word of mouth about the firm and its products or services. Before Net Promoter, many customer satisfaction programs yielded management reports that lacked credibility (Owen and Brooks, 2008). The main reason for the rapid popularity of NPS is that it takes a very complicated theme that is customer satisfaction and turns it into one simple question, enabling companies to address this subject easily, cheaper, and with a good reaction results.

Despite its great success NPS has been severely criticized as simplistic (Molenaar, 2007) but it has especially been attacked by Reichheld’s point that it can be directly related to growth (Reichheld, 2006). Keiningham *et al.*, (2007) compared the NPS with the Net Promoter American Customer satisfaction Index (ACSI) which is an index for measuring customer satisfaction and not growth, and found that the results between the two metrics are similar in relation to driving growth. Fleming, (2006), Morgan and Rego (2006), Keiningham *et al.*, (2007), are among those researchers who through research tried to prove the absence of a relation between NPS and growth. However, it still remains one of the most popular ways for companies to address customer’s satisfaction.

### **Hypothesis formulation**

Many researchers in services studies recognized that there is a strong and positive relation between the quality of services and the satisfaction of customers (Caruana, 2002; Parasuraman *et al.*, 1988). In the virtual environment Website design or usability is one of the most important factors for determining the quality of a website (e.g. Yang *et al.*, 2005; Yang and Fang, 2004; Aladwani and Palvia, 2002; Loiacono *et al.*, 2000) and therefore, it may influence the levels of user satisfaction. Palmer (2002) found that customer satisfaction is significantly associated with usability and design features unique to the Web, and Casalo *et al.*, (2008) also found that usability of websites influences satisfaction and plays a special role in the loyalty formation process. Bai *et al.*, (2008) in research based on three Chinese hotels found that website quality expressed in terms of usability and functionality has a direct impact on users’ satisfaction and their purchase

intentions. According to the above findings we expect that quality dimensions will have an impact on satisfaction. Thus the following hypothesis is formulated:

*H1: Website quality variables (items) have an influence on user satisfaction in the e-hotel business.*

It is obvious that companies should look beyond the strictly technical issues and look into ways of analyzing the factors that affect web customer satisfaction (Wang and Fesenmaier, 2006). Individual loyalty is considered to be the outcome of customer satisfaction and that is what makes the latter so important (Anderson and Sullivan, 1993; Hallowell, 1996; Yoon and Kim, 2000). Furthermore, it is noted that greater degrees of customer satisfaction create loyal customers (Methlie and Nysveen, 1999) who in their turn create positive word of mouth which is likewise significantly important for e-businesses (Reichheld and Scheffer, 2000).

Mazzarol *et al.*, (2007) back up the notion that the word-of-mouth is a new tool in gaining competitive advantage. It can be viewed as an indicator of customer loyalty. Srinivasan *et al.*, (2002) suggest that one of the behavioral outcomes of e-loyalty is positive word of mouth. Dick and Basu (1994), state that loyal customers are more likely to engage in positive word of mouth. Indeed, executives from some of the world's most prestigious firms have wholeheartedly adopted Net Promoter as the gauge of their firms' efforts to improve customer loyalty (Keiningham *et al.*, 2007). In the context of NPS, Promoters are the ones that create positive word of mouth while Detractors are those that should be targeted by marketing due to the fact that their bad word of mouth is damaging the growth and image of the company. Therefore, taking these considerations into account it is of great importance for a web-site to be effective and efficient in order to identify the quality factors (items) that discriminate between detractors and non detractors. The second hypothesis is proposed as follows:

*H2: There are specific quality factors (items) which are significant in dividing users into detractors and non detractors.*

The effects that socio-demographics have on customers satisfaction is an area that is very often neglected by researchers. However, there is research that proves and supports the importance of socio-demographics in customer satisfaction. A survey conducted by Skogland and Siguaw (2004) examined such factors as purpose of travel and demographics, the study revealed that Business travelers were among the least loyal of the guests responding which may puzzle the business if that group deserves the expenditure on marketing policies that could be used for a more loyal group instead. Moreover it revealed that men were more interested than women in reducing risk by purchasing a known hotel. This finding may mean that men should be targeted with loyalty programs more strongly than women. Tsai *et al.*, (2002) also notes about the neglect of demographics that "It was often forgotten by those who used the ServQual scale that the model was originally located by Parasuraman *et al.*, within a framework where socio-

demographic variables, like life-stage and gender, had a role to play in the formation of both expectations and perceptions” (p. 8). Apart from age and gender and the type of user (leisure, business, etc.) it is expected that behavioral measures such as frequency of booking a hotel through internet may also determine the level of quality and satisfaction. Accordingly the following hypothesis is formulated.

*H3: Age, gender, type of user and frequency of booking are factors which can have an impact on quality and satisfaction.*

## **Methodology**

The WEBQUAL 4.0 was the survey instrument and was distributed to a convenience sample of 127 adults. Ritter *et al.*, (2004) supported the idea that convenience samples can be used for web research. All the participants had access and prior experience of using the internet as a tool and had previously agreed to join the research. Also, they were familiar with the websites in order to have more accurate results; therefore they were provided with access to the three websites while completing the questionnaire. The collection of the results was completed in two big meetings in a university library where computers were provided for the completion of the questionnaires. Although the hotels offered to host the survey, we preferred to avoid using existing customers of any of the hotels. This survey judges the quality of the website and not of the hotel itself, therefore it was believed that existing customers of any of the three hotels may had a difficulty in differentiating between what they liked or not in their hotel and what they liked or not on the website. The completion of the 7-scale questionnaire was time consuming, varying from 30-45 minutes per user and therefore not an easy or lighthearted task since they had to navigate back and forth towards the three websites for every question. The websites chosen for the research belong to three hotels located centrally in a large city of Greece named El Greco, Metropolitan and Plaza, they all belong to the three star category. For convenience, their sites will be addressed as Site A, B and C respectively throughout the research.

The questionnaire is divided into three main sections. The first section includes personal information about the user such as gender and age accompanied by questions that state the type of traveler and how accustomed the user is with booking hotels through the internet. From the initial questionnaire three questions were removed (number in the original as questions 17, 18, 22). This adjustment took place because the abovementioned questions did not apply to the hotels in question. Related research from the creators of WEBQUAL (Barnes and Vidgen, 2002) supports this adjustment. Question number twenty is a ten scale rating question regarding the Net Promoter Score (NPS).

To test the first and third hypothesis regression analysis was used. NPS was the dependent variable and the three dimensions were the independent variables. Demographics and type of

user and frequency of booking also served as explanatory variables. To satisfy the second hypothesis a discriminant analysis was performed. It was applied in order to be able to classify the users based upon whether they are detractors or non-detractors. All items of the WEBQUAL 4.0 were used as discriminating variables. Detractors received the value of zero and non detractors received the value of 1.

## Findings

As a first step a regression analysis was run to find the influence that certain variables might have on the overall view of the sites that users can have. Table 2 illustrates the estimated regression models.

**Table 2.** Results of regression analysis with dependent variable overall view of sites

Variables	Model 1		Model 2		Model 3	
	Coef.	Sign.	Coef.	Sign.	Coef.	Sign.
<i>Easy to Navigate</i>	-	-	-	-	0,426 (4,691)	0,00
<i>Easy to Use</i>	0,397 (4,686)*	0,000	0,449 (4,791)	0,000		
<i>Attractive Appearance</i>	-	-	0,182 (2,152)	0,039		
<i>Appropriate Design</i>	0,345 (3,806)	0,001			0,330 (3,616)	0,001
<i>Accurate Information</i>	0,298 (3,157)	0,003	0,281 (2,651)	0,012	0,249 (2,511)	0,017
<i>constant</i>	-0,863 (-1,244)	(0,222)	-0,327 (-0,414)	0,682	-0,676 (-0,992)	0,328
<i>R-adj.</i>	0,645		0,555		0,645	
<i>F-value</i>	23,427		16,364		23,456	
<i>S.E.</i>	0,446		0,500		0,446	

\*t-ratios in parenthesis

The analysis has shown that there are three models that best explain the overall view that users have about the sites. Model 1 and Model 3 appear to prevail over model 2 which has the lowest adjusted R<sup>2</sup> value and standard error. “Appropriate design” and “Accurate Information” provided by the sites are the two variables that were found to be significant in both models. The variable “Easy to navigate” and “Easy to Use” was found significant in models 3 and 1 respectively. These two variables seem to have the same contribution in explaining overall view. However, when both are simultaneously treated as explanatory variables they appear to absorb each others explanatory power. The same happens with the variables appropriate design and

attractive appearance. Therefore, one of them was retained in the right hand side of the equations.

Table 3 illustrates the results of two regression models having as dependent variable the satisfaction as it is expressed by NPS. Model 4 shows that the users' overall view of the sites is an important explanatory variable of satisfaction at the borders of 5% significance level. For the determination of satisfaction two statistically powerful variables was found. These two variables, which also appeared significant in model 2, were the attractiveness of the appearance of the websites and the ease of use of the websites. The latter was considered to be significant at 10%. The positive signs they receive indicate that the higher their value the higher the level of satisfaction and vice versa. That is, the easier the websites are to use and the more attractive they are the higher the level of satisfaction of users.

**Table 3.** Results of regression analysis with dependent variable NPS

Variables	Model 4		Model 5		Model 5	
	Coef.	Sign.	Coef.	Sign.	Coef.	Sign.
<i>Attractive Appearance</i>			0,627 (3,744)	0,001		
<i>Easy to Use</i>			0,299 (1,750)	0,088		
<i>Overall view</i>	0,489 (1,936)	0,057				
<i>Age</i>					0,358 (1,645)	0,108
<i>constant</i>	3,000 (2,539)	0,015	0,670 (0,504)	0,617		
<i>R Square</i>	0,090		0,297		0,065	
<i>F-value</i>	3,852		8,009		2,706	
<i>S.E.</i>	1,13		1,011		1,150	

\*t-ratios in parenthesis

As to the relation of satisfaction with demographics (gender, age) and behavioral variables (frequency of booking, type of user) the analysis showed that only age has a determinant role on the level of satisfaction. However, its significance lies on the borders of 10% level. The application of discriminate analysis on the groups of detractors and non-detractors produced the results illustrated in Table 4. The analysis was broken into two steps. In the first step all variables were included resulting in a non significant discriminant function (function 1). In the second step a more specific function (function 2) was estimated with variables which successfully differentiated the two groups. Specifically, the estimated canonical correlation of function 1 is higher than of function 2. However, the estimated chi-square statistic based on Wilks' Lamda rejects at 5% significance level, the hypothesis that there is no difference in the group mean scores on the discriminant scores only for function 2. Therefore, function 2 instead of function has a

discriminatory ability and it succeeds to discriminate between the two groups to a degree that is unlikely to be due to a chance.

**Table 4.** Discriminant analysis results

	Function 1	Function 2	Function 2
<i>Variables</i>	<i>Standardized coefficients</i>	<i>Standardized coefficients</i>	<i>Structure coefficients</i>
<i>Easy to Learn &amp; Operate</i>	-4,315		
<i>Clear &amp; Understandable</i>	0,685		
<i>Easy to Navigate</i>	3,472		
<i>Easy to Use</i>	1,699	0,302	0,231
<i>Attractive Appearance</i>	2,467	1,004	0,901
<i>Appropriate Design</i>	-3,06		
<i>Sense of Competency</i>	2,746		
<i>Positive Experience</i>	-1,501		
<i>Accurate Information</i>	0,971	0,227	0,111
<i>Canonical correlation</i>	0,928	0,462	
<i>Wilks' Lambda</i>	0,139	0,786	
<i>Chi-square (sign.)</i>	8,894 (0,447)	8,287 (0,040)	

To assess the contribution of the variables to the discrimination process the correlations between the values of the discriminant function and the original variables was examined. The correlations are given by the structure matrix. The variable which discriminated the two groups ranked by importance are: attractiveness of appearance, ease of use, and accuracy of information. The positive signs indicate that the large discriminant scores are associated with higher values of the variables. Finally, an interesting finding is that the three variables compiling the discriminant function were found to be statistically significant in determining the overall view users have about the sites.

To sum up the empirical findings satisfy all three hypothesis of the study. However among the 19 variables only two of them were found to determine satisfaction. These were: attractive appearance and ease of use. The former was found to be a key discriminator between detractors and non detractors followed by ease of use and accuracy of information.

## Discussion and conclusions

In a highly technological reality where the virtual world has become as important as the real one, web-quality should not be neglected by companies that want to stay competitive and grow; especially for the tourism industry where web-sites are one of the most important tools available for information and communication across countries. In the heart of the tourism product lies the hotel sector which is regarded as a highly competitive market place. In this market hotels' strategic position depends greatly on their ability to provide a superior tourist experience which



could generate satisfied and loyal customers (Anderson and Srinivansan, 2003) leading to the sharing of favorable word of mouth and publicity (Wong, 2004). Given the significance of word of mouth intentions in tourism, fostering and managing electronic positive word of mouth behaviors is necessary (Park and Gretzel, 2007).

The main purpose of the present study was to investigate perceived quality and satisfaction in the hotel sector. Results was expected to provide information about the relation between satisfaction and web quality and reveal those factors which are significant in separating respondents into those who spread negative word of mouth about the hotels and those who do not. To measure quality the Web-Qual 4 was adopted slightly modified since our sites have an informational character and not a transactional one. Satisfaction was represented by a new simple instrument called NPS. To our knowledge this is the first time evidence has been provided about relationships between quality and satisfaction using these two instruments in the hotel sector.

Empirical findings of the research largely support the proposed hypothesis. Initially regression analysis showed that on line users evaluate website quality of hotels' on the basis of the attractiveness of their sites, the ease of use, the accuracy of their information, the appropriateness of their design, and the ease of navigation. These results are in line to a large extend with the findings of other studies in tourism where information quality (87%) and ease of use (60%) are the dominant factors in users assessments of web-site quality (Park and Gretzel, 2007). Further empirical estimates revealed that among the 19 measuring items that make up Web-Qual 4.0, only two of them were found to be significant in determining satisfaction. These were: attractive appearance and ease of use. The former was found to be a key discriminator between detractors and non detractors followed by ease of use and accuracy of information. It appears that aesthetics and the absence of difficulties to use the web sites are the major sources of user satisfaction and together with accuracy of information (when scored high) can function as shields to potentially negative recommendations by users. Websites must be seen as a shopping window, in the same way a well designed and pretty shopping window will attract customers a well designed website will too. Since the customer has no immediate or physical contact with the product the website works as the face of the company. A messy and an inconsistent window can turn off on line users. The factor of attractiveness also be compared to the factor of cleanliness of the hotels which is regarded as an important quality attribute. Therefore, when building their web-sites hotels should pay attention to the way information is presented in terms of color use, font size and style and the relevance and quality of pictures so as to end up with a clean and enticing site. It is also essential for hoteliers to provide an easy to use interface so potential customers can conveniently obtain information or even complete a transaction.

Navigation bars or buttons should be in the right position so browsing between pages or having access to various information (e.g. price lists, booking options, maps, currency

converters), can be done easily. Also cumbersome browsing or processes that constantly block can frustrate the user and create negative feelings which can be spread by word of mouth. Inaccurate information can also allow a propagation of negative word-of-mouth. Users often rely on the site's reputation in hopes that the information they provide will be precise. However, most hotels are not known or do not carry a brand name. By providing accurate information online hotels can inspire trust in their potential market thus fueling positive recommendations and other behavioral intentions like revisiting and reusing the website. Therefore, hotels must make sure they often revise their web pages in order to achieve up to date information (Baloglu and Pekcan, 2006). Lastly and Cunliffe (2000) pointed out that a bad site can lead to a loss of even 50% in sales and that bad experience is also a reason for low repeated visits on that webpage.

An interesting result was found on the role of age on both variables of "overall view" and of the "chance to recommend" a site. It appeared that age has a positive impact on those two variables. The older the respondents the more likely they are to favor the overall quality of the web sites and the more satisfied they will be. This finding has a twofold aspect. The first can be linked to the need for further investigation, both qualitative and quantitative, about this relationship. The second aspect deals with the need to redesign the web-sites according to the wants and needs of the specific age groups.

## Limitations

Some limitations of this research should be acknowledged and directions for future studies should also be suggested. The quality measuring items used in this study do not include those regarding transactional purposes. This fact does not devalue our findings since the internet is used primarily as an information gathering tool to enable potential customers to be better prepared to make purchases (Schulze, 1999). Furthermore virtual customers first test the virtual environment of the web site and then they decide whether they will purchase or not (Nielsen, 2000). However, the fact that the survey is based on a small number of web sites with 127 respondents and in a specific geographical region limits the generalizability of its results.

A further investigation with a larger sample could assess the relationships between quality satisfaction and other constructs like loyalty in a way that the current study cannot. Also, research with a larger sample and with more information about respondents of different cultures, education, occupation and traveling purposes, could reveal more reliably the reasons behind the differences between detractors and non detractors. In this way web sites can be structured and designed to target specific on line groups.

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## DETERMINANTS OF EARLY RETIREMENT IN THE EUROPEAN UNION

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### Abstract

Early retirement is a phenomenon which has been studied in some depth in the last three decades. However, the literature has not studied adequately the variables that relate to the desired age of retirement and the variables that explain the discrepancy between the desired and the actual age of retirement, in the European Union.

This study uses a subsample of 18 European countries of the first release of the dataset of the fifth round of the European Social Survey to investigate the factors that affect the desired age of retirement and the discrepancy between the actual and the desired age of employment. We focus on a subsample of around 9,000 respondents who are in the age range of 50-64. People in this age range, not in active employment, may be considered to have retired early.

We used multilevel linear regression models to investigate our research questions. We found that the desired age of employment is explained by both personal (demographic and career) characteristics as well as country-specific characteristics (e.g. the GDP). However, the discrepancy between the actual and the desired retirement age is explained only by personal (demographic and career) characteristics.

We conclude that early retirement is frequently imposed on people by external factors, beyond their control. Early retirement is not just a habitus which appeared in the last decades, but also a complex phenomenon with social as well as financial characteristics.

**Keywords:** Early retirement, multilevel linear regression

### Introduction

Early retirement has traditionally been distinguished from retirement. The former may be defined as the situation at which people do not work, do not seek work and also consider themselves retired, although their age is below the official (depending on the situation and the country) retirement age. Although many definitions of early retirement exist, OECD (2005) has defined early retirement (*retraite anticipée*) as “*a situation when an individual decides to retire earlier and draw the pension benefits earlier than their normal retirement age*”.

The international literature has identified many reasons that lead people to early retirement. These reasons may vary according to personal (e.g. health), social (e.g. social status and occupation) and situational (e.g. country) characteristics. It was very early suggested that economic as well as health reasons may make people decide to go on early retirement (Bazzoli, 1985) e.g. poor health can force people to retire; on the other hand, poor economic conditions may discourage people from retiring early because they need to keep their income at higher levels.

Bould (1980) found that unemployment is another factor that encourages people to proceed to early retirement. More specifically, Bould used regression analysis on the National Longitudinal Survey sample of American men (ages 52–64 in 1973) to show that weeks of previous unemployment were significantly related to early retirement for both Black and White males. A plausible explanation (suggested by Bould) is that unemployed people prefer to present themselves as retired rather than to carry the stigma of unemployment. Bould reached these results after accounting for variables such as social security and pension eligibility, assets, health limitations, family responsibilities, occupation, changes in the unemployment rate and urban residence. Along the same lines, but more recently, Strandh (2000) showed that there was a positive relationship between exit from unemployment and better mental well-being. However, Strandh found that exit to early retirement pension did not significantly change the mental well-being of a sample of 3,500 unemployed Swedes.

However, it is frequently the case that the employers – or the labour legal framework of some countries – may accidentally encourage people to retire early. Fasang (2010) recently suggested that there are a number of institutional early retirement pathways which people can follow in order to retire early. Higgs et al. (2003) suggested that organizational restructuring, financial offers, opportunities for leisure and self-fulfillment are some of the factors affecting people's decision for early retirement. It seems that when people seek ways to early retirement, they will take advantage of little loopholes in the laws and regulations so that they will do so.

It is also possible that the nature of employment can encourage people to seek early retirement. For example, Blekesaune and Solem (2005) suggested that men may find it easier to obtain an early-retirement disability pension because men usually have more physically demanding jobs. Also, according to the same research, even when men and women have jobs of the same nature (e.g., low-autonomy jobs), women do not tend to retire early as frequently as men.

It has been frequently argued that people in the age group of 55-64 should be encouraged to stay in employment for longer. For example, Euwals, De Mooij and Van Vuuren (2009) explained that the goal of the Dutch government is to retain 60% of the people of this age group in employment by 2020. The EU has been investing for years on research projects, such as the "Transnational Exchange for Active Ageing" in order to devise strategies for active ageing. The

aim of such projects is usually to improve the labour market situation of older workers (55+) and to enhance the capacity of, as well as the incentives for, those people to remain in the labour market (or re-enter the labour market) (Ketsetzopoulou, 2007). It is not certain how these measures may have encouraged people to remain in active employment for longer – there is not enough literature to guide on this issue.

An important report by OECD (2006) suggests that the percentage of people in employment in the age range of 50-64 varies significantly between countries and between men and women. Some countries enjoy a participation of less than 50% and others a participation of around 70%. For example, Phillipson and Smith (2005) pointed that in the UK, a quarter of men and women leave work before 58 years of age. Moreover, the percentage of women (of this age group) who decide to remain in employment increases. According to OECD, the effective age of retirement (the age when a person withdraws from the labour force) can affect the economy considerably.

Human Resource managers do not, normally, want their most talented or experienced personnel to retire early. Experienced personnel, say at the age of 54 or 60, are still very young and able to work productively. Business needs them in order to train younger personnel and pass the organizational culture to the younger generations. For example, Brooke (2003) suggested that *“findings refute the proposition that older workers are more expensive to employ than younger employees ...”* (p. 279).

At the micro level, it is important to investigate the reasons that encourage people to escape to early retirement, so that Human Resource managers may find ways to keep the more experienced staff for longer. At the macro level, it is also important to keep people in the labor force for economic as well as political reasons. It is therefore interesting to investigate the reasons that make people to wish to retire early.

However, in real life, people who decide to retire, do not always move to full retirement immediately. The international literature has shown that many people choose to participate in various forms of “bridge employment” which means that they may choose to go to part time employment, self employment or temporary work before final retirement (Feldman, 1994). Sometimes, bridge employment is a phenomenon closely related to early retirement (not just to regular retirement). For example, Davis (2003) studied a sample of 133 early retirees from an oil and gas services firm and found that various factors like organizational tenure, certainty of retirement plans, and career-related factors affected the decision of people to move to bridge employment.

We felt that it was important to make a distinction in our study between people in full early retirement and people in bridge retirement because past research has shown that these are distinguishable groups of people. For example, Heindel, Adams, and Lepisto (1999) found that,



(between non-retired workers), satisfaction from income was negatively correlated with intentions to move to bridge employment. Along similar lines, Weckerle and Schultz (1999) suggested that satisfaction with financial situation may also be a factor that affects people's decision between bridge or continued full-time employment.

Our study does not deal with people in bridge employment, although one might consider them to be in some form of retirement (or at least, they are in the path towards retirement). Including in our sample people in bridge employment would make our investigation more complex and would certainly change our research questions and findings. We only focus on people who considered themselves to be in early retirement and were not (at the time of data collection) looking for part-time employment or were not seeking any form of self-employment.

It is important to ask the question about the relationship between early retirement and fiscal austerity in a period of financial crisis and uncertainty across Europe. We aim to investigate whether the patterns of early retirement changed across different European countries in recent years. Unfortunately, exactly because of the financial problems, a number of countries did not offer a sample for our study. For example, Greece, a country deeply troubled by financial problems in the recent years, decided not to participate in the fifth round of the European Social Survey.

Mirus & Pedde (2009) discussed the issue of early retirement in the era of financial crisis and suggested that, although “the notion of working longer ... is unpalatable to many ...”, it is probably what is needed under the specific circumstances. This, however, means that people should stop retiring early; at least, it means that fewer people will feel secure enough to make the choice to retire early. It is likely that more people will stay in employment longer; is also likely that more people may choose to move to bridge employment postponing their final retirement. It is also possible that some people who have already retired may have to return to employment – even part time employment.

In agreement to the above, Helman, Copeland & VanDerhei (2011) reported that “... *Americans' confidence in their ability to afford a comfortable retirement has plunged to a new low...*”. More specifically, the percentage of respondents who were not at all confident that they would have enough money for a comfortable retirement grew from 22 percent in 2010 to 27 percent. This is the highest level measured in the 21 years of the study. They also reported that the age at which the respondents expected to retire increased (the percentage of respondents who expected to retire after age 65 increased from 11% in 1991 and 1996 to 20% in 2001, 25% in 2006, and 36% in 2011). Moreover, more people intended to work during retirement.

Gelinas (2011) also suggested that many people choose to work for more years in order to shorten the years of retirement because of the crisis. Gelinas presents a historical account of

initiatives at the United States that made people work longer and postpone their retirement: these include legislature initiatives as well as initiatives coming from the private sector.

Whatever the reasons may be, however, one of the aims of this study is to sketch the retirement plans of people in various European countries and to investigate whether the early retirement desire has actually declined in the recent years (probably due to the crisis). We would like to investigate if Gelinas (2011) suggestion is indeed the case: *“So far, people have changed their behavior only gradually. But as those who have received the new signals during their entire working lives approach traditional retirement age, it’s probable that more and more of them will keep working”*.

### The aims of the study

The international literature has accumulated a vast body of knowledge about the factors that make people retire early; therefore, investigating the factors that make people retire early will be a by-product of our analysis. We mostly aim to investigate how the plans of people to retire early may have been affected by financial reasons. We will also suggest initiatives to reduce the burden of early retirement on the modern societies and on businesses.

More specifically, we aim to use data from the first release of the fifth round of the European Social Survey to

- Identify the variables that explain (predict) the retirement age at which people **would like** to retire;
- Identify the variables that explain (predict) the **discrepancy** between the wished retirement age and the actual retirement age.

### Methodology

This study involves two continuous dependent variables:

(a) The first dependent variable is the age at which the respondents wish to retire (if they have already retired, this is the age at which they wished they would have retired). In order to investigate the first research question, we will use all the respondents in the dataset in the age range between 50-64 (more information on this decision is given at a later section). This is the “agertr” variable in the dataset which can be downloaded from the web page of the European Social Survey.

(b) The second dependent variable, is the discrepancy between the age people retired, and the age at which they wished they would have retired. Obviously, this variable concerns only the sub-sample of people that have already retired. We computed this variable by subtracting the desired retirement age from the actual retirement age. Therefore, positive values

of the variable meant that the respondent retired later than the age he/she would like to and negative variables meant that the respondent retired earlier than the age he/she would like to.

Multilevel linear regressions were used in order to identify the factors that explained/predicted the dependent variables because the respondents were clustered in 18 countries. Using multilevel models allows us to take into account the intra-class correlation and describe the structure of the data more accurately in our models. We wanted to measure the between country variance (intra-class correlation) and we enhanced the ESS dataset with country-level information (by means of new variables) such as GDP, country size, growth as a percentage of GDP, average unemployment for the year and inflation (all these measures referred to the year 2010).

The ESS dataset included hundreds of variables, but after studying both the literature and the list of variables at length, we decided to follow the paradigm of Davis (2003) and we selected a specific sub-sample of variables in order to build theory-driven statistical models. In addition to the country-level independent variables mentioned above, we selected the following variables from the ESS dataset (a) demographic and personal characteristics such gender, age, years spent in full-time education, the country, marital status, living with partner, living with children, satisfaction from income and subjective health condition; and (b) work and career-related variables such as if the respondent was supervising other employees, the degree to which he/she was allowed to take initiatives (an aggregate measure from 0 to 30 which was computed by adding the responses of the respondents to the variables *wkdcorga*, *iorgact* and *wkdcpce* of the ESS dataset where larger integers indicate more freedom for initiatives), the type of organization of employment, the size of the organization and the type of employment (self-employed or employee).

There were three ordered categorical independent variables in our dataset i.e. the perceived satisfaction from the household income of the respondents (variable "*hincfel*"), the length of past unemployment (4 levels from 'Never unemployed' to '5 years of unemployment') and the subjective overall status of health (5 levels from 'Very bad' to 'Very good'). Helmert coding of the ordered variables was used to compare each level of the variable to the mean of the previous levels; e.g. for the 'satisfaction from income' variable, the first contrast compared the mean of the dependent variable for the category "*Difficult on present income*" with the mean of the previous category "*Very difficult on present income*"; the second contrast compared the mean of category "*Coping on present income*" with the mean of all of the previous categories ("*Very difficult on present income*" and "*Difficult on present income*") and the third contrast compared the mean of category "*Living comfortably on present income*" with the mean of all of the previous categories.

The unordered categorical variables with more than two categories, were entered into the linear regression models using a simple dummy coding (such as the type of the organization of the past employment with categories 'A state owned enterprise', 'Central or local government', 'Respondent is Self-employed'). The categorical variables with only two categories (e.g. whether the respondent lives with his/her children or not) were entered into the models as binary (0/1) variables.

### **The data**

Data from 18 participating countries (all countries but Israel and Russian Federation) of the first release of the data of the 5<sup>th</sup> round of the 2010-2011 European Social Survey were used. For this study, we investigate the early retirement status of people in the sample in the age range of 50-64, which is the age range to which OECD (2006) referred. Only the respondents in the age group 50-64 (including ages 50 and 64) were selected for the analyses. Overall, there were 8,764 respondents in this age group, approximately 500 respondents per country. Approximately half of them (around 47.4%) were males. Around three quarters of the respondents were classified as active (employment-wise), whereas 1,975 respondents were classified as early retired (an average sample size of 110 early retired persons per country). The average age of all respondents in the sample was 57 years (the median had the same value). On average, they spent 12.2 full years equivalents in education.

### **Results**

The average retirement age for the 1805 respondents who actually gave information about their year of retirement was 54.90 years (SD=7.07) whereas the median age was 57.00 years. It is important to mention here that the maximum retirement age is 64, simply because we restricted our sample to respondents in the age range [50 , 64].

Overall, 8006 respondents gave information about their wished age of retirement. The average wished age of retirement was 60.45 years (SD=4.71) whereas the median age was 60.00 years.

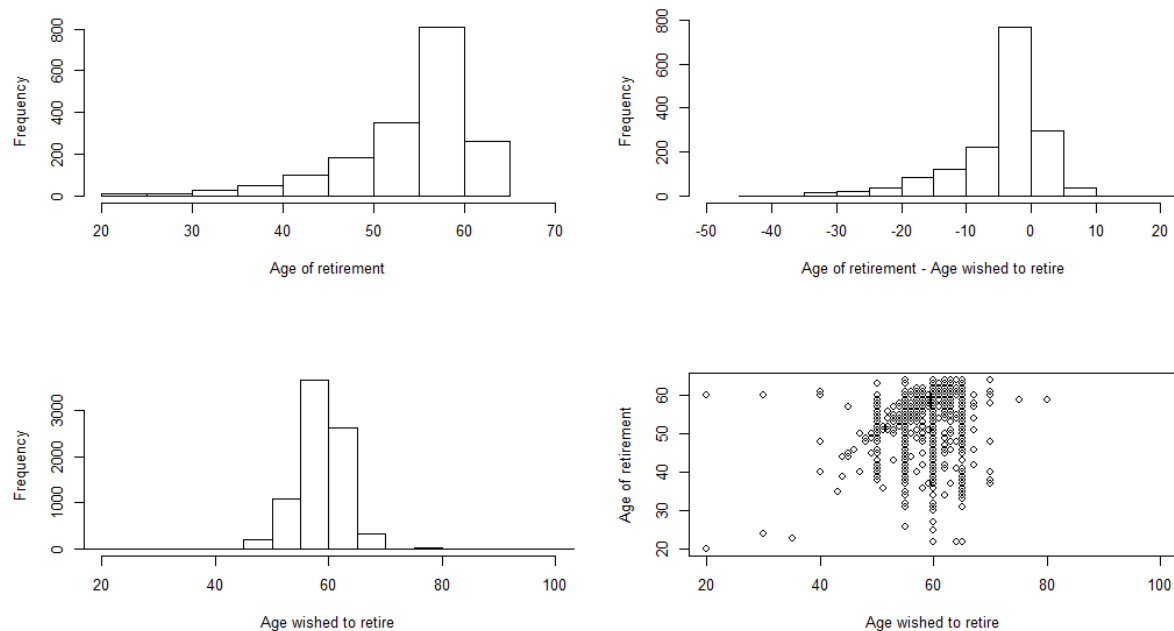


Figure 1. The distribution of the variables “age of retirement” (up left), “age wishing to retire / wishing to have retired” (low left), “actual – wished age of retirement” (up right) and the correlation between the wished and actual age of retirement.

If we compare the average age of retirement to the average wished age of retirement (for those who retired and actually responded to both questions), we may observe that the mean age of retirement is, on average, 3.7 years smaller (95% Conf. Interval of 3.3 to 4.0 years) compared to their wished age of retirement ( $t(1608)=20.0$ ,  $p<0.001$ ).

From Figure 1, we may also observe that the age the respondents wanted to retire was usually much larger than the age they had actually retired. On average, the 1609 respondents who gave the necessary information, wanted to retire 3.65 years later ( $SD=7.49$ ) than their actual retirement age. The variable ranged from -43 to 40 years and the median difference was -1 year (50% of the respondents wanted to retire 1 or more years later than their actual retirement age).

### The desired age of retirement

Multilevel linear regressions were used in order to identify the variables that explain the age at which the people wish to retire (or wished they had retired, if they have already retired).

Table 1 shows the results of Model 1. It is interesting to note that the variance attributed to the countries is practically negligible, indicating that we could instead use a single-level linear regression model. In addition to that, Gender (being a male) does not represent a significant amount of variance – suggesting that the effect of gender is roughly constant across the countries.

Interestingly, the desire of people to retire early is related to the size of the country as well as the GDP of the country. The larger the GDP of the country, the later the respondents would like to retire. On the other hand, the larger (in population) the country, the earlier the respondents would like to retire. It is not possible, at the moment, to speculate on why the population of the country was related to the desire to retire earlier.

Table 1: (Model 1) Regression coefficients (standard errors in parenthesis). Country and Gender (being a Male) are random effects (all other variables are fixed effects)

<u>Fixed effect</u>	<u>Type of Organization</u>							<u>GDP</u> (2010)	<u>Population</u>	<u>Health</u>			
	<u>Intercept</u>	<u>Age</u>	<u>Initiative</u>	<u>State owned</u>	<u>Government</u>	<u>Self-employed</u>	<u>Educational</u>	<u>(per 10.00 euros)</u>		<u>Bad</u>	<u>Fair</u>	<u>Good</u>	<u>Very Good</u>
<i>beta</i>	-11.41*	1.06	0.04*	-	-0.75	-0.04	0.12*	0.04*	-0.09*	0.40	0.75*	0.59	0.43
<i>(s.e.)</i>	(2.57)	*	(0.02)	2.57*	(0.32)	(0.61)	(0.04)	(0.01)	(0.03)	(0.39)	(0.15)	*	*
		(0.04)		(0.38)						)	)	(0.09)	(0.10)
		)		)								)	)
<u>Variance of Random effects:</u>													
Country (random intercept): 1.37													
Gender (being Male) : 2.36													
Residual : 29.20													

\* indicates a significant coefficient at least at the 0.05 level

Older respondents responded that they would like to retire later and the more initiatives a respondent was allowed to take at work, the later he/she would like to retire. More education was also related to retiring later.

Working for State owned organizations rather than working for private firms was related to a desire to retire almost three years earlier. Also, better health was related to a desire to retire later in life.

### The discrepancy between the desired and the actual age of retirement

Model 2 (see Table 2) investigates the discrepancy between the desired and the actual age of retirement. The country was modeled as a random effect and the coefficients of gender (being a male) were allowed to vary between countries.

The between-country variance was significant, and the variance attributed to Country was approximately 20% of the total variance. This is strikingly different compared to the previous model. The coefficients of the gender (being Male) variable were also allowed to vary by country. The variance attributed to Gender was approximately 12% of the total variance. In other words, in some countries, the respondents desired to retire significantly earlier than in other countries, and being a male had a different impact on the wished retirement age, depending on the country of residence. This is a result that clearly contradicts the previous model: the discrepancy between the desired and the wished retirement age is clearly affected by the country and the gender (and the gender effect is, by large, country-specific).

It is interesting to note, however, that none of the country-level variables were statistically significant. This is again in contrast to the previous model. It is possible that the inclusion of the “country” variable in the model absorbed most of the variance that could be attributed to country-specific characteristics. It is also possible that the personal variables were substantially more important than the country-level ones. For example, an individual may be more sensitive to his/her personal conditions (e.g. long unemployment) rather than the country-specific equivalent index (i.e. average country unemployment). Personal characteristics can substantially define the decision to go to early retirement.

Table 2: (Model 2) Regression coefficients (standard errors in parenthesis). Country and Gender (being a Male) are random effects (all other variables are fixed effects)

<u>Fixed effects</u>	<u>Type of Organization</u>				<u>Income Satisfaction</u>				<u>Health</u>				
<i>Intercept</i>	<i>State owned</i>	<i>Government</i>	<i>Self-employed</i>	<i>Age</i>	<i>Difficult</i>	<i>Coping</i>	<i>Comfortable</i>	<i>Ever Unemployed</i>	<i>Bad</i>	<i>Fair</i>	<i>Good</i>	<i>Very Good</i>	
<i>beta</i>	-57.55*	-1.74*	0.12	0.17	0.87*	0.18	0.31	0.45)	0.80*	0.38	1.06*	0.86*	0.69*
<i>(s.e.)</i>	(3.10)	(0.46)	(0.38)	(0.25)	(0.05)	(0.29)	(0.14)	(0.12)	(0.27)	(0.49)	(0.18)	(0.12)	(0.13)
<u>Variance of Random effects:</u>													
Country (random intercept): 10.81													
Gender (being Male) : 6.67													
Residual : 37.34													

\* indicates a significant coefficient at least at the 0.05 level

Another interesting finding is that the years of education were not statistically significant, but this is probably because similar information is introduced in the model by the variable “satisfaction from income”, in the sense that more education usually leads to more well-paid jobs

and more satisfaction from income. On the other hand, age was a significant variable and every year of additional education corresponded to almost an additional year in wished retirement age.

Respondents who experienced unemployment retired, on average, almost a year later than they desired compared to those who never experienced unemployment. This probably means that they felt that they had to stay in employment in order to enhance their retirement plans. Better health also corresponded to retiring earlier than the age they wished (probably because they felt that they still had the energy to work for longer). More satisfaction from income corresponded to retiring earlier than they wished. Finally, working for a State owned organization rather than working for a private firm corresponded to (probably been forced?) to retire earlier than wished.

## Discussion

The factors that relate to early retirement have been investigated in depth. Financial, demographic and other personal reasons can explain the decision of employees to go on early retirement. However, past research has also shown that people are sometimes being pushed to early retirement because of external factors, which cannot be controlled by them, such as long unemployment. Such issues can sometimes cause anxiety among researchers because intuitively, one might expect people who are unemployed to look for a job rather than retire and forfeit any possible income from job.

For this reason, we decided that it is important to investigate the factors that relate to the age at which people **desire** to retire and then to investigate the factors that relate to the **discrepancy** between this **desired** retirement age and the **actual** retirement age. To this end, we run two models: the first investigated the variables that related to the desired age of retirement and the second investigated the variables that explained the discrepancy between the desired and the actual age of retirement.

We used the first release of the data of the fifth round of the European Social Survey, which had just been released at the time this study was being written. The dataset included around 8.000 respondents from 18 European countries (Israel and the Russian Federation were removed from the dataset).

Regarding the desired age of retirement, we found that there were differences between countries, but these differences were not substantial, compared to the effect of other variables. People working in State organizations would like to retire earlier, probably because they have a secure retirement/pension plan, so they do not have significant motives to be in active employment until late in age. Good health was also associated to a desire to stay in employment for longer. People with longer education also desired to stay in employment longer, probably because their jobs were less physically demanding, more fulfilling or provided them with other rewards (in addition to monetary capital) such as social or symbolic capital. Living in a country



with a higher GDP was also related to staying into employment for longer, probably because of better health systems and because richer economies have been lately based on services which are jobs that do not demand high physical strength. One could argue that our findings are reasonable, but unfortunately there is no recent relevant literature with which we could compare our results.

However, desiring to retire early does not necessarily mean that a person has the luxury to retire at will. Retiring early usually demands a good retirement pension plan, savings or some other form of stable and secure support. This is important because retiring early means that a person will have to sustain his living for longer. Therefore, we investigated the variables that explained the discrepancy between wishing to retire early and actually retiring early. What we found was very interesting, in the sense that these results were very different from the results we found for the previous model. The most striking difference was that no country-specific variables were included in the model. The variables relating to individual characteristics and conditions were much more important than the country-specific variables. In addition to this, it was clear that there were factors that had a very strong impact on retiring earlier than wished: for example, working for a State organization, was related to retiring almost three years earlier than the wished retirement age.

These findings are in agreement with past literature, although there is no recent literature on this issue using data from Europe. For example, we know from the literature that financial and health reasons may make people decide to go on early retirement or work for longer (Bazzoli, 1985). Also, Bould (1980) found that unemployment is another factor that encourages people to proceed to early retirement and this is in agreement with our findings.

From the perspective of Human Resource managers, it is important to know which are the employees who are more likely to decide to go to early retirement. Such a knowledge can help governments as well as Human Resource managers to prepare the succession of important employees, or to give to other employees the appropriate motives to stay in employment for longer. The message from this study is that the factors that define the desire of people to retire at certain age, and the factors that actually give shape to their actual retirement age are different. To keep people in active employment for longer, they must be in good health, and they need to feel that they are still useful. There is a large number of people who seem to be forced to retire earlier than they wish. It is up to the State, the legislature and the Human Resource managers to take all necessary measures to give to the people the right to keep working for longer, if they wish.

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## **MONEY LAUNDERING POLICIES IN THE GREEK BANKING SECTOR AND PERSPECTIVES RELATED TO AN EFFECTIVE CONFRONTATION FRAMEWORK**

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### **Abstract**

This paper analyses the money laundering policies in the Greek Banking Sector. It identifies and scrutinizes the causes that led to the implementation of policies against money laundering and it analyses the confrontation framework used in Greek banks. The main goal of this dissertation is to reveal the weaknesses of the national and global policies against money laundering and find perspectives related to an effective confrontation framework. Thus, there are suggestions of appropriate methods in order to strengthen the national and international financial system against money laundering phenomenon.

**Keywords:** Greek Banking Sector, Money Laundering, policies

### **Introduction**

According to the daily terminology and experience, money laundering is all that actions and procedures, the practices or omissions that deliberately happen with the purpose of disguising and transforming by any means or methods the identity of the illegally acquired “dirty” money, so that it gets the desired legitimacy, in order to look like it was acquired or that it comes from a legal cause or origin (Tragakis, 1996).

The phenomenon of money laundering hasn’t come up the last years, not even the last century. According to Stenimahitis C. (2002), the hiding of legal and illegal wealth has its origin even earlier, having a history of 3.000 years ago. The historian Sterling Seagrave, in his book “Lords of Rim”, describes that, even before 1000 b.C., traders in China were hiding their fortune, out of fear that the governments would bag the wealth they had gathered through trading. The techniques Seagrave describes –conversion of money into easily transportable valuable elements, export of cash out of the country, “overvaluation” for emigration of capital - are also used up to a point nowadays as well.

The term “money laundering” seems that comes from the United States during the decade of 1920s (Lilley P., 2003). Gangs of criminals at that time were trying to do the same thing they are trying to do today: to dissociate the product of their criminal actions from them same criminal actions. In order to achieve that, they were setting up businesses that had very high profits in cash, like for example laundries or launderettes or car washers and they were mixing the legal earnings with their illegal earnings. This way, they had a great alibi for the possession of great amounts of cash. According to Tragakis G. E. (1998), “cash” gives the desirable and necessary anonymity in most forms of criminal action, while it is also the most usual mean of exchange in smuggling and in retail drug trafficking, in the “markets” or “pitches” of big and small towns. So, while today the term “money laundering” is metaphorically connected with the cleaning and purification of “dirty money”, it seems that its origin has to do with the “washing” and “laundry” businesses of the United States of 1920s.

Nowadays, money laundering has taken tremendous dimensions. With the evolution of technology, millions of U.S. Dollars can go across the whole planet in less than a second (Lilley P., 2003), while more than two trillion U.S. Dollars are transferred worldwide every day. Organized crime takes the advantages of the rapid development in information technology, globalization, the almost unimpeded money transferring ability, the inexistence of the national boundaries thanks to the modern payment systems and the Internet while it has extended its “activities”, not only to drug trafficking – which initially was the main source of income – but to other sectors as well. And as a result, the rapid increase of its income which calls to be legalized somehow.

Indicatively we mention that according to Human Development Report of 1999 of the United States (Lilley P., 2003), the income of organized crime sums up to 1.5 trillion U.S.D. annually. On March of 1998, Dow Jones News reported that money laundering comes between the 2% and the 5% of the World Gross Product. At a national level, we indicatively mention the following:

- In Great Britain, Bank of England estimated in 1994 that 2.4 billion GBP were laundered every year.
- In Switzerland, the Ministry of Economics confirmed in 1998 that the country was involved in the laundering of 500 billion USD annually.
- In Greece, the former President of Money Laundering Committee, Counter Public Prosecutor Judge of a Court of Appeal Mr P. Nikoloudis, reported that in 2000 there were attached 4.3 billion drachmas (“Kathimerini”, 2001) coming from the effort to legalize income from illegal actions while in 1999 there were attached 2.5 billion drachmas (increasing tension). In 2002 there were attached about 23.5 million Euro (about 8 billion drachmas), according to the report of the Institution and Transparency Committee (“Vima”, 2003). Although we can see that there is a tremendous increasing tension in money laundering year by year, it was noticed that

the above mentioned amounts were supposed small compared to the real amount of capital that is laundered. In the meeting of the Institution and Transparency Committee in June 12<sup>th</sup>, 2003, Mr P. Nikoloudis and the President of the Committee for “money laundering”, Counter Public Prosecutor Judge of a court of appeal, Mr G. Pantelis, mentioned that “the money we do not catch is very much and the money we can not catch is even more”.

The impressive thing in the investigation of money laundering phenomenon is the inventiveness of criminals. The whole system displays a remarkable dynamic: the moment that the authorities find out an application of “money laundering”, the same moment, somewhere else by someone else, a new form of action is found out.

### **Determination of the problem of money laundering and the international experience**

The legalization of income coming from illegal actions is an integral part of the evolution and transformation of modern societies and it expresses the effort of modern organized crime to “clean up the dirty money” their actions bring in. The level of the amounts of money and the constant character of that procedure, demonstrates the magnitude of the danger the economical systems are facing.

Many kinds of criminals followed money laundering phenomenon that came from various illegal actions, during the history. But we shouldn't ignore the fact that nowadays, the criminality levels have ejected and apart from drug traffickers, there are also many categories of criminals and crimes that face the need to find ways to legalize their incomes.

After the internationalization of economies and the abrogation of controlling of capital transfer, organized crime was tremendously facilitated to find methods for money laundering while on the other hand the efforts for finding and punishing that phenomenon were obstructed.

The realization of the complexity, the extension of the problem and its implications in the social and political stability of nations and in the solvency and security of credit institutions, has led the international community to intervene for the adoption of joint and particular proceedings and policies.

The main of these interventions are the following:

- The “**Basel Committee Principles**” since December of 1988, with the purpose of the establishment of new templates in the transaction behavior of the banks.<sup>66</sup>

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<sup>66</sup>Basel Committee-BIS “Money laundering and terrorist financing”, [www.bis.org/list/bcbs/tid\\_32/index.htm](http://www.bis.org/list/bcbs/tid_32/index.htm)

- The **“United Nations Agreement”** in December 20<sup>th</sup>, 1988, that enforced the contracting nations to enact criminal penalties in cases of legalization of income from criminal actions. (United Nations, “United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988”.<sup>67</sup>
- The **“Strasbourg Agreement of the member nations of the European Committee”** in November 8<sup>th</sup>, 1990, where the contracting parties have the obligation to introduce in their internal legislation stipulations for the suppression and punishment of “money laundering”.<sup>68</sup>
- The **decision for the establishment of “Financial Action Task Force” (F.A.T.F.)** from the seven biggest industrial countries and the European Community Committee in July 15<sup>th</sup>, 1989, with the purpose of preventing the legalization of income from illegal actions.<sup>69</sup>
- The **Guideline 308/91 of the European Commission**, that obligates the member nations to care for the prohibition in their land of the legalization of income from illegal actions.
- The **Law 2331/95** that incorporates the Guideline 308/91 for Greece.

## Methodology

The methodology used in this paper for the approach of money laundering phenomenon is the presentation of its different aspects according to the current banking experience, since that is the main source not only of the suspicious transactions but of the policies applied against that problem in our country as well.

Theory comes especially from the material we gathered from different organizations and banking institutions and especially from Bank of Greece. Existing bibliography and studies on this matter are also taken into account, but the main point of the theory has to do with the policies that are used from the banks against money laundering.

The method used, concerns the quotation of the existing legislation in national and international level and the implementation from banks in the Greek society, of circulars and orders of Bank of Greece for the prevention and suppression of money laundering phenomenon.

Finally, there is an effort for recording the way of action of the different money laundering nets and the way the numerous organizations against money laundering cooperate in national and international level for the confrontation of the problem. We will also try to find any perspectives related to an effective confrontation framework.

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<sup>67</sup> [http://www.unodc.org/pdf/convention\\_1988\\_en.pdf](http://www.unodc.org/pdf/convention_1988_en.pdf)

<sup>68</sup> [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52004PC0559\(01\):EL:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52004PC0559(01):EL:HTML)

<sup>69</sup> FATE, “History of the FATF”,

[http://www.fatf-gafi.org/document/63/0,3343,en\\_32250379\\_32236836\\_34432255\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/63/0,3343,en_32250379_32236836_34432255_1_1_1_1,00.html)

## Money Laundering Framework

### Definition of money laundering.

Money laundering is the legalization of income from any criminal action through the financial system. The purpose of most of the criminal actions is to create individual or joint earnings. Money laundering is the proceedings that are used by some people, in order to hide the illegal origin of the capital they acquire and to change its identity as if it is shown that it was acquired by a legal source (Tragakis G., 1995).

The term “criminal action” by which it is possible to be acquired the ill gotten property that is wanted to be legalized, goes to the punishable acts that are determined by the Laws No 2331/1995 and No 3424/2005 of the Hellenic Republic. Some of the most important are the following:

Crimes that are anticipated by the law for combating proliferation of narcotic drugs

- Crimes that are anticipated by the law as far as weapons, ammunition etc. is concerned
- The crime of robbery

The crime of extortion

The crime of abduction

The special cases of theft

The illicit appropriation of articles of particularly high value

The illicit appropriation involving abuse of confidence

The fraud resulting in particularly large damage

The commitment of fraud as an occupation or habitually or under circumstances proving that the perpetrator is particularly dangerous

The illicit trading in antiquities

The theft of ship cargo of particularly high value

The removal and transplantation of human tissues and organs

The embezzlement against the government

The crimes out of ionizing radiation

The crimes on games of chance and other games

Money launderers, for gain or for the purpose of concealing or disguising the illicit origin of the property or assisting or abetting any person who is involved in criminal activity, purchase, conceal, receive as a pledge, acquire possession or in any way become beneficiaries, convert or

transfer to another person any property which has resulted from such activity. They can also give witness or report to any judiciary or other authorities, intentionally disguise or conceal the true nature, source, disposition, movement or location of the property, knowing that such property is derived from criminal activity. Finally, they can establish or acquire an undertaking or set up an organization for the purpose of committing one of the above mentioned offences (Laws No 2331/1995 and No 3424/2005 of the Hellenic Republic).

Most of money laundering actions pass through the banking and financial institutions, leasing companies, factoring companies, venture capital companies and exchanges. The responsible authority in Greece, that is in charge of supervising and controlling these institutions, is Bank of Greece. But we can also meet money laundering actions in insurance companies and other financial organizations for whom the responsible authority is the Hellenic Capital Market Commission (HCBC) (Laws No 2331/1995 and No 3424/2005 of the Hellenic Republic).

### **The implications of money laundering phenomenon**

Countries with increasing and developing financial centers are especially vulnerable in money laundering phenomenon. Offenders take the advantage of differences between the confrontation methods against money laundering phenomenon from country to country. That is why they transfer their networks to countries and financial systems with deficient and ineffective countermeasures.

If the phenomenon cannot be kept under control, the social and political cost is and will be very serious. Organized crime has intervened in financial organizations, has taken the control of wild sectors of the economy, having bribed many times even functionaries, judicial authorities and political authorities as well. That has resulted in weakening social building and democratic statutes of modern society.

Money laundering phenomenon, because of its origin from criminal actions, enlarges and supplies them. A determined fight against that phenomenon has great importance on the promotion of democracy, the legal system and the human rights (Gilmore C. William, 1999). Money laundering restriction could be a fatal blow against the organized crime, since the exploitation of ill-gotten gains obtained from such actions would not be possible any more.

### **Money laundering stages**

Money laundering takes place especially through (Tragakis G., 1990):

- Transactions in cash
- Bank accounts and safe deposit boxes
- Exchanges



- Insurance companies
- Capital markets
- Estate agencies
- Casinos
- Commercial transactions
- Foreign countries called “tax heavens”
- Offshore companies
- Bank executives involved in criminal actions
- Bank credit of loans

Cash money offers anonymity in most forms of criminal actions. That fact gives rise to the need of continuous hiding of the real origin of capital gathered from such actions, the maintenance of controlling of that capital as well as the need for transforming it.

The three stages of “money laundering” during which numerous transactions take place are the following:

**Stage I: The stage of “placement”**

The most usual way of legalizing “dirty” money is by depositing the packets of money, usually in small nominal value, in one or more financial institutions or by exchanging that money with objects of high value, like jewels, works of art etc. This practice consists the first stage of a complicated system of complex financial transactions, which is the most crucial and the easiest to be located in “money laundering” action and for the further surveillance of the whole procedure. The physical transportation of cash and its deposit to a bank consist the weakest point of the organized crime during the “money laundering” procedure.

**Stage II: The stage of “layering”**

Since the income from criminal actions is introduced in the financial system, the second stage of “layering” takes place. In that phase, money launderer makes a series of conversions or movements of amounts in order to send them away from their source. The amounts can be followed through markets and sales of depositing, investing or and insurance products or they can be netted through a series of money transfers from account to account in different banks worldwide. That use of scattered bank accounts is being used and is especially spread in countries that do not steadily cooperate against money laundering phenomenon, like the Carribean countries, small island countries of the Pacific and Indian Ocean, even also small European countries. The purpose of this stage is the misleading of inspecting authorities, the

alteration of checking evidence and the supply of anonymity of the beneficiaries of bank accounts to their advantage.

### **Stage III: The stage of “integration”**

In this stage, the apparent legalization of the ill-gotten wealth is succeeded. Having effectively passed the ill-gotten gains through the first two phases of “money laundering” procedure and having changed their real identity, they are introduced again in the financial network, under the cloak of the normal business investments, through the investments on real estate, the establishing of new businesses, the purchase of works of art, the donations and charities, the entrance in sections with mass effect like professional athletics etc.

### **Money laundering sources**

A few years ago, outlaws were worrying about how they would appear in front of the counter of the bank carrying whole suitcases full of banknotes, without raising suspicions to the bank employees. Nowadays things have become even more complicated and of course we don't only mean the usual and seemingly simple method of “money laundering” through purchasing real estate. Indicatively, we mention some –least- brainwave methods of “money laundering” that became widely known:

- **“Money laundering” through lottery and lottery coupons** (“Kathimerini”, 2005). In practice goes in the following way: some winning lotteries or lottery coupons are bought from the real winning owners (unambiguously against a higher price) and in continue the coupons in question are deposited by their new owners who receive the payment of the earnings and simultaneously a legal certification of the earnings (through which the capital is legalized since they are presented as earnings from lottery or lottery coupons).
- **“Money laundering” through casinos** (“Vima”, 2001). It concerns businesses that accept cash and not checks (because of the existence of the danger of bringing bad checks). This way, a supposed player can visit a casino, bringing a large amount of cash, buy chips, play, lose a short portion of his money, stop and ask the staff of the casino in charge to give him the remaining of his initiative capital in the form of a bank check (this way, the initially illegal capital that was brought is legalized).
- **“Money laundering” through the Stock Exchange** (“Vima”, 2005). The practice is simple, although the first step is considered the most difficult: the basic thing is the code to be opened and the first buy of shares to be made (usually, companies that increase their stock fund with gratis shares are preferred, with the intention, the final number of shares that will be liquidated, to be higher). In continue, the aspiring

“launderer” carries out a large number of transactions, in order to generate problems in a possible investigation of the authorities and to make it difficult for the first transaction to be found. Afterwards, he aims to “break” the capitals in many codes, in different securities companies and in continue he proceeds to liquidations (so, this way, he ensures the “origin” of his capitals).

- **“Money laundering” through the trade of antiquities and auctions** (“Kathimerini”, 2006). Antiquities – generally originating from smuggled excavations – are usually sold and bought during auctions from the same person, who mysteriously appears as an anonymous collector (as the first contributing member) and as an offshore company (as the second contributing member).

### **Off-shore companies and money laundering**

The biggest part of “dirty money” that is gathered from illegal actions is in cash. The main three scenarios, that are recorded out of observations of the pursuing authorities and the officials against “money laundering”, as far as the procedures and the way of action of the “launderers” is concerned, for the physical transportation of the dirty money, are the following:

- The first scenario is the one where the cash stays in the country where it is gathered and people are found, that do not belong to the network, but systematically are occupied with the “laundering” on behalf of money holders and owners. Those people are “beyond” any suspicion and they are carefully chosen, taking especially into account their professional activities that from their nature should gather and transfer amounts of cash every day. Of course those people are informed about this action and they quite often deposit in one or more banks either small amounts or higher amounts of money. That money in a following phase is transferred in other countries’ banks, being presented as products of exports or loans.
- The second scenario is the one where the cash is not transferred abroad, nor is “broken” into smaller amounts, but it is deposited in big amounts without its origin being suspicious. This case refers to countries where the banking secrecy exists in its rigorous form and money laundering business hasn’t been penalized.
- Finally, the third scenario is the one where the cash is identically transferred with different methods (boats, crafts, airplanes etc.) from the country where it is gathered out of illegal actions to a destination that is usually a tax “heaven”. The money is deposited in a bank in that country and that is the way the “laundering” through the international banking system begins.

Although globalization has provided the potential of financial development, on the other hand it has also given tremendous capabilities for the expansion of organized crime without having supranational mechanisms to confront it. The whole issue is a matter of each nation separately.

Offshore companies offer a variety of services that are not normally available in other countries. These services include secret bank accounts, establishment of bogus companies and foreign trusts. That is why money launderers are very easy to exist in those companies.

The countries that are attractive to money laundering have at least one of the following characteristics (Douvis P., 2003):

- Fragile financial infrastructures with private banking systems that are in the first development stages or that are capable to be bought in such a low cost that make them just available with the possession of a small controlling proportion.
- Lack of substantial and special regulation as far as money laundering is concerned.
- Not well trained and not well equipped personnel of controlling and of banking services, on the tracing and on succeeded prosecution of offences that have to do with money laundering.

In Greece, according to the law 2238/1994, "Offshore companies are meant the companies that have their headquarters in a foreign country and according to their legislation they are exclusively activated in other countries and they are in favor of an especially favorable tax treatment".

The biggest tax heaven for capital base is Manhattan, where there is no mechanism of exchanging information for the capital that is invested in the U.S.A. International Monetary Fund estimates that 600 billion U.S.D. are annually laundered, half of which in U.S.A. It is not contingent that U.S.A. is opposed to OECD efforts to implement restrictions on "tax heavens".

Organized criminals have put on the mantle of a succeeded businessman, laundering their illegitimate child through offshore companies. This does not mean of course, that every offshore company performs an illegal action. Since that legal creature exists and it is accepted from the whole of the legal class it would be utopian if anyone tried for its whole abolition. However, it is essential the world's legal class to be legally armed in order to avoid the exploitation of that kind of companies from criminals.

In a level of prevention, European Union should introduce the obligation of reporting to local authorities (e.g. tax offices, stock exchange) the real owner of the offshore company since it takes action to a member nation, without adding him tax charges. While, in the level of suppression, the enforcement of an "embargo" on financial transactions with tax heavens, that do not follow the international rules, is a kind of pressure and punishment for those who protect crime than

improving their legislation according to the obligation of governmental, police and judicial cooperation.

### **The awareness for the need to take action against money laundering phenomenon**

Whoever studies the many-pleated money laundering phenomenon in depth comes to the conclusion that there is a huge menace to the financial and social structure of a country. The relatively recent examples of Italy, Russia and other countries in Central and South America are indicative. According to a statistical study of the I.M.F. on the last decade, it was calculated that amounts of money on the level of 700 billion dollars are legalized through money laundering, being increased in a pace of 10% annually.

One could include in that amounts the “dirty money” that comes from sources that are directly involved with the political corruption, the illegal commissions, the great tax evasion, the illegal export of currency, the properties of the third-world dictators and the wealth that was gathered by the strong leadership of the previous political and financial form of the government of the East Europe e.t.c. (Tragakis, 1996).

During 1980s, especially in the world of banks, it was realized that institutions and rules of behavior with a long time effect and a great tradition, like the bank secrecy, come often in opposition with the social interest and that is the reason they should be newly defined taking into account the modern conditions and views. It was noticed that inactivity includes the danger that banks could be stamped as shelters of criminals and that their interests are identical with the organized crime and that is why they do not show any sensitivity on such a serious problem like the fighting against the curse of drugs, the international terrorism and other serious criminal offences.

Another important step towards the realization of the need to take particular measures was the “Manifestation of Principles” that was adopted by the Basel Committee and who officially formulated the main principles on dealing behavior that should be followed by the banks today in the whole world in order to convince everyone that they are not used as asylums for criminals and as money laundering machines (Tragakis, 1996). For all these reasons, Basel Committee concluded that the responsible authorities on supervision and controlling of the banking system owe to realize that now they have the additional general role to encourage the observance of the new templates of professional behaviour in the financial institutions.

The formulation of the professional ethics has helped enough until today, on the realization of the need to take legal measures against money laundering in national level and especially in countries where important financial institutions work.

## **Application of the policies against money laundering in the Greek Banking Sector**

### **The Greek regulatory framework against money laundering.**

The Greek regulatory framework on the prevention and suppression of money laundering is being consisted of regulations that are included in the Laws 1990/1991 (Sheet of the Greek Government Gazette A' 193/16.12.1991, articles 1-13), 2655/1998 (Sheet of the Greek Government Gazette A' 264/1.12.1998, articles 1-44) and 3034/2002 (Sheet of the Greek Government Gazette A' 168/19.7.2002, articles 1-28), the Law 2331/1995 (Sheet of the Greek Government Gazette A' 173/24.8.1995, articles 1-12) which was amended and complemented by the Law 3424/2005 (Sheet of the Greek Government Gazette A' 305/13.12.2005, articles 1-14), and the relative administration's circulars and instructions of Bank of Greece.

- By the Law 1990/1991 the Vienna Agreement of 1988 was confirmed.
- By the Law 2655/1998 the Strasbourg Treaty of 1990 was confirmed.
- By the Law 3034/2002 the United Nations' International Treaty of 1999, for the suppression of terrorism financing was confirmed.
- The Law 2331/1995 embodies in the Greek Law the regulations of the Guideline 308/1991 of the European Community while the Law 3424/2005 embodies in the Greek Law the Guideline 2001/1997 of the European Parliament and the Committee against the use of the financial system for money laundering.
- By the Law 2331/1995, Bank of Greece is assigned as the responsible authority for the implementation of its regulations on the financial institutions, leasing companies, factoring companies, exchanges and intermediate services companies for money transfer. They also determine the crimes included in the term of criminal activity as well as the penalties imposed on the outlaws and it was established, by the article 7 (Law 2331/1995), the constitution of a committee whose task would be gathering, evaluate and investigate the information transferred to them from the financial institutions and the other financial organizations for suspicious transactions for money laundering.
- By the Law 3424/2005 the financial system is more armed against its usage for money laundering and terrorist financing, the implementation of its regulations is also enforced to other sectors and professions, the term of basic crimes is expanded, the responsibilities of the Committee of the article 7 of the Law 2331/1995 are strengthened, penal punishment is rationalized, the Ministry of National Economy is assigned as the central coordinating authority for the prevention and suppression of money laundering

phenomenon and the obligations of the banks and the other financial organizations and their supervising authorities are marked out.

- By the Law 3691/2008, there is reinforcing and improving the legislative framework on the prevention and suppression of money laundering and terrorist financing. This new law transposes into legislation the provisions of Directive 2005/60/EC of the European Parliament and of the Council “on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing” (Official Journal of the European Union L 309/15/25.11.2005) and certain provisions of Directive 2006/70/EC of the European Commission (Official Journal of the European Union L 214/29/4.8.2006) and replaces relevant provisions of Law 2331/1995 (Government Gazette 173 A).

In 18<sup>th</sup> February, 1997, Bank of Greece issued the Administration’s Circular No.2 which referred to the obligations of credit and financial institutions under the Law 2331/1995 and the obligations of credit and financial institutions arising from the Forty Recommendations of FATF, some other obligations as far as the SWIFT is concerned and the obligation for the provision of information to Bank of Greece. (Bank of Greece, “Prevention of Money Laundering”, Administration’s Circular No.2”, 1997)

In 2<sup>nd</sup> August, 2004 the Administration’s Circular No.2 stops being in effect and it was replaced by the Administration’s Circulation No.16 which is the united text that contains all the obligations of credit institutions arising from the circulation documents and guidelines until then, as well as the adjusting developments that took place under the ground of the Recommendations of FATF (Bank of Greece, “Codification of Regulation for the Prevention of Money Laundering”, Administration’s Circular No.16”, 2004).

In 9<sup>th</sup> March 2006 the Supplement No.4 of the Governor’s Order No.2577 of Bank of Greece was issued and the Administration’s Circulation No.16 stops being in effect. The purpose of Bank of Greece with this issue was to include the new regulations of Law 3424/2005 in its provisions for credit institutions as well as the regulations of the Law 2331/1995 that were still in effect. These provisions refer not only to credit institutions but to financial organizations as well and they compose the criteria for the valuation of supervised institutions from Bank of Greece.

A few general provisions for the supervised institutions are the following:

- they should demand proof for the identity of their clients
- they should inspect very carefully each transaction that could be related to money laundering or terrorist financing because of its nature or by evidences that have to do with the character or the profession of the client

- they should enact internal control and intercommunication procedures in order to prevent and deter the effect of transactions combined with the above mentioned crimes
- they should evaluate the whole portfolio the client may keep in them, in a level of Group of the bank, in order to verify the relation and convention of the transaction with that portfolio
- they should take care that these obligations are enforced in their branches and subsidiaries abroad
- they should take any other appropriate measures including not working out the transaction or the severance of their relationship with the client, since the provisions for the certification and verification of his identity according to the law for the prevention of money laundering and terrorist financing are not satisfied or his transactional behavior is not in accordance with the policy and the procedures that are enforced by the bank for the confrontation of relevant dangers.

Banks should also follow the provisions for the appropriate and consistent with the enterprising goals policies, the procedures for tracking down suspicious transactions, the precautionary measures like those that are implemented for other risks and especially the classification of transactions, clients or both according to their level of risk, the conception of the dangers, the policy and the procedures from the executives, the implementation of criteria for the acceptance of contractual relation with the clients and its surveillance and the periodical valuation of the methodologies that are in effect and the conformity of the training in the changing circumstances.

The Supervised Institutions have the responsibility to specify the policy measures and procedures for the observance of their obligations according to the above mentioned provisions. For their most possible united implementation the Supplement No.4 of the Governor's Order No.2577/9.3.2006 of Bank of Greece quotes the least procedures that should be enforced by the Supervised Institutions for the adequate performance of their obligations and a typology of suspicious transactions for money laundering and terrorist financing is also appended. (Bank of Greece, "Prevention and Suppression of Money Laundering and Terrorist Financing", Supplement No.4 of the Governor's Order No.2577, 2006).

The Decision of the Banking and Credit Affairs Committee No 242/6/4.5.2007 brought the first amendment on the Supplement No.4 of the Governor's Order No.2577/9.3.2006 of Bank of Greece with which are specified the basic principles and the valuation criteria of the organizational structure of the system of Internal Control as far as the prevention of money laundering and terrorist financing is concerned. (Bank of Greece, Decision of the Banking and Credit Affairs Committee No 242/6, 2007).



Finally, the Decision of the Banking and Credit Affairs Committee No. 257/4/22.2.2008 brought the second and final, so far, amendment on Supplement No.4 of the Governor's Order No.2577/9.3.2006 of Bank of Greece. The amendments referred to some changes and additions on the least procedures that should be enforced by the Supervised Institutions for the adequate performance of their obligations (Bank of Greece, Decision of the Banking and Credit Affairs Committee No 257/4, 2008).

### **Enrollment of the Greek regulatory framework against money laundering in the internal regulation of the Greek financial institutions.**

In our effort to find out whether the Greek regulatory framework against money laundering is being implemented in the internal regulation of the Greek banks, we picked a major group of the Greek banking system, "Piraeus Bank" and we asked them to give us information about their compliance policy against money laundering.

From the material collected we came to the following conclusions:

- First of all they have a great organization as far as controlling, updating and applying the compliance system in the group. They have a General Director of the Corporate Governance who is above the Chief Compliance Officer who is above the Deputy Director. All of them are above two groups: the AML/CTF Group and the Compliance Group. The first group, AML/CTF Group, gives information about the records of the customers when it is needed for an investigation and generally they apply the AML/CTF policy of the bank. The second group, Compliance Group, works on the compliance of the bank with the regulatory framework against money laundering which is imposed by the responsible authorities of the country and for its implementation from the branches and subsidiaries of the Group.
- The compliance policy of the bank was in conformity with the regulations that are given from the responsible authorities of the country against money laundering. They follow the procedures in recognizing and identifying their customers, they implement the "risk – based approach" of money laundering and terrorist financing, they enforce the due diligence process for intermediaries, they keep records, they give orders as far as tracing, dealing and reporting suspicious transactions, they have a process of internal control and communication, they educate and train their personnel, they follow the essential procedures on electronic fund transfers, they give the needed information to Bank of Greece every March and they are also informed about the charges they will have if they do not comply with the regulation given by the responsible authorities.

- The bank is trying to enrich the given regulation, analyzing with many details each part and they are also stricter in some of the measures they impose, in order the bank to be more safe. For example, they do not rent safe deposit boxes but to their customers who must be well identified and they do not accept to keep any sealed envelopes or boxes (Piraeus Bank, Group Compliance Department, "Compliance Policy of the Bank of Piraeus Group", 1<sup>st</sup> edition, May 2008)

However, taking Piraeus Bank as a model, the general conclusion we get is that banks in Greece do comply with the regulations imposed by the responsible authorities. So we come to the subsequent question: If banks do comply with the imposed regulation against money laundering then why do we have an increase in the amounts of money that are laundered?

A possible answer could be that money launderers are always finding ways to pass over the obstacles the banking system imposes by its regulation. Because of the big competition between banks, all of their employees are obliged to find ways to increase the earnings of the bank. That can easily result to not following the regulation of the same bank against money laundering. Thus, even if new and more effective regulation is being enacted against that phenomenon, we can see that they never have a satisfactory result when they are imposed.

We suggest that a more effective method against money laundering could be the more often and severe investigations on the banks for that issue and to be imposed huge fines and some tough sanctions depending on the case. Maybe this way competition between banks could be reduced and banks will use more lawful means for their development.

According to the Basel Committee on Banking Supervision, whatever the legal position in different countries, the first and most important safeguard against money-laundering is the integrity of banks' own managements and their vigilant determination to prevent their institutions becoming associated with criminals or being used as a channel for money laundering. (BCBS, 1988).

*Table 1 – Number of investigations on the spot from Bank of Greece*

	2005	2006	2007
<b>On banking institutions</b>	<b>240</b>	<b>200</b>	<b>201</b>
<i>which concern:</i>			
Internal control – risk management	56	55	32
Money laundering	152	97	129
Transparency of transactions	32	48	40
<b>On Financing Institutions</b>	<b>20</b>	<b>23</b>	<b>8</b>
<b>Other Controls</b>	<b>136</b>	<b>101</b>	<b>131</b>
<b>General Total</b>	<b>396</b>	<b>324</b>	<b>340</b>
<i>from which:</i>			
On branches out of Attica	152	164	106
On branches and subsidiaries abroad	6	6	13

*Source: Bank of Greece*

From Table 1 it's clear that during the period between 2005 and 2006 there was a decrease in the number of investigations on the spot from Bank of Greece while from 2006 to 2007 there was an increase. According to Bank of Greece Governor's Annual Report for 2007, the number of investigations on the spot cannot be considered as the only evidence of supervisory presence of Bank of Greece. Conversations with the authorized executives of the banks and the daily supervision for the progress of the banks are some crucial factors that help Bank of Greece to form an image timely, taking into account the special risk characteristics of each bank, and making sure its compliance with each regulation that is in effect.

*Table 2 – Sanctions that were enforced from Bank of Greece  
(Amounts in Euro)*

<i>Transparency in transactions</i>			
	2006 (14 banks)	2007 (8 banks)	Total 2006–2007 (22 banks)
<i>Interest - free deposits height</i>	34,373,200	14,400,000	48,773,200
<i>Total Cost (1)</i>	859,330	360,000	1,219,330
<i>Average Cost</i>	42,603	45,000	43,801
<i>Least Cost (2)</i>	3,000	10,000	-
<i>Greatest Cost</i>	77,778	160,000	-
<i>Money Laundering</i>			
	2006 (14 banks)	2007 (12 banks)	Total 2006–2007 (26 banks)
<i>Interest - free deposits height</i>	13,413,200	20,200,000	33,613,200
<i>Total Cost (1)</i>	335,330	505,000	840,330
<i>Average Cost</i>	14,436	42,083	28,260
<i>Least Cost (2)</i>	6,108	20,000	-
<i>Greatest Cost</i>	20,804	75,000	-
<p><i>Calculated with the interest rate of the marginal funding (5%). Calculated with a cost of capital of 7%, the total cost of sanctions for the period 2006–2007 on transparency issues comes up to Euro 1,707,062, while on money laundering issues comes up to Euro 1,176,462.</i></p> <p><i>Under the principle of proportionality, some categories of penalties cannot exceed the limit of the relative category of the Law 2912/2001 as far as interest rates from compound interest is concerned (e.g. on delayed answers to the clients law determines width of penalties from Euro 2,934.70 to 14,673.51)</i></p>			

*Source: Bank of Greece*

In Table 2 we can see that from 2006 to 2007 there is an increase on the amount in Euro from sanctions imposed from Bank of Greece to the banking institutions while fewer banks are found to have problems. This shows us that more banks comply with the measures against money laundering and they do enforce them, but the banks that do not enforce them in practice are accused for big irregularities with great sanctions.

Bank of Greece has cut back expansion plans for banks that were found inadequate on their internal control systems. That is a sanction which is proven for its effectiveness. It has also utilized the potential to increase the minimum capital requirements of the banks. Today, seven commercial banks ought to keep Prudential Ratio more than the least ratio of 8% (Bank of Greece, "Governor's Annual Report for 2007", 2008).

Within 2007, the valuation of Greece from F.A.T.F. on the prevention and suppression of money laundering and terrorist financing had been completed. F.A.T.F. observations were quoted on their Assessment Report. In that report the relevant weaknesses of the Greek Financial System

were marked and methods for the improvement of supervision framework were suggested (Bank of Greece, "Governor's Annual Report for 2007", 2008).

## **Conclusion**

### **The erosive influence of organized crime to the society.**

Money laundering reflects negatively the capability of the governments to successfully apply measures for the fiscal and monetary policy. So, it is expected when an important part of the financial values is controlled by the organized crime that the basic indexes of the financial activity lose their reliability as far as the configuration of a powerful financial policy is concerned.

The factors that lead the syndicates of the organized crime to their investing decisions are substantially different than that of the legal businesses. It is well known that these illegal companies are mainly used for facilitating money laundering, its recycling and the development of the criminal activity while the main factors that influence these decisions is their fear of leaving evidences of their identity as well as facilitating these transactions. (Tragakis G., 1996)

In developed countries, reliability of the applied financial policy is heavily damaged when a part of the financial system is under the influence and control of the organized crime. The capital that is managed from them usually has a damaging influence on the social prosperity during a period when the investing decisions of private sector of the economy and the level of crediting ability of a country for its borrowing from the international markets of money and capital are significantly influenced from the length of the penetration and undermining of that country from the organized nets of the underground. (Tragakis G., 1996) So, whatever advantages obtained by the inflow of suspicious origin capital are minimized or smashed.

However, the biggest threat from money laundering is located on the way the organized crime uses the huge amounts of capital they have in their possession for the general corruption of the political-social system and the control of the financial activity of a state. It is observed that society and economy are divided as the legal businesses are not in position to compete with the businesses that belong or are controlled by the organized crime, since they do not pay taxes, they get the best jobs, they are not supervised as they should and in addition they use criminal ways in order to destroy the dynamic and competing competitors. (Katsios S., 1998)

### **International Economy and Money Laundering.**

The general progress of international economy has a causal link with money laundering. The biggest facility for the transfer of the ill gotten gains abroad is a problem not only to the country of origin of capital but to countries of destination of the capital as well. When the capital of organized crime enters in a country and it is used for "investments", the immediate result is

decomposition of the business environment, uncertainty and interference of many insurmountable obstacles in the development of those economies (Tragakis G., 1996).

Generally, Third-World Nations and countries have a big need for pulling in capital from abroad for the financing of development programs and they do not have legislation and mechanisms for the prevention and suppression of money laundering. For this reason and for others, fighting against that anti-social practice is linked with the promotion of financial progress and the abolition of poverty and unemployment.

As the organized crime enters all the time in different sectors of financial activity, as the universality of the financial system is given and the liberalization of the rules of its set-up, supervision and operation, as electronic fund transfer is nourishing nowadays, we are unavoidably led to the facilitation of the organized crime to legalize its ill gotten gains (Katsios S., 1998).

So, it is at least imperative to arm the financial system with any legal mean for the prevention and suppression of the above mentioned criminal activity. Today, more than ever, the function of the international financial system is threatened by the organized crime. Countries that accept the organized crime are mathematically led to financial destruction, undermining of institutions and of course to the establishment of governmental relations with corruption. This way they are immediately transformed into tax heavens dependant from organized crime gangs (Katsios S., 1998).

#### **General conclusion-the Greek case**

The new law 3691/2008 for the prevention and suppression of money laundering and terrorist financing is considered as more stringent than its earlier ones. With this law more occupational sectors are involved in the effort for confronting this damaging phenomenon. For example, lawyers, who did not have the obligation to give information to the responsible authorities about their clients, when they were involved with money laundering, because of the secrecy of their job, with the new law they will not only have that obligation but they can also be accused for aiding and abetting criminals if they do not do so.

Comments and remarks from different occupational sectors are being taken into account by the government, in order to be implemented an even more effective framework against money laundering phenomenon in Greece. But that is not enough!

We should all be in the mood of helping for the correct implementation of this framework and not sabotage it or just accept the “dirty” money in our transactions. Each one of us separately or as a team could help to confront the problem and that would be the most effective policy against the destroying phenomenon of money laundering!

The most interesting conclusion is the fact that after so many years since the enforcement in Greece of the basic law against the legalization of income that comes from criminal actions, the authorities that are occupied with this issue have realized the following:

- There are many potential dangers because of the acceptance of transactions with “dirty money”
- The damaging consequences in individual as well as in national level of this illegal action
- The provisional profitability of the acceptance and of transactions with “dirty or black money” for the whole national financial system and
- The international consequences from the exposure of such actions, since a very powerful and effective mechanism has been developed in international level for the harsh punishment of the phenomenon.

The restrictions of this paper come along with the fact that the results of this problem are not demonstrated easily to the public, under the limits of the essential discretion and the protection of the people who mention such transactions. There are also restrictions as far as the methods that are used in order to detect and trace suspicious transactions since the “specialists” in these transactions take good care in order not to be traced and neither revealed their techniques.

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**MARKETING AND SALES CONFLICT: ANTECEDENTS AND CONSEQUENCES****Lionakis, Konstantinos<sup>1</sup>; Avlonitis, George J.<sup>2</sup>**

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**Abstract**

This is a summary of a dissertation which focuses on the relationships between the Marketing and Sales departments, exploring specific organizational and functional factors as sources of Marketing-Sales conflict, as well as the consequences of this conflict on company performance. Based on the data collected from both Marketing and Sales managers of 132 consumer goods' companies, the dissertation identifies as sources of Marketing-Sales conflict (a) the low degree of market orientation, (b) inconsistencies in the perceptions of Marketing and Sales managers regarding their respective companies strategy, (c) the unequal level of power between the Marketing and Sales departments, (d) differences in the perceptions of Marketing and Sales managers regarding the importance of basic marketing activities, and (e) the low quality of cooperation between M&S departments for the execution of these activities, and as a consequence of this conflict the reduced company performance. The implications of the dissertation are discussed.

**Introduction**

Historically there has been tension between Marketing and Sales (Lorge, 1999); senior managers often describe the working relationship of Marketing and Sales (hereinafter M&S) as unsatisfactory (see Kotler, Rackham and Krishnaswamy, 2006), while some scholars report this relationship to be far from harmonious (Homburg, Jensen & Krohmer, 2008; Montgomery & Webster, 1997). Overall, the M&S relationship is characterized, mainly, by negative outcomes, e.g. a lack of cohesion, distrust, dissatisfaction and conflict (Dewsnap & Jobber 2000, 2002). The poor Marketing – Sales relationships may be the outcome of certain organizational and functional characteristics pertaining to these two departments.

Specifically, regarding the organizational characteristics, the low degree of market orientation is a barrier in the creation of effective Marketing-Sales interface (Biemans & Brencic, 2007), while Meunier-FitzHugh and Piercy (2007) argue that problematic relationships between M&S may be caused by different perspectives and poor alignment between these two departments, especially regarding company's strategy (Shapiro, 2002). Also, it has been reported that imbalances of

power are a source of problematic relationship between M&S departments (Homburg et al., 2008; Meldrum, 1996).

Regarding the functional characteristics, Krohmer, Homburg and Workman (2002) and Rouzies et al. (2005) identified a dispersion of influence on basic marketing activities such as marketing research, market segmentation, product design, pricing etc, especially between M&S departments, which could be considered as a source of conflict, while Shapiro (2002) suggested that the low level of importance assigned to marketing activities from M&S departments, is associated with poor collaboration between these two departments. Also, Homburg et al. (2008) indicated that reduced cooperation quality of M&S departments, in respect to marketing activities, is connected with poor Marketing-Sales relationships.

Although the Marketing-Sales dyad has been championed in the normative literature, it has not been subjected to any vigorous empirical analysis, despite the fact that other interdepartmental relationships have received empirical attention, e.g. Marketing and Manufacturing (see Mukhopadhyay and Gupta, 1998), Marketing and Engineering (see Weinrauch and Anderson, 1982), Marketing and R&D (see Griffin and Hauser, 1996). Moreover, extant literature in the area of interdepartmental relationships, and more specifically between the M&S departments, has not examined as yet the perceptions of the M&S managers of the same company simultaneously. As Massey and Dawes (2007) point out, researchers, ideally, need to examine M&S managers' perspectives simultaneously.

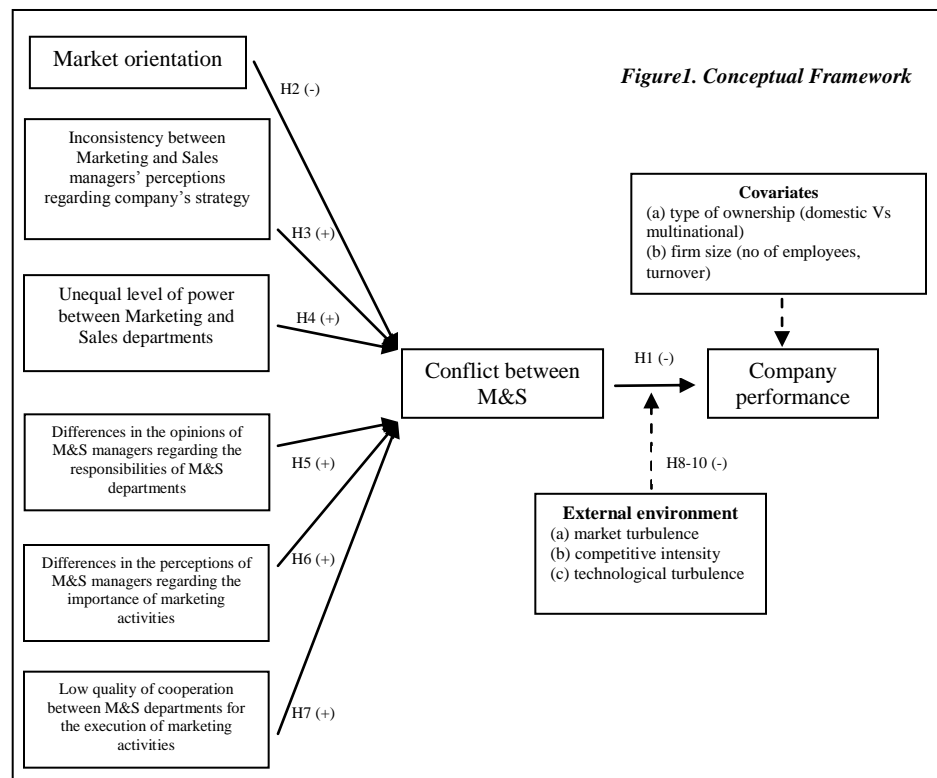
Thus, the objectives of this dissertation are to capture the perceptions of both M&S managers within the same company in order to investigate whether (a) the low degree of market orientation, (b) inconsistencies in the perceptions of M&S managers regarding their respective companies strategy, (c) unequal level of power between M&S departments, (d) differences in the decision authority of M&S departments regarding the basic marketing activities, (d) differences in the perceptions of M&S managers regarding the importance of these activities, and (e) poor cooperation quality between M&S departments for the execution of the activities in question, lead to the creation of Marketing-Sales conflict, as well as the effects of this conflict on company performance. Moreover, the dissertation investigates whether the environment within which the company operates (in terms of market turbulence, competition intensity and technological turbulence) is a moderator in the relationship between Marketing-Sales conflict and company performance, as suggested by the normative literature (Rouzies et al., 2005). It also examines company characteristics (type of ownership, size) as covariates of performance, since it is indicated in the relevant literature (e.g. Panagopoulos & Avlonitis, 2010).

This paper, therefore, is organised as follows. Firstly, the conceptual framework of this dissertation is presented and the study's hypotheses are developed, based on the theoretical

premises underlying this dissertation. Then, the research methodology is discussed and the empirical analysis and results are presented. Thereafter, the findings are interpreted and explained in light of extant theory and various conclusions are derived. Finally, the implications for researchers and managers are highlighted, and the dissertation's limitations and suggestions for future research are discussed.

### Conceptual framework and hypotheses development

The core construct of this dissertation is Marketing-Sales conflict, and the conceptual framework of this research project, which is depicted in figure 1, illustrates the antecedents of Marketing-Sales conflict in terms of organisational and functional characteristics of M&S departments, as well as the consequences of this conflict on company performance. Moreover, figure 1 indicates the moderation effect of the external environment in the relationship between Marketing-Sales conflict and company performance, and the covariance between certain company characteristics and performance. The following sections focus on the rationale of these relationships.



### Marketing-Sales conflict

A significant attention, mainly normative, has been devoted to the conceptualization of Marketing-Sales interface (Cespedes, 1993; Dewsnap & Jobber, 2000; Homburg et al., 2008; Rouzies et al., 2005; Kotler et al., 2006). There is evidence to suggest that while M&S are both independent and interdependent, they are not always seen as working collectively or

collaboratively (Dawes & Massey, 2005; Kotler et al., 2006; Lorge, 1999; Shapiro, 2002). In most instances, the relationship between M&S is reported as exhibiting a lack of understanding, disbelief, poor co-operation and being in conflict (Dewsnap & Jobber, 2000; Rouzies et al., 2005; Kotler et al., 2006; Meunier-FitzHugh & Piercy, 2007).

Conflict has been defined in the organisational science literature as the “collision of actors” (Katz & Kahn, 1978) and “tension between two or more social entities - individuals, groups or larger organisations - which arises from incompatibility of actual or desired responses” (Gaski, 1984). In the marketing literature, Menon et al. (1996) conceptualized conflict as dysfunctional, task-based tension between departments, which manifests in the form of “turf battles” and “destructive self-serving efforts”, which are both counter to collaboration (Morgan & Piercy, 1998).

On the other hand, collaboration between M&S departments in organisations is linked to improved business performance (Meunier-FitzHugh & Piercy, 2007). The literature concurs that the M&S interface frequently appears as lacking collaboration, and that improvements in this relationship should be beneficial to the organisation in terms of improved business performance (e.g. Cespedes, 1993; Dewsnap & Jobber, 2000; Rouzies et al., 2005; Kotler et al., 2006). Specifically, Meunier-FitzHugh and Piercy (2007) proposed that a reduction of conflict between M&S will improve their collaboration, which in turn will lead to superior company performance (Rouzies et al., 2005). In a similar vein, Chimhanzi (2004) identified a negative link between conflict and the effectiveness of strategy implementation, which is reported as an antecedent of improved company performance (Shapiro, 2002). Moreover, conflict has been found to reduce inter-functional performance (Dutton & Walton, 1996; Souder, 1981) as it results in the absence of depth of communication and infrequency of contact between functional units (Menon et al., 1997). Additionally, Kotler et al. (2006) emphasized the need for ending the war between M&S in order to create superior company performance. In general, the consequences of conflict on organisational performance are characterized as deleterious (Chimhanzi, 2004). Thus, we can hypothesize that:

*H1: Marketing-Sales conflict has a negative impact on company performance.*

## **Market orientation**

A strong market-oriented culture is an effective means for the generation of superior customer value (Deshpande et al., 1993; Homburg & Pflesser, 2000), which is the base for a company's competitive advantage (Guenzi & Troilo, 2007). Market orientation has been studied extensively over the past thirty years with the general consensus that it is positively related to business performance (e.g. Avlonitis & Gounaris, 1997; Jaworski & Kohli, 1993; Kirca, Jayachandra &

Bearden, 2005; Narver & Slater, 1990). Research in the area of market orientation has addressed the construct's conceptual clarification (Day, 1994; Kohli & Jaworski, 1990; Narver & Slater, 1990; Slater & Narver, 2000), measurement issues (Narver & Slater, 1990), and antecedents and performance outcomes (Avlonitis & Gounaris, 1997; Jaworski & Kohli, 1993; Slater & Narver, 1994).

Basically, two perspectives on market orientation can be distinguished (Cano, Carrillat and Jaramillo, 2004), a behavioral and a cultural perspective. The behavioral perspective describes market orientation in terms of specific behaviors related to generation and dissemination of market intelligence and responsiveness to it (Kohli & Jaworski, 1990), while the cultural perspective is related to more fundamental characteristics of the organization, such as customer orientation, competitive orientation and inter-functional coordination (Narver & Slater, 1990).

Both perspectives place cross functional relationships at the very heart of market orientation, in terms of (a) dissemination of market intelligence within the company (Kohli & Jaworski, 1990), and (b) inter-functional coordination (Narver & Slater, 1990), which are crucial matters for the entire company (Guenzi & Troilo, 2007), since a company must disseminate marketing intelligence throughout the organization and all departments must respond consistently (Kohli & Jaworski, 1990; Slater & Narver, 2000). This applies especially for the M&S departments, since they are both "outward looking", focused on the customer and the market (Shapiro, 2002), while their relationship is reported to be far from harmonious (Guenzi & Troilo, 2007).

Recent literature indicates that the strategic choice of a company to place emphasis on market orientation could contribute to the creation of smooth relationship between M&S (Biemans & Brencic, 2007; Elg, 2008). Market orientation is considered as an antecedent for the creation of esprit de corps (Kirca et al., 2005; Kohli & Jaworski, 1990), which in turn reduces interdepartmental conflict (Barclay, 1991). Moreover, Jaworski and Kohli (1993) indicated that the dissemination of market intelligence across all departments, which is an element of market orientation, aids collaboration. Thus, we can hypothesize that:

*H2: A high degree of market orientation is reducing the level of Marketing-Sales conflict*

### **Marketing and Sales perceptions regarding company's strategy**

Companies can employ different strategies in order to create superior customer value (e.g. Day, 1994), which is the basis of their competitive advantage (Guenzi & Troilo, 2007). The M&S relationship is highly connected with the quality of strategy formulation and implementation (Menon et al., 1996). There is also seems to be a connection between M&S alignment and inconsistencies in the perceptions of M&S managers regarding their respective companies strategy (e.g. Viswanathan & Olson, 1992). For instance, Strahle, Spiro and Acito (1996) demonstrated inconsistencies in strategy formulation between M&S departments, suggesting that

in most cases the activities performed at the Sales department level does not reflect the strategy at the SBU level. Likewise, Colletti and Chonko (1997) showed that changes in marketing strategies do not drive to consistent modifications of sales strategies and tactics, while Evans and Schlacter (1985) found that companies hardly integrate the sales force in marketing planning processes. Moreover, Shapiro (2002) suggested that the existence of a clear, unified and explicit strategy between M&S will improve their cross functional relationships. There appears sufficient ground to hypothesize that:

*H3: Inconsistencies in the perceptions of M&S managers regarding their company's strategy are enhancing the level of Marketing-Sales conflict*

### **The relative power of M&S departments**

Focusing on Marketing-Sales interface, Webster (1997) reported that the presence of power imbalance in an exchange relationship creates the potential for conflict, while Homburg et al. (2008) identified power balance between M&S as an important dimension in their interface. Scarce extant research suggests a great deal of variation among companies regarding the relative power of M&S departments. In some companies, sales units are dominant, while in others, marketing units are dominant (Piercy, 1986; Workman et al., 1998; Homburg et al., 2008). In general, these power and status differentials may lead to disharmony between the engaged departments (Souder, 1981).

The organizational theory concurs that when two engaged parts are lacking a balanced level of power, then their dyadic relationship is characterized, mainly, by a high level of conflict (Anderson & Weitz, 1989). Additionally, Bucklin and Sengupta (1993) report that the presence of power imbalance in a relationship creates disharmony and the potential for conflict. Souder (1981) indicated that power differentials between the Marketing and R&D departments may lead to disharmony and conflict, severely hindering new product successes, which seems to be connected with company performance (Menon et al., 1997). Furthermore, Homburg et al. (2008) developed a taxonomy regarding the Marketing-Sales organization, where it was shown that companies in which the Marketing department has equal power with the Sales department are characterized by (a) high quality of cooperation between these two departments, and (b) enhanced performance. On the contrary, this taxonomy revealed that when the Sales department is more powerful than the Marketing department or via-versa, then both cooperation quality of M&S departments and company performance are reduced. Thus, we can hypothesize that:

*H4: Differences in the level of power between the M&S departments within the organization tend to enhance the level of Marketing-Sales conflict*



## **Marketing and Sales departments' responsibilities**

Krohmer et al., (2002) found that in certain marketing activities such as pricing and new product development there is a high cross-functional dispersion of influence, while in some other activities such as decisions concerning advertising there is a relatively low cross-functional dispersion of influence. Their results show that functional groups other than Marketing, and especially the Sales department, clearly have a great deal of influence on marketing activities. In a similar vein, Troilo, de Luca and Guenzi (2008) found that traditional marketing activities such as pricing and distribution are under Sales department responsibility. These findings concur with the Marketing Compass (2007), which shows that Marketing departments have weaker influence and control on historical "4Ps" strategies and tactics such as pricing and distribution. Beverland et al. (2006) suggested that the M&S departments have different cultural frames in relation to their respective roles regarding the activities that they carry out. Moreover, Rouzies et al. (2005) argued that if M&S are not congruent regarding their responsibilities, then conflict may arise. Thus, we can hypothesize that:

*H5: Differences in the perceptions of M&S managers regarding their responsibilities for the execution of marketing activities tend to enhance the level of Marketing-Sales conflict.*

## **Marketing and Sales managers' perceptions regarding the importance of marketing activities**

Shapiro (2002) notes that it is extremely important for the "twin customer-facing functions of M&S" to work together. He also suggests that these two departments must collaborate at every level from the core central concepts of the strategy to the minute details of execution. A considerable body of the normative literature calls for both M&S departments to modify their role and practices in order to increase the coordination vis-à-vis their activities and give life to integrated processes (e.g. Cespedes, 1993; Day, 1994; Kotler et al., 2006).

A crucial matter in integrated processes is the importance that each of the engaged departments assign to their common activities (e.g. Clark & Fujimoto, 1991; Lawrence & Lorsch, 1967). Moreover, integration between M&S departments is achieved when these two departments are avoiding dissimilarities regarding the importance they assign to the activities that they carry out (Meldrum, 1996; Rouzies et al., 2005). Thus, the importance that M&S departments assign to marketing activities is essential for the creation of smooth Marketing-Sales relationship, since such relationship is reported as a benefit of integration between these two departments (Kotler et al., 2006). Moreover, a main characteristic of this smooth relationship is the reduced level of conflict (Dewsnap & Jobber, 2002). Accordingly, we can hypothesize that:

*H6: Differences in the opinions of M&S managers regarding the importance of basic marketing activities tend to enhance the level of Marketing-Sales conflict*

### **Marketing and Sales departments' cooperation for the execution of marketing activities**

The dimension of harmonious inter-group relationships, according to Brown (1995), is associated with cooperation. Consistent with this suggestion, Homburg et al. (2008) define the quality of cooperation between M&S as the extent to which there is a state of collaboration between M&S that is characterized by unity of effort. They also indicate a connection between quality of cooperation for the execution of marketing activities and the harmonious relationships with respect to these two departments. A number of marketing activities require cooperation among the engaged departments, (Maltz, 1997), which are – mainly – the M&S departments (Krohmer et al., 2002). The quality of this cooperation is linked with the relationship of the engaged departments (Homburg et al. 2008). According to the literature, cooperation between M&S departments during the execution of marketing activities is one of the most important issues that practitioners are facing (Rouzies et al. 2005). A major impediment in the cooperation of activities across functional areas is that employees in the various functions have different mind-sets and different perspectives (Lorge, 1999). Accordingly, cooperation quality depends on the extent to which the M&S managers have similar perceptions regarding the level of the cooperation of their departments in the execution of marketing activities. Consequently, we can hypothesize that:

*H7: Differences in the opinions of M&S managers regarding the cooperation of their departments with respect to the execution of marketing activities tend to enhance the level of Marketing-Sales conflict.*

### **External environment**

*(a) Market turbulence:* is defined as the degree of changes in the composition of customers and their preferences (Pine, 1993). Menon et al. (1997) reported that businesses operating in turbulent markets are likely to have a greater need for positive interdepartmental interactions (i.e., less conflict and high connectedness) than businesses in stable markets. Additionally, they indicated that high market turbulence is reducing the negative effect of interdepartmental conflict on product quality. Moreover, market turbulence has been found to strengthen the interfunctional coordination–innovativeness relationship (Han, Kim and Srivastava, 1998), and enhance the positive effect of Marketing-Sales integration on business performance (Rouzies et al., 2005). Consequently, Marketing-Sales conflict is likely to have a more significant impact on company performance in turbulent markets than in stable markets. Thus, we can hypothesize that:

*H8: High market turbulence is strengthening the negative effect of Marketing-Sales conflict on company performance.*

(b) Competitive intensity: refers to the degree to which a firm faces competition within its industry (Jaworski & Kohli, 1993). According to Rouzies et al. (2005) competitive intensity is expected to have a moderating influence on the relationship between Marketing-Sales integration and business performance. The same authors argue that if competitive intensity is relatively low, a firm may be able to attain good business performance even without Marketing-Sales integration because of the “slack” afforded by the marketplace. Moreover, when competitive intensity is high, it is particularly important for a firm to deliver superior value to customers (Kohli & Jaworski, 1990), and Marketing-Sales integration is crucial for meeting customer needs and requirements (Rouzies et al., 2005). Thus, we can hypothesize that:

*H9: High competitive intensity is strengthening the negative effect of Marketing-Sales conflict on company performance.*

(c) Technological turbulence: refers to the rate of technological change (Jaworski & Kohli, 1993). Olson, Walker and Ruekert (1995) suggested that when technology is changing rapidly, the organization must be able to share information more effectively and more quickly than when technology is more predictable. This information flow could enhance collaboration (Jaworski & Kohli, 1993). Moreover, Menon et al. (1997) indicated that the relationship between smooth interdepartmental interactions and product quality is positively moderated by technological turbulence. Thus, smooth M&S relationships are expected to play a more important role when technology is changing rapidly. Accordingly, we can hypothesize that:

*H10: High technological turbulence is strengthening the negative effect of Marketing-Sales conflict on company performance.*

## **Covariates**

In this dissertation, we use firm size and type of ownership, as covariates of company performance. The literature suggests that firms with superior resources will be able to conceive and implement unique strategies that rivals will find difficult to emulate (Barney, 1991). Because large firms have more such resource advantages than do small firms, we included firm size (in terms of number of employees and turnover) as a covariate of performance. Moreover, prior studies indicate that the performance of foreign subsidiaries is superior to that of domestic firms because of firm-specific advantages associated with multinational companies (Caves, 1982). Thus, type of ownership (domestic vs. multinational) was also included as a covariate of performance.

## **Research methodology**

### **Sample & data collection**

Consumer goods companies with turnover of more than 5 million euro and more than 50 employees were specified as the population of this study. Consumer goods companies are reported as an ideal context for empirical investigation in the M&S interface (Dewsnap & Jobber, 2002), while in large organizations, M&S are frequently structured as separate and discrete departments (Piercy, 1986; Workman, Homburg and Gruner, 1998) performing different functions (Shapiro, 2002).

Using the ICAP (Gallop's Subsidiary) Census of Greek Companies Financial Position, 409 firms were identified as fulfilling the above criteria. The M&S managers of these companies were contacted through letters and phone calls asking their cooperation in our research. From these companies, 132 agreed to participate in our research (32.3% response rate). Personal interviews were conducted, using a structured questionnaire, with the M&S managers of these companies. Both M&S managers answered the same questionnaire in separate personal interviews (without knowing each other's answers). This method apparently is the most appropriate one in order to control common method bias, as from each sample company two key-informants provided the data (Podsakoff et al., 2003). Moreover, empirical studies in this area suggest that data should be collected from multiple respondents within the organization (e.g. Massey & Dawes, 2007; Guenzi & Troilo, 2007; Homburg et al., 2008).

### **Operationalization of study variables**

The constructs of the dissertation were operationalized using: reflective multi-item scales, dichotomous variables and observed variables. The constructs of Marketing-Sales Conflict, Market Orientation, M&S Departments' Power, the characteristics of the companies' external environment (in terms of Market Turbulence, Competitive Intensity and Technological Turbulence), and Company Performance, were measured as reflective models, since a reflective measurement model is appropriate when observed variables are interchangeable manifestations of an underlying construct (Bagozzi & Baumgartner, 1994). Marketing-Sales consistency regarding the company's strategy, company's size and type of ownership were measured as dichotomous variables. Differences in the perceptions of M&S managers regarding (a) the responsibility of M&S departments vis-à-vis certain basic marketing activities, (b) the importance of these activities, and (c) the level of cooperation between M&S departments for the execution of these activities, were measured as observed variables. Specifically, the variables of this study were operationalized as follows.

#### **(a) Reflective multi-item scales**

Marketing-Sales Conflict: In order to capture the level of Marketing-Sales conflict, both M&S managers were presented with the seven statements measuring interdepartmental conflict, as proposed by Jaworski and Kohli (1993). Then, using a 5-point Likert type scale, the respondents indicated their degree of agreement or disagreement (1="fully disagree" to 5="fully agree") with each of these seven statements. Later, during the analysis of the results, where necessary, the scales were reverted so that higher levels of agreement would always represent higher level of conflict. The perspective adopted in this dissertation is that of interdepartmental conflict as dysfunctional task-based tension arising from goal and action incompatibility (e.g. Jaworski & Kohli, 1993).

Market Orientation: In order to capture the degree of market orientation, both M&S managers were presented with the fifteen statements measuring this construct, as proposed by Narver and Slater (1990). Then, using a 5-point Likert type scale, the respondents indicated their degree of agreement or disagreement (1="fully disagree" to 5="fully agree") with each of the fifteen statements. The scales were formulated so that higher levels of agreement would always represent higher degree of market orientation.

Departmental Power: In order to capture the level of Marketing department's power and Sales department's power within each company, we adopt the five statements proposed by Kohli (1990) which measure departmental power. Both M&S managers were presented with these five statements and were asked to indicate their degree of agreement with each of these statements (for both M&S departments) using a 5-point Likert type scale (1="fully disagree" to 5="fully agree"). During the analysis of the results, where necessary, the scales were reverted so that higher levels of agreement would always represent higher level of departmental power. The estimation of the absolute value of the difference between the Marketing department's power and the Sales department's power provided the relative power of M&S departments, which was examined as an antecedent of Marketing-Sales conflict.

External environment: In order to measure (a) market turbulence, (b) competitive intensity, and (c) technological turbulence, we adopted the respective statements developed by Jaworski and Kohli (1993). Both managers indicated, using a 5-point Likert type scale (1="fully disagree" to 5="fully agree") with each of the statements. The scales were formulated so that higher levels of agreement would always represent higher (a) market turbulence, (b) competitive intensity, and (c) technological turbulence respectively.

Company Performance: Company performance was measured in terms of profits, sales volume, market share and ROI (e.g. Narver & Slater, 1990; Avlonitis & Gounaris, 1997). The two managers indicated, using a five point scale, the firm's performance in comparison with their main

competitor (1: much worse, 5: much better), as well as the degree of the firm's satisfaction (1: very unpleased, 5: very pleased), for each one of the four performance criteria.

We assessed reliability and validity of each reflective measure with confirmatory factor analyses (CFAs), pertaining to both Marketing and Sales managers' perceptions, as shown in table 1. Each construct manifests a composite reliability (CR) of at least 0.6 (Bagozzi & Yi, 1988). Average variance extracted (AVE) is higher than the squared phi coefficient for any pair of two latent variables, which supports the discriminant validity of the reflective measures (Fornell & Larcker, 1981). Independent samples t-tests indicated no significant differences in the opinions of M&S managers regarding the reflective measures in question, as shown in table 1. Thus, the mean value of the responses from the two managers of each company was computed and used as a composite measure for each reflective measure.

Table 1. Operationalisation of study variables

Variables		CFI	TLI	GFI	RMSEA	mean		AVE	CR	Cronbach's alpha
					A					
Marketing-Sales conflict	Marketing Manager	.943	.915	.944	.060	2.5	ns	.835	.781	.939
	Sales Manager	.962	.942	.947	.075	2.6		.849	.801	.949
Market Orientation	Marketing Manager	.922	.913	.921	.072	4.0	ns	See Table2	See Table2	See Table2
	Sales Manager	.919	.908	.920	.077	3.9		See Table2	See Table2	See Table2
Marketing dept power	Marketing Manager	.945	.925	.955	.080	3.2	ns	.635	.830	.845
	Sales Manager	.960	.919	.961	.056	3.1		.679	.812	.829
Sales dept power	Marketing Manager	.929	.915	.936	.054	3.7	ns	.612	.790	.804
	Sales Manager	.965	.930	.968	.042	3.7		.570	.729	.793
Company performance	Marketing Manager	.919	.903	.920	.078	3.2	ns	.879	.920	.958
	Sales Manager	.921	.904	.922	.080	3.2		.866	.897	.953
Market turbulence	Marketing Manager	.993	.986	.978	.065	3.3	ns	.644	.712	.734
	Sales Manager	.983	.965	.965	.074	3.5		.720	.758	.801
Competitive intensity	Marketing Manager	.993	.986	.978	.065	3.9	ns	.685	.738	.794
	Sales Manager	.983	.965	.965	.074	4.1		.682	.720	.727
Technologic al turbulence	Marketing Manager	.993	.986	.978	.065	3.3	ns	.785	.845	.899
	Sales Manager	.983	.965	.965	.074	3.4		.764	.815	.874

In the case of market orientation, the CFAs provided evidence in favour of the three Narver and Slater's (1990) market orientation components (Customer Orientation, Competitive Orientation, Inter-Functional Coordination), as shown in table 2. Following standard procedures

(see Narver & Slater 1990; Slater & Narver, 2000) the mean value of these three components for both M&S managers was computed, providing their perception of market orientation.

Table 2. Market Orientation components

<i>latent variable</i>	<i>Marketing Managers</i>	<i>Sales Managers</i>
<i>Customer Orientation</i>	AVE=0.635 / CR= 0.737 / Cronbach's <i>a</i> =0.902	AVE=0.679 / CR= 0.721 / Cronbach's <i>a</i> =0.887
<i>Competitive Orientation</i>	AVE=0.617 / CR= 0.754 / Cronbach's <i>a</i> =0.816	AVE=0.631 / CR=0.708 / Cronbach's <i>a</i> =0.760
<i>Inter-Functional Coordination</i>	AVE=0.629 / CR=0.730 / Cronbach's <i>a</i> =0.826	AVE=0.620 / CR=0.719 / Cronbach's <i>a</i> =0.778

#### (b) Dichotomous variables

Company's Strategy: McKee, Varadarajan and Pride's (1989) operationalization was adopted in order to capture the perceptions of M&S managers regarding the type of their company's strategy. Thus, both M&S manager were provided with the definition of the three strategies of Miles and Snow (1978) typology (Prospector, Analyzer, and Defender) and were asked to identify the strategy of their company. Following the approach proposed by Stathakopoulos (1998), instead of using the terms "prospector", "analyzer" and "defender", we labelled the descriptions as "Type 1", "Type 2", and "Type 3" respectively, in order to control for socially undesirable responses. Through this operationalization, the companies were classified in two groups, as shown in Table 3, whereby group 1 contains companies in which the M&S managers had similar perceptions regarding their company's strategy (79.5%), while group 2 contains companies in which the two managers had different perceptions regarding the strategy in question (20.5%). Thus, a dichotomous 0 / 1 measurement was devised whereby the value of 0 stands for companies in group 2, while the value of 1 stands for companies in group 1.

Table 3. Marketing and Sales managers perceptions regarding their company's strategy

<i>Group 1 - Consistency (N=105 – 79.5%)</i>		<i>Group 2 - Inconsistency (N=27 – 20.5%)</i>	
<i>prospector</i>	68 (65%)	<i>prospector-analyzer</i>	18 (67%)
<i>analyzer</i>	24 (23%)	<i>prospector-defender</i>	3 (11%)
<i>defender</i>	13 (12%)	<i>analyzer-defender</i>	6 (22%)

Company's characteristics: From the sample of 132 companies, 91 were domestic, while 41 were subsidiaries of multinational firms. Thus, a dichotomous (0/1) variable was devised whereby the value of 0 stands for domestic companies, while the value of 1 stands for multinational companies. Moreover, we used the number of employees as well as the company's turnover in



order to measure company size. Two groups were emerged using both number of employees and turnover. Companies in group 1 have less than 150 employees and turnover less than 5 million euros (small companies - N=95), while companies in group 2 have more than 150 employees and turnover more than 5 million euros (large companies - N=37). Thus, a dichotomous (0/1) variable was devised whereby the value of 0 stands for companies in group 1, while the value of 1 stands for companies in group 2.

(c) Observed variables

Departmental responsibility for the execution of marketing activities: We adopted Krohmer's et al. (2002) operationalization in order to measure the responsibility of M&S departments for the execution of the basic marketing activities. Specifically, both M&S managers of each company were provided with a list of 9 marketing activities (namely: marketing research, market segmentation, targeting, positioning, product design, advertising objectives, design of channels of distribution, pricing, customer relationships), and were asked to indicate the responsibility of M&S departments (or any other departments involved) for their execution, using a 100-point constant sum scale. Surprisingly, no significant differences emerged in the opinions of M&S managers regarding the responsibility of M&S departments for the execution of the activities in question as shown in table 4. Thus, the gap in the perceptions of M&S managers regarding the responsibility of M&S departments for the execution of marketing activities could not be computed, and as a consequence H5 could not be tested.

Table 4. Marketing and Sales departments' responsibility for the execution of basic marketing activities

Table 4. Marketing and Sales departments' responsibility for the execution of basic marketing activities									
N=132		Sales department			mean	Marketing department			paired samples t-test
activities		Marketing manager	Sales manager	Independent sample t-test		Marketing manager	Sales manager	Independent sample t-test	
Marketing research		24.0	26.6	ns	25.3	70.9	66.3	ns	p<0.05
Market segmentation		45.2	50.1	ns	47.7	50.9	43.6	ns	ns
Targeting		48.3	53.8	ns	51.0	47.8	41.9	ns	ns
Positioning		42.5	49.0	ns	46.0	52.3	45.5	ns	ns
Product design		23.1	27.0	ns	25.7	62.0	58.6	ns	p<0.05
Advertising objectives		16.4	21.1	ns	18.7	80.4	75.3	ns	p<0.05
Channels of distribution		61.9	65.1	ns	63.5	33.0	30.5	ns	p<0.05
Pricing		57.0	60.5	ns	58.7	37.3	33.8	ns	p<0.05
Customer relationships		60.8	65.3	ns	63.0	28.6	25.9	ns	p<0.05

Importance of Market Activities: The respondents were provided with the aforementioned list of marketing activities and were asked to indicate, using a 5-point scale (1: low-5: high) the importance assigned to each one of them in their respective companies. Independent samples t-test indicated differences in the perceptions of M&S managers regarding the importance of each activity as shown in table 5. Thus, the absolute value of the differences in the responses of the two managers in each company was computed. Then, the mean value of these gaps was also computed and used as a measure for the difference in the perceptions of M&S managers regarding the importance of marketing activities, as shown in table 5.

*Table 5. Importance of marketing activities*

<i>N=132</i>	<i>Marketing Manager</i>		<i>Sales Manager</i>		<i>Independent samples t-test</i>	<i>Gap (mean)</i>
	<i>Mean</i>	<i>SD</i>	<i>Mean</i>	<i>SD</i>		
<i>Marketing research</i>	3.39	1.14	2.70	1.29	<i>p&lt;0.01</i>	0.69
<i>Market segmentation</i>	3.53	1.14	2.97	1.36	<i>p&lt;0.01</i>	0.56
<i>Targeting</i>	3.68	0.95	3.05	1.16	<i>p&lt;0.01</i>	0.63
<i>Positioning</i>	3.77	1.01	3.17	1.26	<i>p&lt;0.01</i>	0.6
<i>Product design</i>	3.36	1.34	2.87	1.41	<i>p&lt;0.01</i>	0.49
<i>Advertising objectives</i>	3.94	0.98	3.25	1.20	<i>p&lt;0.01</i>	0.69
<i>Channels of distribution</i>	3.92	0.95	3.17	1.28	<i>p&lt;0.01</i>	0.75
<i>Pricing</i>	3.89	1.01	3.38	1.25	<i>p&lt;0.01</i>	0.51
<i>Customer relationships</i>	3.87	0.78	3.32	1.05	<i>p&lt;0.01</i>	0.55
<i>Mean (total)</i>	3.7		3.1		<i>p&lt;0.01</i>	0.60

Cooperation between Marketing and Sales: The respondents were provided with the aforementioned list of activities and were asked to indicate, using a 5-point scale (1: low-5: high) the degree of cooperation between the Marketing and Sales departments in their respective companies regarding the execution of the activities in question. Following the same procedure as above, we conducted independent samples t-test which indicated differences in the perceptions of M&S managers regarding the level of cooperation between M&S departments for the execution of each activity as shown in table 6. Thus, the absolute value of the differences in the responses of the two managers in each company was computed. Then, the mean value of these gaps was also computed and used as a measure for the difference in the perceptions of M&S managers regarding the cooperation of M&S departments for the execution of the marketing activities, as shown in table 6.

Table 6. Cooperation between M&amp;S departments for the execution of marketing activities

N=132	Marketing Manager		Sales Manager		Independent samples t- test	Gap (mean)
	Mean	SD	Mean	SD		
Marketing research	2.48	1.26	3.29	1.10	$p<0.01$	0.81
Market segmentation	2.56	1.31	3.31	1.16	$p<0.01$	0.75
Targeting	2.75	1.21	3.41	1.07	$p<0.01$	0.66
Positioning	2.81	1.22	3.39	1.10	$p<0.01$	0.58
Product design	2.38	1.28	3.06	1.18	$p<0.01$	0.68
Advertising objectives	2.50	1.28	3.27	1.03	$p<0.01$	0.77
Channels of distribution	2.83	1.34	3.39	1.09	$p<0.01$	0.56
Pricing	2.76	1.33	3.30	1.16	$p<0.01$	0.54
Customer relationships	2.94	1.16	3.40	1.00	$p<0.01$	0.46
Mean (total)	2.7		3.3		$p<0.01$	0.60

## Analyses and results

In order to test the research hypotheses advanced regression analyses were conducted estimating two models, as it has been suggested in the literature (Baron & Kenny, 1986; Guenzi & Troilo, 2007). Specifically, in the first regression model the independent variables were the antecedents of Marketing – Sales conflict, and the dependent variable was the level of Marketing-Sales conflict; while, in the second regression model the independent variables were the antecedents in question together with the Marketing-Sales conflict, and the dependent variable was company performance. The second regression model also interprets the moderation effect of the external environment (market turbulence, competitive intensity, technological turbulence) on the relationship between Marketing-Sales conflict and company performance, as well as the company characteristics (type of ownership, size) as covariates of performance, according to the suggestions of the relevant literature regarding moderated mediation (Edwards & Lambert, 2007). Although this dissertation has not developed specific hypotheses regarding the direct impact of all antecedents on company performance, these examinations are coherent with the exploratory spirit of this research project. Both regression models are significant at 0.01 levels and indicate the antecedents and the consequences of Marketing-Sales conflict, as shown in table 7.

In order to examine the potential presence of multi-collinearity the variance inflation factors (VIF) were estimated. The VIFs range from 1.072 to 1.901, well below the recommended cut-off of 10. In order to examine the potential presence of auto-correlation, Durbin-Watson test was conducted in both models, providing results which indicate no auto-correlation (values: 1.927 in regression 1 / 2.076 in regression 2). Thus, the relatively high explanatory power of the two

models (see Adj. R<sup>2</sup>) seems to be fair. Table 7 shows that all hypotheses (except H5 which could not be tested and H10) find support.

Table 7. Antecedents and Consequences of Marketing – Sales Conflict / Regression Analyses

Dependent variable	Independent Variables	Hypothesis	Std Beta (t-value)	F-value	Adj. R <sup>2</sup>
Marketing-Sales Conflict	Regression model 1			75.441*	.530
	Market orientation	H2	-.511 (-8.76*)		
	Inconsistency between Marketing and Sales managers perceptions regarding company's strategy	H3	.145 (2.84**)		
	Unequal level of power between Marketing and Sales departments	H4	.441 (7.75*)		
	Differences in the opinions of M&S managers regarding the importance of marketing activities	H6	.445 (4.17*)		
	Low quality of cooperation between M&S departments for the execution of marketing activities	H7	.432 (4.24*)		
Company performance	Regression model 2			89.773*	.630
	Marketing-Sales Conflict	H1	-.623 (-8.12*)		
	Market orientation	not developed	.255 (4.06*)		
	Inconsistency between Marketing and Sales managers perceptions regarding company's strategy	not developed	-.104 (2.78**)		
	Unequal level of power between Marketing and Sales departments	not developed	ns		
	Differences in the opinions of M&S managers regarding the importance of marketing activities	not developed	-.263 (3.07*)		
	Low quality of cooperation between M&S departments for the execution of marketing activities	not developed	-.231 (2.98*)		
	moderators				
	Marketing-Sales Conflict x Market turbulence	H8	-.243 (2.11**)		
	Marketing-Sales Conflict x Competitive intensity	H9	-.209 (1.97**)		
	Marketing-Sales Conflict x Technological turbulence	H10	ns		
	covariates				
	Type of ownership		.362 (3.042*)		
	Size		ns		

\* Significant at 0.01 level / \*\* Significant at 0.05 level / ns: not significant

Specifically, the results identified as antecedents of Marketing-Sales conflict (a) the low degree of market orientation, (b) inconsistency in the perceptions of M&S managers regarding company's strategy, (c) unequal level of power between M&S departments, (d) the differences in the opinions of M&S managers regarding the importance of marketing activities, and (e) the differences in the opinions of M&S managers regarding the level of cooperation between M&S departments for the execution of marketing activities.

Moreover, the dissertation indicated a strong negative impact of Marketing-Sales conflict on company performance, supporting the relative normative literature (Kotler et al., 2006). Additionally, market turbulence and competitive intensity seem to reduce this negative effect, confirming the arguments of Rouzies et al. (2005). On the other hand, no moderation effect emerged regarding the technological turbulence in the relationship between Marketing-Sales conflict and company performance. This could be explained by the low rate of technological change in the external environment of the sample companies (mean=3.3, SD=.85), since according to Menon et al. (1997) only high rate of technological turbulence can act as a moderator in pertinent relationships.

Our study also indicated that differences in the perceptions of M&S managers regarding (a) the importance of basic marketing activities, and (b) the cooperation of their departments for the execution of these activities, are hurting company performance indirectly, through the creation of Marketing-Sales conflict, as well as directly. These findings highlight the necessity for alignment between M&S departments, as it has been suggested in the literature (e.g. Shapiro, 2002). Moreover, a positive direct impact of market orientation on company performance emerged, supporting the relevant literature (e.g. Cano et al., 2004; Kirca et al., 2005). Additionally, consistent with the relevant normative literature (Shapiro, 2002), our study indicated a negative direct impact of inconsistencies in the perceptions of M&S managers regarding their respective companies strategy on company performance. Finally, the analyses show that the unequal level of power between M&S departments does not have a direct significant impact on company performance, since it seems that it hurts company performance only indirectly through the creation of Marketing-Sales conflict.

## **Findings and Discussion**

The present dissertation is one of the very few empirical investigations regarding the conflict between M&S departments, and the only one, as far as we know, which base its results on the perceptions of both M&S managers of the same organization, following the pertinent extensive calls of the relevant literature (e.g. Massey & Dawes, 2007; Guenzi & Troilo, 2007; Homburg et al., 2008). The dissertation highlights the functional and organizational characteristics which tend to

raise the level of conflict between the M&S departments, as well as the consequences of this conflict, considering also the environment within which the companies operate. Our findings contribute to the scarce existing relevant literature on several fronts.

First, Vorhies et al. (1999) indicated that the most successful companies are placing a lot of emphasis on basic marketing activities. Our study expands these findings by adding that the M&S managers have different perceptions regarding the importance of basic marketing activities, and that these differences are hurting company performance through the creation of conflict between M&S departments. Moreover, while Vorhies et al. (1999) examined only six marketing activities namely, market research, pricing, product development, channels, promotion, and marketing management, our study incorporated more crucial activities such as market segmentation, targeting and positioning, following the suggestions of the relevant literature (Rouziès et al., 2005).

Second, the dissertation confirms the findings of Homburg et al. (2008) which indicated that low quality in the cooperation of M&S departments is associated with lower company performance. Specifically, our study revealed low cooperation quality of M&S in the execution of basic marketing activities by highlighting differences in the perceptions of M&S managers regarding their departments' cooperation. These differences are reducing company performance by enhancing the level of conflict between M&S departments.

Third, the literature suggests that M&S effective relationship is one of the components of market-driven organizations (Guenzi & Troilo, 2006; Rouziès et al., 2005). Our findings concur with these results, by indicating that the adoption of market orientation can reduce the level of M&S conflict. Moreover our study provides findings which support the positive relationship between market orientation and company performance (e.g. Avlonitis & Gounaris, 1997; Cano et al., 2004), placing the M&S conflict as a mediator in this relationship. These findings are highly connected with the consideration of "inter-functional coordination" as a basic component of market orientation (Narver & Slater, 1990). Specifically, it seems that the adoption of market orientation can reduce the level of Marketing-Sales conflict by enhancing inter-functional coordination which in turn has a positive effect on company performance.

Fourth, our research empirically demonstrates that a source of conflict between M&S is inconsistency in the managers' perceptions regarding their respective companies strategy. Likewise, it seems that these inconsistencies are also directly hurting company performance regardless of their effect on the level of Marketing-Sales conflict. These findings provide support to literature suggestions emphasizing the need for the strategic alignment of M&S (e.g. Shapiro, 2002).

Fifth, our study focused on the role of the relative power of M&S departments, in the creation of effective cross functional relationships. Our findings indicate that when M&S departments have equal level of power, then the level of conflict between these two departments is decreasing, and, as a consequence, the company's performance is increasing. These findings concur with those reported by Homburg et al. (2008). In addition, our study indicated that unequal level of power between M&S is not hurting company performance directly, but only through the creation of Marketing-Sales conflict. Thus, it seems that the most successful companies are characterized by fairly strong M&S departments.

Finally, the dissertation contributes to our understanding of the effect of the Marketing-Sales conflict on company performance. Our research provides empirical data demonstrating that Marketing-Sales conflict has a strong negative impact on company performance. This finding supports the relative normative literature (e.g. Kotler et al., 2006). Moreover, the relationship between Marketing-Sales conflict and company performance seem to becoming more negative when a company's external environment is characterized by market turbulence and competitive intensity. These results are consistent with the suggestions put forward by Rouzies et al. (2005).

### **Managerial implications**

The dissertation has several managerial implications, providing guidance for top management responsible for the M&S organization. The general implication is that top management should be aware that creating fair relationships between M&S, which are characterized by a low level of conflict, requires changes in the company's culture, as well as people's attitudes and behaviours. These changes will lead to substantial improvement in important performance metrics.

Specifically, our findings indicated that a source of Marketing-Sales conflict can be the different perceptions of M&S managers regarding the importance of basic marketing activities. Consequently, top management must make sure that the M&S managers should not only place a lot of emphasis on these activities, but should also start strive to work very closely for their execution as (a) a high level of cooperation between their departments in executing the aforementioned activities will reduce the level of conflict and enhance company performance, and (b) the decision authority for the execution of the activities in question seem to be dispersed between M&S departments. It may be wise for top management to implement in-house common training programmes in order to reduce the psychological distance between the two functional managers. Additionally, requiring each manager to spend some time working with hers/his counterpart manager could improve flows of information and expertise between them. Similarly, it may be also wise for the Marketing manager to spend a specified amount of time in the field with the Sales manager (Massey & Dawes, 2007; Rouzies et al., 2005).

Additionally, the findings of this dissertation suggest that the adoption of market orientation, positively affect both the relationship of M&S departments, and company performance. Given the performance advantages witnessed by the market-driven firms in the literature (e.g. Cano et al., 2004; Kirca et al., 2005), it is important for firms to become more market oriented by developing internal processes needed for focusing on customer desires and on competitors' strategies, and enhancing inter-functional coordination, especially between M&S.

Moreover, top management should focus on the creation of a clear and integrated strategy between M&S. Our study indicated that there are companies in which the M&S managers have different perceptions regarding the strategy that their company implements. This lack of alignment between M&S managers regarding their respective companies' strategy seems to be a source of Marketing-Sales conflict and ends up hurting company performance. Thus, M&S executives should be encouraged by the top management to meet on a regular basis in order to review and discuss strategy decisions, developing a common understanding of their respective companies strategy, and reach a consensus on the strategy which they implement (Strahle et al., 1996).

Finally, top management should attend to status differences of the two departments, by removing barriers between these two units, and providing them both with an equal strategic voice.

### **Limitations and future research directions**

There are several limitations that deserve attention. Specifically, the selection of (a) a single geographical context as a sampling frame, and (b) a single type of companies (consumer goods' companies) might be considered major limitations of this dissertation. Future research should address the issues examined in this study in other countries and in other types of companies (such as services) in order to ensure confidence in the stability of the findings and ultimate generalizability.

In addition, the measure of the impact of Marketing-Sales conflict on performance indicators, other than those examined in this dissertation (e.g. financial, organizational), would add some value to the model.

To better interpret the model proposed in this dissertation and to provide managers with clear guidelines, future research should analyze other drivers of effective relationships between M&S, such as company culture, organization structure and personal characteristics of managers of the two departments (Guenzi & Troilo, 2007). The addition of such variables to the model would increase its explanatory power and provide evidence to the relevant role of organizational design and managerial systems.



Finally, future research should also investigate the role of “conflict resolution mechanisms” (see Cespedes, 1993), such as job rotation, information exchange, liaison unit, formulation of common training programs etc, in the reduction of the level of Marketing-Sales conflict.

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## TRANSFORMING AFTER-SALES SERVICE TO THE CUSTOMER SUPPORT SYSTEM (CSS): THE CONTINGENCY THEORY PERSPECTIVE

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### Abstract

Since the concept of "supply chain management" has been raised in the 19th century, many of the related discussion mainly focus on the manufacturing-based industry. In 1988, Vandermerwe and Rada pionnerred the "servitization"-related discussion. As proposed by these scholars, involving service into the product provided brings more benefits to both manufacturers and consumers.

The contingency theory is utilized in the Customer Support System (CSS) area by (Gebauer, 2007) and (Gebauer et al., 2008). For a CSS, the environment factor represents the change of customers' need to manufacturing firms. In order to response to this change, firms have to adjust their internal strategy, and include services into their business activities. Further, under this strategy, the designs of organization and process are adjusted. As such they can meet customers' requirements and improve customers' loyalty.

The discussion of how to build business processes centering on service is still limited in the literature. One of the models most commonly discussed is the service supply chain framework (Σφάλμα! Το αρχείο προέλευσης της αναφοράς δεν βρέθηκε.) proposed by Ellram et al. (2004). In this model, Ellram et al. (2004) argue that, a service-oriented supply chain needs to be supported by the information flow. Through the comprehensive information flow, the chain members can define their own needs, share information, communicate on their service range and anticipated service level, and then receive the feedbacks after providing service. Meanwhile, through the establish of information flow, the business activities within the service supply chain can be monitored, which in turn decreases unnecessary risk and resources waste (Davis, 1993, Lee and Billington, 1995, Scott and Westbrook, 1991).

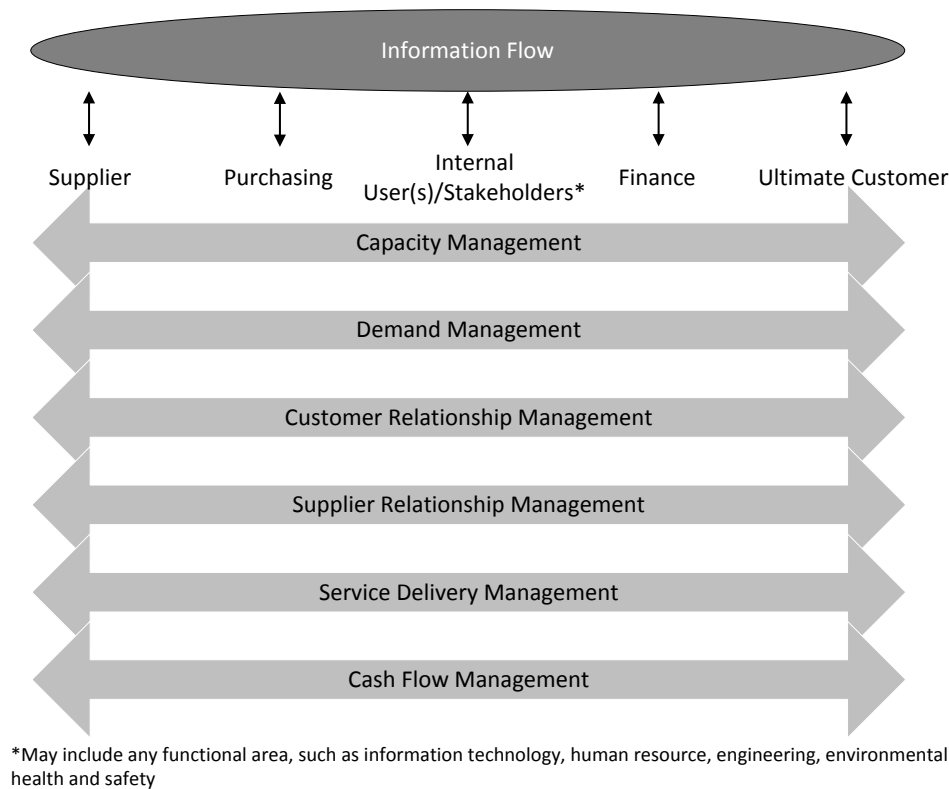


Figure 1. The Services Supply Chain Model (Ellram et al., 2004)

With the increasing importance of customer satisfaction in the competitive business activities, firms nowadays change their views of after-sales services to the weapon of creating competitive advantage, or even an important change to win customers' loyalty (Lele, 1997, Saccani et al., 2007). After-sales is further considered as one of the first steps which leads manufacturing firms to service organization (Gebauer, 2007).

In light of the importance of building a service-oriented supply chain, and the important role of after-sales in business activities, this study aims to investigate how organizations can adjust their internal business activities to face the challenges of response to customers' service-based needs, by utilizing the contingency theory as the framework.

This study uses the case study method to approach the collection and validation of qualitative data. Focusing on the selected case company, a well-known mobile phone distributor in Taiwan, we adopted the multiple data collection method as the way to collect our data. These methods include in-depth interviews, plant tours, documentation, and archival records.

With regards to the environment factors, this study figures the following five challenges facing by the case company: the close collaboration between mobile phone distributors and telecom operators, the threat of the "direct retailing" model, the losing bargaining power of branded mobile phone manufacturers, the growing bargaining power of customers, and the threat of new entrants.

In response to these external challenges, the case company has decided to solve their business problems via their organizational structure and process design. The case company aims to: attract young consumers with both tangible products and intangible service, provide consumers one-stop-shop which brings convenience to consumers, and keep their promise to consumers of fixing consumers' mobile phones within one to three days, respectively.

By using Ellram et al.'s (2004) framework of service supply chain, the detailed business process of the case company is further analyzed.

### **Information Management**

The case company changed its traditional point-of-sales system to an enterprise resource planning (ERP) system. Via this ERP system, the case company manages its inventory, shipment, and maintenance status on a real-time basis. It also integrates the small systems distributed in different department and provides more accurate information for decision making. It also connects partners via the Internet, by building the customer and supplier relationship management systems.

### **Capacity Management**

The case company exchanges its logistics information with third-party transporter via bar-code. This system integrates the communication between the case company and its logistics partners. It eliminates the mistakes caused by paper operations.

### **Demand Management**

The case company uses a new forecast mechanism for the spare parts to deal with the inaccurate forecast problem. It builds up a database for its mobile phone products, analyzes the life cycle of mobile phone, and predicts how many spare parts needed based on these data. Each product has its own forecast model, which can be further utilized for the corresponding spare parts.

### **Customer Relationship Management**

The case company wishes to add more value to their customers through the after-sales activity. To manage good customer relationships, it builds an internet-based membership database, analyzes customers' behaviors, and provides differentiated marketing strategy to each targeted customer group.

### **Supplier Relationship Management**

The case company communicates with the brand company via a self-developed information portal, where the brand companies can check their historical transaction records and receive new

orders. The case company can also manage the percentage of purchase amount from each brand company easily on the portal.

### **Service Delivery Management**

Because of the implementation of CRM system, the case company now transfers its marketing strategy from “push” to “pull”. They divide their products and customers into different groups, and promote suitable products to the needed customer groups.

### **Cash flow Management**

The case company manages its cash flow mainly with its retailers. When customers come to the sales-points of retailers and make transactions, the retailers keep the record in the case company's sales system. The system will then check the account at the night time. Compared with the traditional approach of checking the account manually, it saves much time for the case company and its retailers.

### **Research limitations/implications**

This research chooses a well-know Taiwanese company as the case to study. An increase in the sample size could more comprehensively encapsulate the interpretation of the transformation of after-sales system.

### **Practical implications**

This study utilized the contingency theory as the framework, to explore how after-sales service could transfer from the traditional product-oriented to service-oriented process. It can be served as the basis of a general reference for the computer-related industry.

This study collects practical evidence to investigate the transformation process of after-sales service from the traditional product-oriented perspective to the service-oriented one. By using the contingency theory as the framework, the environmental factors, strategy, and business processes of the case company are explored. It extends the knowledge body of service-oriented supply chain literature.

**Keywords:** Customer Support System (CSS) Service Supply Chain Model After-sales Contingency Theory Computer Industry Taiwan

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## THE EFFECT OF DIMENSIONS OF DESTINATION IMAGE ON SATISFACTION AND PLACE IDENTITY: THE CASE OF SAOTOME AND PRINCIPE ISLANDS

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### Abstract

This paper aims to provide a contribution to the newly emerging field of place identity by studying the relationship between the dimensions of place image and satisfaction, as well as between the dimensions of place image and place identity. Based on previous literature, a model was tested using tourists who stayed in Sao Tomas and Principe as the population. The hypotheses were tested by employing factorial analysis and the PLS approach.

The main findings suggest that typicality, place quality, and pleasantness exercise a significant effect on satisfaction and place identity. The results of the study provide practical suggestions to the local authorities. Those should preserve the typicality and not mischaracterize the islands and, at the same time, they should create a better infrastructure for tourists and local habitants, such as roads. The network of water supply and electricity should also be improved. The improvement of these aspects must be conducted in conjunction with a plan to establish the identity of the islands, following by its communication in several African and European countries.

As far as the authors know, this is the first attempt to relate place image with place identity in islands such as Sao Tomas and Prince.

**Keywords:** destination image, satisfaction, place identity, island, typicality

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### Introduction

In a turbulent socio-economic environment, where the economic crisis is not yet completely overcome, it is worthwhile contributing to a better understanding of the image dimensions and identity of destinations. In order to apply the model proposed, this study focuses on the Sao Tome and Principe islands, which, so far, have not been the subject of significant attention by

researchers of tourism related fields. Sao Tome and Principe are two islands and several isles adjacent bathed by the Atlantic Ocean. Sao Tome and Principe, situated in the gulf of Guinea in Western Africa, have a tropical climate and an abundant vegetation. The archipelago is particularly reputed for its beaches and the production of coffee and cocoa beans.

The uninhabited islands were discovered in the reign of Alfonso V, by the Portuguese navigators João de Santarem and Pêro Escobar. Nowadays, the Sao Tome and Principe population result of miscegenation between Portuguese and natives from the coast of the Gulf of Guinea, Angola, Green Cape, and Mozambique. Concerning gastronomy, fish, crustaceans, lobster, crab, and mollusks such as conch, octopus and cuttlefish species are indispensable in the gastronomy of the islands. Plants that exist in abundance are essential ingredients in cooking of Sao Tome and Principe islands, making its cuisine one of high nutritional value in animal protein and other plant nutrients. In handicrafts raw materials such as wood, coconut husk, wicker of the palm and reeds or shells are used. The beaches are surrounded by a lush vegetation mantle and the blue sea. In light of all these natural potentialities, it is highly recommendable that the authorities of the islands create a brand identity for Sao Tomas and Prince. Hence, the main goal of this research is to analyze the impact of destination image dimensions on satisfaction and place identity.

## Literature Review

Founded on the psychological theory of attraction, place attachment has been increasingly an object of interest in the field of tourism (e.g., Bricker and Kerstetter, 2000; Warzecha and Lime, 2001; Lee, 2001; Hwang, Lee, and Chen, 2005; Gross, Brien, and Brown, 2008; Ednie, Daigle, and Leahy, 2010).

Bricker and Kerstetter (2000) analyzed place attachment as to whitewater recreation. Warzecha and Lime (2001) studied the influence of place attachment, motivation, management actions, and the encounter norm on the Canyon lands National Park. Lee (2001) used attractiveness of destination, past experience, satisfaction, travel to the destination as a family tradition, familiarity with the destination, and the age of the tourist at his/her first visit, to predict the level of place attachment. Hwang, Lee, and Chen (2005) studied the relationship among tourists' involvement, place attachment, and interpretation satisfaction. Ednie, Daigle, and Leahy (2010) focused on reasons and causes associated with the way individuals become connected to a landscape. Yuksel, Yuksel, and Bilim (2010) explored the effects of destination attachment on customer satisfaction and cognitive, affective, and conative loyalty.

Place attachment is defined as an affective bond or link between people and specific places (Hidalgo and Hernandez, 2001). According to Low and Altman (1992), place attachment involves the interplay of affect and emotions, knowledge and beliefs, and behaviors and actions in

reference to a place. Moore and Graefe (1994) point out the extent to which an individual values and identifies with a particular environmental setting. The place attachment concept has been regarded as having two distinct dimensions: place identity, which refers to a symbolic or affective attachment to a place, and place dependence, which refers to a functional attachment to a place (Backlund and Williams, 2003). In addition, Bricker's and Kerstetter's (2000) study established a measurement profile for place attachment that includes place dependence, place identity, and lifestyles. Blackwell, Miniard, and Engel (2001) defined lifestyle as patterns in which people live and spend their time and money reflecting people's activities, interests, and opinions. Gross, Brien, and Brown (2008) examined the dimensions of a lifestyle tourism destination. Those dimensions include place attachment and place identity.

As this study concerns the component place identity and the effect of destination image on place identity and satisfaction, it is important to review the conceptualizations of such constructs. In this context, Proshansky (1978) alludes to the fact that place identity is related to dimensions of self that define the individual's personal identity in relation to the physical environment by means of a complex pattern of conscious and unconscious ideas, beliefs, preferences, feelings, values, goals and behavioral tendencies and skills relevant to this environment. For Proshansky, Fabian, and Kaminoff (1983) it is the connection between the self and a particular setting that consists of a collection of memories, interpretations, ideas and related feelings about physical settings as well as types of settings. Furthermore, place identity is the symbolically important connection between an individual and a setting (Stedman, 2002) and a psychological investment with a setting that has developed over time (Williams and Patterson, 1999; Yuksel, Yuksel, and Bilim, 2010). Summarizing, place identification is the connection between the tourists's self and a particular setting of a region's characteristics.

The relevance and interest of the tourist destination's image is universally acknowledged, which has led to a growing body of research on the tourism destination. However, there are several definitions of destination image. Lawson and Bond-Bovy (1977) defined it as an expression of knowledge, impressions, prejudice, imaginations and emotional thoughts an individual has of a specific object or place. Crompton (1979) mentions that an image may be defined as the sum of beliefs, ideas, and impressions that a person has of a destination. Embacher and Buttle (1989) state that image may comprise both, cognitive and evaluative components. According to Gartner (1996), destination images are developed by three hierarchically interrelated components: cognitive, affective, and conative ones. Nevertheless, the majority of researchers prioritize the cognitive dimension of image.

Echtner and Ritchie (1991, 1993) highlight the existence of a continuum from the functional to the psychological attributes of a destination. The functional component contains more tangible or measurable perceptions (such as scenery, accommodation) whereas the psychological component

emphasizes more abstract and intangible characteristics (such as atmosphere or friendliness). This study follows Echtner and Ritchie's conceptualization of destination image.

Consumer satisfaction has been the subject of much attention in the literature (e.g., Oliver, 1980; Bitner and Hubbert, 1994; Rust and Oliver, 1994; Mazanec, 2006; Han and Back, 2007; Loureiro and González, 2008). Giese and Cote (2000) conducted a thorough review of conceptual and operational definitions. After the literature review, the authors outlined three general components shared by the definitions, that is, consumer satisfaction is a response, an emotional or cognitive judgment; the response refers to a specific focus, and the response is linked to a particular moment (such as: prior to purchase, after purchase, after consumption). This research assesses the emotional and cognitive tourists' judgment of the stay in Sao Tome and Principe islands when they are leaving the islands.

On the basis of the secondary research reported above, the following hypotheses are proposed:

H1: Destination image has positive impacts on tourist satisfaction.

H2: Destination image has positive impacts on place identity.

## **Method**

### **Participants and procedure**

The surveys were conducted in March and May of 2010 through structured face-to-face interviews at the airport and in the port of the Sao Tome and Principe islands (when the tourists were preparing to leave the islands). The authors collected 272 completed and usable questionnaires, which, with the help of language professors, had been devised in two languages, Portuguese and English. A pilot sample was also conducted to ensure that the wording of the questionnaire was clear and that conceptual equivalence could be guaranteed. In terms of gender, the respondents split almost equally. Over fifty percent of the sample fell within the 21-40 year age group, and 43.9% of respondents were Portuguese. According to the Direction of Tourism and Hospitality of San Tome and Principe, most of the tourists are Portuguese.

### **Measures**

Place identity was measured using 4 items based on Gross, Brien, and Brown (2008). This study used a multi-attribute approach in order to evaluate destination image (Echtner and Ritchie, 1991, 1993; Bigné, Sánchez, and Sanz, 2009). Satisfaction was assessed using 3 items adapted from previous researches (Bigné, Sanchez, and Sanchez, 2001; Loureiro and González, 2008). Each statement of the questionnaire was recorded on a 5-point Likert scale (1=strongly disagree, 5=strongly agree). The instrument was designed in English and translated into Portuguese using a dual focus method (Erkut et al. 1999).

### Data analysis

For data analysis, a principal components analysis and Varimax rotation method were used to reduce the 22 destination image items into a set of simplified composite service factors. Only factors with eigenvalue equal to or greater than one were considered to be significant (Hair et al., 1992).

After that we applied the PLS (partial least squares) approach. The PLS is analyzed and interpreted in two stages. First, the adequacy of the measures is assessed by evaluating the reliability of the individual measures and the discriminant validity of the constructs (Hulland, 1999). Then, the structural model was appraised. Composite reliability was used to analyze the reliability of the constructs (Fornell and Larcker, 1981). To determine convergent validity, we used the average variance of variables extracted by constructs (AVE) that should be at least 0.5, and to assess discriminant validity we followed the rule that the square root of AVE should be greater than the correlation between the construct and other constructs in the model (Fornell and Larcker, 1981). Bootstrap is used to estimate the precision of the PLS estimates and to analyze the significance of the beta coefficients. Tenenhaus et al. (2005) proposed the geometric mean of the average communality and the average R<sup>2</sup> (ranging from 0 to 1) as overall goodness of fit (GoF) measures for PLS. The main reason for choosing PLS concerns the presence of a large number of variables and formative factors (Chin, Marcolin, and Newsted, 2003).

### Results

The principal components analysis for the destination image items generated six factors that accounted for 66.9% of total variance. The results show that the loadings of reflective variables approach exceeded 0.707, except for one item of the destination image dimension named accessibility. That item was eliminated and the accessibility was analyzed with only one item.

Composite reliability was used to analyze the reliability of the constructs, since this has been considered a more exact measurement compared to Cronbach's alpha (Fornell and Larcker, 1981). Table 2 indicates that all constructs are reliable since the composite reliability values exceed the threshold of 0.7 and even the strictest one of 0.8 (Nunnally, 1978). The measures also demonstrated convergent validity as the average variance of manifest variables extracted by constructs (AVE) was at least 0.5, being indicative that more variance was explained than unexplained in the variables associated with a given construct.

*Table 2 Measurement Results*

<i>Variables</i>	<i>LV Index Values</i>	<i>Item Loading</i>	<i>Composite reliability</i>	<i>AVE*</i>
<i>Place quality</i>	<i>3.5</i>		<i>0.83</i>	<i>0.62</i>
<i>The quality of the beaches is high</i>		<i>0.731</i>		
<i>The quality of the resorts is high</i>		<i>0.893</i>		
<i>The availability of accommodation is good</i>		<i>0.795</i>		
<i>Agreeableness</i>	<i>4.2</i>		<i>0.86</i>	<i>0.51</i>
<i>Their inhabitants are friendly</i>		<i>0.725</i>		
<i>There are interesting places to visit It is possible to visit the coffee and chocolate plantation</i>		<i>0.708</i>		
<i>It is possible to visit the coffee and chocolate plantation</i>		<i>0.720</i>		
<i>It is a quiet place</i>		<i>0.754</i>		
<i>It has attractive natural attractions and scenery</i>		<i>0.746</i>		
<i>The climate is pleasant</i>		<i>0.736</i>		
<i>Typicality</i>	<i>3.3</i>		<i>0.83</i>	<i>0.70</i>
<i>The urbanization (typical houses) is interesting</i>		<i>0.871</i>		
<i>There are suitable craft (typical products) facilities (to look and to buy)</i>		<i>0.805</i>		
<i>Culture</i>	<i>3.2</i>		<i>0.82</i>	<i>0.60</i>
<i>There is a good availability of open air activities</i>		<i>0.760</i>		
<i>There are high quality restaurants</i>		<i>0.840</i>		
<i>There are many historic sites/museums</i>		<i>0.727</i>		
<i>Accessibility</i>	<i>2.7</i>		<i>-</i>	<i>-</i>
<i>The local transport is good</i>		<i>1.000</i>		
<i>It has an easy access (by air and sea)</i>		<i>a</i>		
<i>Functionality</i>	<i>3.0</i>		<i>0.92</i>	<i>0.65</i>
<i>There is high quality accommodation</i>		<i>0.731</i>		
<i>Night life/entertainment is good</i>		<i>0.841</i>		
<i>Tourists can enjoy fairs, festivals and exhibitions</i>		<i>0.804</i>		
<i>It offers a good value for money</i>		<i>0.791</i>		
<i>.It has quality services</i>		<i>0.818</i>		
<i>Tourists can do different activities</i>		<i>0.829</i>		
<i>Satisfaction</i>	<i>4.1</i>		<i>0.92</i>	<i>0.80</i>
<i>The stay here (São Tomé e Príncipe) has been very satisfactory</i>		<i>0.897</i>		
<i>This experience was rewarding for me in many aspects</i>		<i>0,921</i>		
<i>I will speak well of the São Tomé e Príncipe to other people</i>		<i>0,858</i>		
<i>Place identity</i>	<i>3.7</i>		<i>0.87</i>	<i>0.63</i>
<i>São Tomé e Príncipe means a lot to me</i>		<i>0.730</i>		
<i>I am very attached to São Tomé e Príncipe</i>		<i>0.833</i>		
<i>I identify strongly with São Tomé e Príncipe</i>		<i>0.824</i>		

*The distinctive lifestyle of São Tomé e Príncipe is  
something that attracted me here* 0.771

*a: item eliminated; \* Average Variance Extracted.*

The measures also demonstrate discriminant validity, according to the criteria defined in Methods (see Table 3).

Table 3 Discriminant Validity

Construct	Correlations					<i>Place</i>	<i>Place</i>	<i>Typicality</i>
	<i>Accessibility</i>	<i>Agreeableness</i>	<i>Culture</i>	<i>Functionality</i>	<i>Satisfaction</i>	<i>identity</i>	<i>quality</i>	
<i>AVE<sup>1/2</sup></i>	1.000	0.713	0.777	0.803	0.893	0.790	0.784	0.839
<i>Accessibility</i>	1.000	0.242	0.253	0.425	0.179	0.251	0.310	0.434
<i>Agreeableness</i>	0.242	1.000	0.481	0.386	0.287	0.490	0.516	0.235
<i>Culture</i>	0.253	0.481	1.000	0.535	0.285	0.392	0.388	0.419
<i>Functionality</i>	0.425	0.386	0.535	1.000	0.221	0.341	0.353	0.476
<i>Satisfaction</i>	0.179	0.287	0.285	0.221	1.000	0.235	0.446	0.311
<i>Place identity</i>	0.251	0.490	0.392	0.341	0.235	1.000	0.220	0.412
<i>Place quality</i>	0.310	0.516	0.388	0.353	0.446	0.220	1.000	0.286
<i>Typicality</i>	0.434	0.235	0.419	0.476	0.311	0.412	0.286	1.000

The structural results are presented in figure 1. In this study, a nonparametric approach, named Bootstrap, was used for estimating the precision of the PLS estimates and support the hypotheses. Four path coefficients were found to be significant at the 0.001, 0.01, and 0.5 level. All significant coefficients had the expected sign.

The Pearson's correlation value times the path coefficient value of each of the two constructs reveal that 16.3% of the satisfaction variability is explained by place quality and 21.1% of the place identity variability is explained by agreeableness.

## Conclusions

This study is the first attempt to consider the effect of destination image dimensions on place identity and even on satisfaction in a destination such as the Sao Tome and Principe Islands. The results only partially support the hypotheses H1 and H2.

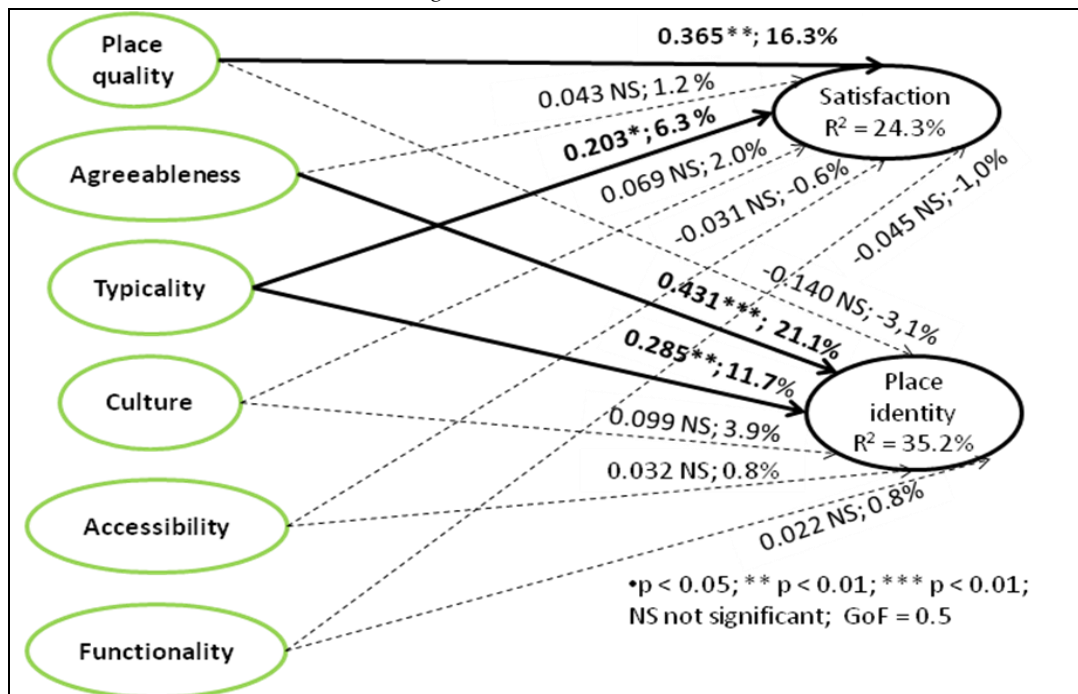
The typicality dimension is the most important and significant determinant of satisfaction and place identity. Typicality alludes to typical urbanization of the islands and the existence of suitable craft facilities (to see and buy).



The quality of the place is another important dimension that contributes to the tourist's satisfaction. This dimension covers the quality of the beaches, the quality of the resorts and the availability of accommodation. On the other hand, the dimension agreeableness exercises a significant effect on place identity.

The agreeableness is one of the largest dimensions, in terms of number of items. This dimension groups items such as: there are interesting places to visit, it is a quiet place, the climate is pleasant, the gastronomy is good and the reference to the coffee and cocoa plantations.

Figure 1. Structural Results



Functionality is another dimension that combines a large number of items: high quality accommodation, night life/entertainment tourists can enjoy fairs, festivals and exhibitions, good value for money, quality services, and tourists can participate in different activities. The functional nature does not significantly impact on satisfaction and place identity. Although not significant, the beta coefficient between function and satisfaction is negative.

Finally, the dimensions culture and accessibility do not significantly influence satisfaction and place identity. The first concerns availability of open air activities, quality restaurants, and the existence of historical sites/museums. The second refers to the existence of good local transport facilities.

The tourists identify themselves with the climate, gastronomy, local visits, local urbanization, typical crafts, and calm environment. They are satisfied with the typicality but also with the

quality of beaches and resorts. In this way, government and local managers should be aware of these conclusions so as to preserve this typicality and not embark on excessive modernization and mischaracterization of Sao Tome and Principe.

In the future, the model should be improved with other variables and should be tested employing a larger sample and applying the model to different islands.

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## THE INFLUENCE OF BRAND IMAGE AND BRAND SATISFACTION ON WINE LOVE AND LOYALTY

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### Abstract

The current study focuses on brand love of wine and on whether or not customer expertise influences the relationship between brand love of wine and satisfaction, brand image, worth-of-mouth, and loyalty. Derived from a review of previous literature, hypotheses were tested by employing the PLS approach and an initial model was tested with a sample of wine consumers.

The main findings suggest that wine consumers satisfied with their preferred wine brand and conscious of a good brand image are more likely to love wine, buy it and encourage others to buy and give advice. The results of the study provide some practical implications. When developing, labeling and naming a wine brand, wine producers and managers should be aware that it is possible to create not only attraction but even passion as well as feelings of love for a wine. Hence, it is important to focus on positive emotions towards the wine, planning for favorable experience with the wine, and create an image of trustworthiness. As to the knowledge of the authors, this is the first attempt to investigate satisfaction and brand image as antecedents of brand love and customer expertise as moderator. It is also the first time that the construct of brand love is applied in the wine context.

**Keywords:** wine, brand love, brand image, satisfaction, loyalty, word-of-mouth.

### Introduction

Whether entrenched in culture over centuries in the old world or experimented with in the new world, wine inspires fascination and passion. Once regarded as a luxury good and only reserved for a few elitists, it has now become a “widespread consumer good enjoyed by a much wider socio-economic range of increasingly sophisticated consumers in many countries” (Bruwer and Wood, 2005, p.194). Consumer research could help understand what aspects of a product and its promotion these diverse consumers use to make their purchase decision. This type of research can guide wineries and distributors to highlight or even change important aspects to better suit consumer needs, which, due to the hedonistic characteristics of the wine product, have to be differentiated from those relating to other brands. Especially in the context of wine purchase,

consumers' decision-making is often an unconscious process entailing, in fact, many features or attributes entangled in complex combinations. So far, research has only provided partial understanding on how consumers really compare and then choose or recommend wines by focusing on individual facets (e.g. brand, price, region, label, color), specific consumer segments (e.g. heavy buyers), gender or cultural contexts.

A study conducted in Australia, revealed that brand was the most important factor for consumers' wine choice, closely followed by price and medals (Lockshin et al., 2009). In this study, eight different Australian brands were tested representing four different tiers of brand reputation from very well-known brands (such as Wolf Blass and Hardys) to unknown brands (such as Basalt Ridge and Duck Hollow). The total effect of difference in choice between these brands was mainly caused by one brand with a very high reputation, while they found only small differences between medium-known and unknown brands. This confirms the strong impact of a very well-known and positioned wine brand.

In Portugal, wine culture has been flourishing for centuries. Several brands from regions such as Dão, Alentejo or Bairrada are internationally known. Above them all raises wine from the Douro valley and the Port wine. The Douro valley was the first officially demarcated wine appellation in the world (18th Century) created under the guidance of Marquês do Pombal. Port got its name from the city of Oporto, which is situated at the mouth of the 560-mile long Rio Douro or River of Gold. Although many port-style wines are made around the world (Australia, South Africa and United States), the strict usage of the terms Port or Porto is reserved only to wines produced in Portugal.

The above considerations show that wine consumers have the knowledge and experience to name and identify wine brands, both national and foreign brands. Beyond these more cognitive aspects, the main aim of this paper is to propose a model explaining and interrelating antecedents and outcomes of the brand love of wine, so far neglected in literature.

## Literature Review

### Brand love as a complex phenomenon

The wine culture has strong ancestral roots with the Roman Empire having immensely influenced the development of viticulture and oenology. As the Roman Empire expanded, wine production in the provinces grew to the point where the provinces were competing with Roman wines. One can say that the major wine producing regions of Western Europe today were established by the Romans.

Wine is often associated with poetry, pleasure, and love. In Egypt, for example, wine played an important role in ancient ceremonial life. Similarly, ancient Greece had a god, Dionysos, dedicated to wine, pleasure, and festival.

Love is regarded as a very complex emotion, probably the most complex of all. Strongman (1996) states that love includes various emotions, some of them being positive. The following positive emotions contribute to explain this very complex phenomenon: interest, joy, pleasure, happiness, euphoria, victory, intense own satisfaction, delight, and so many others (include more sources here). This research regards brand love of wine as the central construct.

Given the complexity of the construct including aspects of branding and consumer behavior as antecedents and consequences, interpersonal love theory (Sternberg, 1986) alone does not allow for the discovery of specific dimensions of brand love.

In consumer research, Thomson *et al.* (2005) identified a higher-order emotional attachment construct consisting of three factors: affection, passion, and connection. Thus, attachment reflects an emotional bond similar to love. Ahuvia (1993; 2005a; 2005b) pioneered empirical research in the field of brand love and investigated in detail consumers' ability to love products and consumption activities using an interpretive paradigm. He found that many consumers do have intense emotional attachments to some "love objects" such as a brand, a product or a service.

According to Carroll and Ahuvia (2006), brand love is defined as the degree of passionate emotional attachment a satisfied consumer has for a particular trade name.

The interpersonal triangular theory of love (Sternberg, 1986) adapted to the consumption context is closely related to the emotional attachment construct; it considers that brand love is made up of dimensions such as: passion, intimacy, and commitment (Kamat and Parulekar 1997; Keh *et al.*, 2007). Similarly, Ahuvia (1993) suggests that consumers can have real feelings of love toward an object and conceptualizes the love as having two dimensions: real and desired integration.

Regarding models that integrate the brand love concept, three influential ones can be found: the holistic approach proposed by Fournier (1998), the causal approach of Carroll and Ahuvia (2006), and the systemic approach of Batra *et al.* (2008). Fournier (1998) suggests six strong relationships and is interested in the different relationships a consumer may have with a brand. Batra *et al.* (2008) integrate the seven dimensions of perceived functional quality, self-related cognitions, positive affect, negative affect, satisfaction, attitude strength, and loyalty into a model

of brand love relationship; however, they do not differentiate between antecedents and outcomes of the consumer's love for a brand and do not explicitly use the construct of love.

Reversely, Carrol and Ahuvia (2006) model the relationships between brand love and both its antecedents and consequences. They propose that brand love is influenced by a hedonic product and self-expressive brand and has a positive effect on brand loyalty and positive word-of-mouth.

Carroll and Ahuvia (2006) also highlight that brand love includes a willingness to declare love (as if the brand were a person) and involves integration of the brand into a consumer's identity. A consumer's love toward a brand is greater for brands that play a significant role in shaping the consumer's identity and as an image that fits somehow to the way of the consumer is, for example, transferred by a trustworthy, reliable, likeable, and attractive brand.

A concept closely affiliated with positioning which can contribute to this emotional bond between brand and consumer is brand image. Brand image refers to the set of associations linked to the brand that consumers hold in memory (Keller, 1993). In this way, the meaning of brands is constructed in two different ways: firstly, there is a primary meaning of the brand, which contains the benefits associated with it, and the physical attributes of the brand, and, secondly, an implicit meaning, made up of emotional and psychological meanings of brand attributes and other associations (Corbu, 2009).

Linking brand love to the concept of consumer satisfaction, Fournier and Mick (1999, p. 11), in their discussion of the various modes of consumer satisfaction, suggest that "satisfaction-as-love probably constitutes the most intense and profound satisfaction of all." In this way, being satisfied with a wine product can lead to the situation that the consumer loves it. Consumer satisfaction has been the subject of much attention in literature (e.g., Oliver, 1977, 1980; Rust & Oliver, 1994; Loureiro, 2010). Giese and Cote (2000) provide a thorough review of conceptual and operational definitions. Based on a literature review, the authors outline three general components shared by the definitions, that is, consumer satisfaction is a response, an emotional or cognitive judgment; the response refers to a specific focus and the response is linked to a particular moment (such as prior to purchase, after purchase, after consumption) (Giese and Cote, 2000, p.15). In this study, satisfaction is viewed as a post-consumption evaluation (e.g., Johnson et al. 2001; Loureiro, 2010).

Based on above considerations, the following hypotheses are formulated (see figure 1):

H1: Brand satisfaction impacts positively on brand love.

H2: Brand image impacts positively on brand love.

Relating to the ultimate achievement of consumer satisfaction, Oliver (1999, p. 34) defines brand loyalty as a deeply held commitment to rebuy a preferred good/service consistently in the

future, thereby causing repetitive same-brand purchasing, despite situational influences and marketing efforts having the potential to cause switching behavior. This definition emphasizes two different aspects of brand loyalty that have been described in previous work on the concept: behavioral and attitudinal. Behavioral, or purchase loyalty consists of repeated purchases of the brand, whereas attitudinal brand loyalty includes a degree of dispositional commitment in terms of some unique value associated with the brand (Chaudhuri and Holbrook, 2001; Odin et al., 2001). In this research, we will concentrate mostly in the behavioral loyalty. In this way, consumers satisfied and in love with a brand are more willing to repurchase and to recommend it to others (Carroll and Ahuvia, 2006) and the following hypotheses are proposed (see figure 1):

H3: Brand love has a positive impact on word-of-mouth.

H4: Brand love has a positive impact on loyalty.

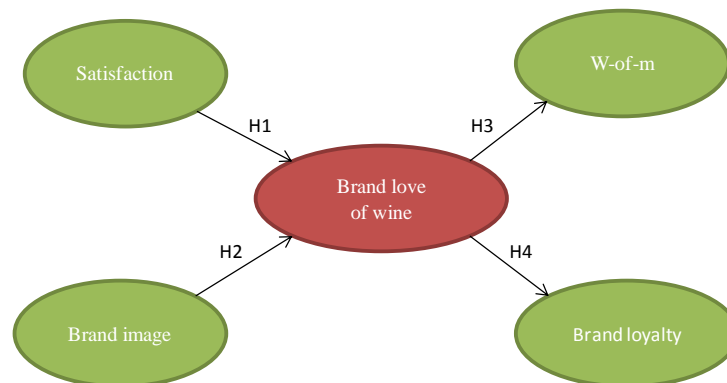


Figure1. Proposed model

Interestingly, knowledge was a factor not explicitly included yet in the discussion on conceptualization related to brand love. Consumer knowledge has been studied in western countries (Guo and Meng, 2008), and the level of knowledge partially explains consumer behavior and activities. Past research has found that experts and novices differ in the amount, content and organization of their knowledge reflected in large variances when they perform product-related tasks (Aurier and Ngobo, 1999). Two major dimensions of consumer knowledge can be distinguished, namely, familiarity or product-related consumption (Muthukrishnan and Weitz Barton, 1991) and product knowledge or subjective expertise which is the sum of product class information and rules stored in memory, that is, cues to evaluate their familiarity with the product (Bloch et al., 1989).

Referred to by a variety of authors in the previous discussion, consumer experience is conceptualized as sensations, feelings, cognitions, and behavioral responses evoked by brand-



related or product-related stimuli. In case of a brand that stimuli are part of a brand's design and identity, packaging, communications, and environments where the consumer has been exposed to the brand (Murray, 1985; Brakus et al., 2009).

Based on above considerations, in this study, the expertise of wine experts is regarded as a moderator. We define expert consumers as those who feel comfortable in the world of wine, have a great deal of experience in buying wine, and frequently shop for wine. Consumers with expert knowledge and high levels of experience in wine should be more willing to love wine. So, we postulated the following hypotheses:

H5a: The higher the level of expertise, the greater the positive relationship between customers' satisfaction and brand love of wine.

H5b: The higher the level of expertise, the greater the positive relationship between brand image and brand love of wine.

H5c: The higher the level of expertise, the greater the positive relationship between brand love of wine and word-of-mouth.

H5d: The higher the level of expertise, the greater the positive relationship between brand love of wine and loyalty.

## Methodology

### Sample and Data Collection

The questionnaire that captured both latent and demographic variables was pre-tested using 20 master students and wine experts which were personally interviewed. Then, an online survey was launched in Portugal during January and February of 2010. The main target population is young and mature women and men who are wine drinkers, even if they are just occasional drinkers, or even non-drinkers that purchase wine as a gift for friends, colleagues or family and, therefore, have some wine culture.

In this way, universities in the North and South of Continental Portugal, as well as, in Azores and Madeira were contacted in order to access students and staff. The Wine Commissions and wine Demarcated Regions were also contacted.

The sample of 476 respondents was split almost equal between genders. Over 50% of the respondents were under 46 years old (Table 1). Most of the respondents have a university degree and 47.4% are married or partnered with or without children.

Table 1 Demographic characteristics

<i>Age</i>	<i>Gender</i>	<i>Qualification</i>
18-25: 26.9%	Female: 48.6%	School – Standard level: 3.7%
26-35: 29.9%	Male: 51.4%	School – High level: 20.9%
36-45: 22.1%		University Degree: 50.3%
46-55: 13.8%		University Higher Degree (Masters, Ph.D.): 25.1%
56-65: 4.4%		
> 65: 2.9%		

### Measurement

The items in the questionnaire were first written in English, translated into Portuguese, and then back translated to English. Back translation was used to ensure that the items in Portuguese communicated similar information as those in English (Brislin, 1970; Sekaran, 1983) meaning that conceptual equivalence was assured. The questionnaire was developed so that respondents could focus on their favorite wine brand: “Concerning your favourite wine brand, to which extent do you agree with the following statements”.

Brand love related to wine was measured using eight items adapted from Carroll and Ahuvia (2006). Brand image was measured with five items based on Woisetschläger (2007) and Woisetschläger, Hartleb, and Blut (2008). Satisfaction was measured using four items based on Brakus, Schmitt, and Zarantonello (2009). Word-of-mouth was assessed with three items (Zeithaml, Berry, and Parasuraman, 1996) and loyalty with two items based on Chaudhuri and Holbrook (2001).

In order to measure the experience with wine, in the questionnaire used three items: I don’t feel comfortable in the world of wine (reversed); I have a great deal of experience in buying wine; I frequently shop for wine.

Respondents rated all measures on a 5-point Likert scale ranging from 1 (Completely Disagree) to 5 (Completely Agree).

### Results

First, the adequacy of the measures (see Table 2 and 3) is assessed by evaluating the reliability of the individual measures and the discriminant validity of the constructs (Hulland, 1999). All the loadings of items exceed 0.707, which indicates that over 50 percent of the variance in the observed variable is explained by the construct (Carmines and Zeller, 1979) (see Table 2).

Table 2 Measurement Results

Construct	LV Index Values	Item Loading	Composite reliability	AVE
<i>Brand Image</i>	3.8		0.942	0.764
I1: This wine brand is trustworthy		0.867		
I2: This is reliable wine brand		0.913		
I3: This wine brand is likeable		0.836		
I4: This wine brand is a very good brand		0.901		
I5: This is a very attractive wine brand		0.851		
<i>Satisfaction</i>	3.5		0.931	0.771
S1: I am satisfied with this wine brand and its features		0.819		
S2: My choice to get this wine brand has been a wise one		0.884		
S3: I feel good about my decision to get this wine brand		0.912		
S4: I am happy with this wine brand		0.893		
<i>Brand love of wine</i>	3.2		0.954	0.723
LW1: I am passionate about this wine brand.		0.823		
LW2: This wine brand is totally awesome.		0.875		
LW3: This wine brand makes me very happy.		0.862		
LW4: This is a wonderful wine brand.		0.886		
LW5: This wine brand is a pure delight.		0.863		
LW6: This wine brand makes me feel good.		0.850		
LW7: I'm very attached to this wine brand.		0.837		
LW8: I love this wine brand.		0.806		
<i>Word-of-mouth</i>	3.6		0.923	0.799
W1: I have said positive things about this wine brand to other people.		0.906		
W2: I have encouraged other people to buy this wine brand.		0.873		
W3: I have recommended this wine brand to people who seek my advice.		0.902		
<i>Loyalty</i>	3.5		0.888	0.799
L1: I will buy this brand the next time I buy wine.		0.878		
L2: I intend to keep purchasing this wine brand.		0.810		
AVE – Average Variance Extracted				

Composite reliability was used to analyze the internal consistency of the constructs, since this method is considered a more exact measure than Cronbach's alpha (Fornell and Larcker, 1981). Table 2 shows that all constructs are reliable since the composite reliability values exceed the threshold of 0.7 and exceed even the stricter threshold of 0.8 (Nunnally, 1978). The measures also demonstrate that the convergent validity as the average variance of manifest variables extracted by constructs (AVE) was at least 0.5; this indicates that more variance was explained - rather than unexplained - in the variables associated with a given construct.

Finally, to assess discriminant validity, the square root of AVE should be greater than the correlation between the construct and other constructs in the model (Fornell and Larcker, 1981). Table 3 shows that this criterion has been met.

Table 3 Discriminant Validity

Construct	Correlations				
	Brand Image	Brand love of wine	Loyalty	Satisfaction	Word-of-mouth
$AVE^{1/2}$	0.875	0.851	0.899	0.878	0.894
Brand Image	1.000	0.798	0.744	0.829	0.789
Brand love of wine	0.798	1.000	0.685	0.806	0.737
Loyalty	0.744	0.685	1.000	0.726	0.732
Satisfaction	0.829	0.806	0.726	1.000	0.778
Word-of-mouth	0.789	0.737	0.732	0.778	1.000

The full structural results are presented in Figure 2. In this study, a nonparametric approach called Bootstrapping was used to assess the precision of the PLS estimates and support of the hypotheses. All path coefficients were found to be significant at the 0.001 or 0.01 levels. Consequently, the first four hypotheses were supported. In addition, all the signs were in the expected direction.

The  $Q^2$  statistic is used to evaluate the predictive relevance of the model. Since all  $Q^2$  are positive in the model, the relations in the model have predictive relevance. The model also demonstrates predictive power ( $R^2$ ) since the modeled constructs explained 77.0% of the variance in brand love of wine and 46.9% of the variance in loyalty (Figure 2).

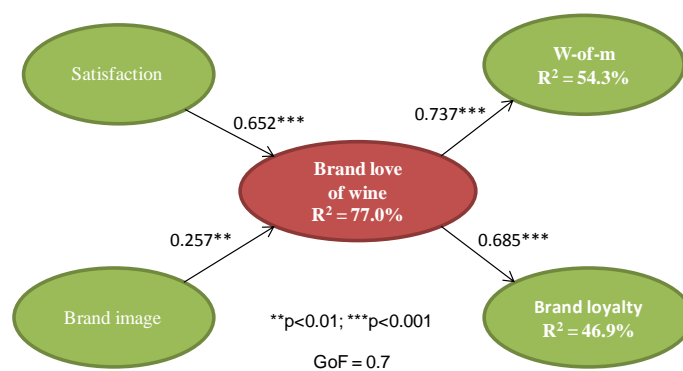


Figure 2. Structural results (full).

Then, the sample was divided into two groups, the high experience group (n=141) and the low experience group (n=135). The measurement results for each of two sub-samples reveal reliability of the individual measures, as well as, the convergent validity and the discriminant validity of

the constructs. The structural results and the multi-group analysis are presented in Table 4. In order to compare the two groups (high expertise group and low expertise group) we used the procedures described by Chin et al. (2003) and Chin (2007). The t-test results suggest that there are no significant differences (critical t-value = |1.960|) in the causal order relationships. So, the fifth hypothesis is not supported.

*Table 4 Structural results and Multi-group Analysis*

<i>Structural paths</i>	$\beta_{\text{High expertise group}}$	$\beta_{\text{Low expertise group}}$	<i>Standard error High</i>	<i>Standard error Low</i>	<i>Sp<sup>1</sup></i>	$\beta_{\text{High}} - \beta_{\text{Low}}$	<i>t-test</i>
<i>Satisfaction -&gt; Brand love of wine</i>	0.682***	0.666***	0,075	0,092	3,371	0,016	0,040 NS
<i>Brand Image -&gt; Brand love of wine</i>	0.214**	0.210*	0,074	0,091	3,355	0,005	0,012 NS
<i>Brand love of wine -&gt; Word-of-mouth</i>	0.683***	0.760***	0,072	0,054	2,956	-0,066	-0,187 NS
<i>Brand love of wine -&gt; Loyalty</i>	0.709***	0.620***	0,050	0,076	2,900	0,089	0,255 NS
$R^2_{\text{Brand love of wine}}$	75,0%	71.1%					
$R^2_{\text{Word-of-mouth}}$	46.7%	56.2%					
$R^2_{\text{Loyalty}}$	50.2%	38.4%					
<i>GoF</i>	0.7	0.6					

1. Unbiased estimator of average error standard variance; \* $p < 0.05$ ; \*\* $p < 0.01$ ; \*\*\* $p < 0.001$ ; NS: not significant.

## Conclusions

Ancestrally, wine has been identified with love and associated with several romantic songs. This study innovatively brings to the context of wine the construct of brand love proposed by Carroll and Ahuvia (2006).

The results support the first four hypotheses but not the fifth. Summarizing, wine consumers satisfied with their preferred wine brand and conscious of a good brand image are more likely to develop strong feelings of love for the wine. This strong feeling means to be attached, passionate, feel good, and regard the wine brand as wonderful and pure delight. Therefore, to be happy with the wine chosen and satisfied with the wine features influence the necessary involvement that leads to love.

Another important point is the image of the wine created in the consumer's mind. An image of attractiveness, trustworthiness, and likeability can help to create the passion for a wine label. Hence, the consumer should not be misled and a positioning created that matches the flavour and other organoleptic features to the lifestyle, and inner and social self of the consumer. The package and other symbolic representations of the wine brand should also be adjusted to the wine and the target consumer.

Brand love is a good predictor of recommendation and loyalty in the wine sector. Those who have a passion for a particular wine are the first to buy it again and suggest it to others to buy.

The higher the level of expertise does not improve significantly the effect of customer' satisfaction and brand image on brand love of wine, as well as, does not lead to a greater loyalty or to encourage or recommend other people to buy the wine brand. Customers with more knowledge and experience on wine are not significantly more likely to develop feelings of love than others less knowledgeable. So, it is possible to involve consumers in order to generate wine lovers, even if they are not experts. So it could be concluded that the level of expertise can not be regarded as a moderator.

The wine should have strong flavors specific of each region that allow consumers to identify themselves with the wine, the region and the history and place related to the Portuguese wines in a unique and differentiated way.

As a suggestion for further research, it should be interesting to investigate potential other antecedents and outcomes of brand love of wine. In addition, consumers should be segmented according to different types of passion for the wine and its different features.

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## VOLUNTARY ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS BY THE ITALIAN PRIVATE FIRMS: A STUDY OF THE DETERMINANTS

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### Abstract

In our paper we explore the determinant of the voluntary adoption of Ias/Ifrs by the Italian private firms.

The Positive Accounting Theory is used as theoretical framework. We study the explanatory variables (firm size, leverage, shareholder nationality, legal form of the firm, audit and industry sector) of this accounting choices.

**Keywords:** Voluntary adoption; IAS/IFRS; Private firms; Financial Statements Determinant.

### Introduction

The aim of the paper is to observe the determinant of voluntary adoption of the IAS/IFRS by the Italian private firms. In Italy, the Legislative Decree 28<sup>th</sup> February 2005, No. 38 (Exercise of the options provided by the Article 5 of Regulation (EC) No. 1606/2002 concerning the International Accounting Standards) allows also the private firms to adopt *voluntarily* the IAS/IFRS in both individual and consolidated financial statements if they're subsidiaries of public firms. So, firms reporting under IAS/IFRS can be divided into three distinct groups: "non-IAS/IFRS adopters" that exploit the exemptions and choose to report under domestic accounting standard; "mandatory adopters" that only adopt when they are forced to comply with; and, finally, the voluntary adopters that choose to comply with the IAS/IFRS.

Our paper focus on this third group of firms for the following reason. The IAS/IFRS is a set of accounting standards that can be used to bring about uniformity in (consolidated) financial statements of public firms on a global basis. Many studies (e.g. Ashbaugh, 2001; Leuz, 2003; Ball, Robin and Wu, 2003; Tarca, 2004; Cuijpers and Buijink, 2005; Van Tenderloo and Vanstraelen, 2005; Soderstrom and Sun, 2007) concerning these firms, highlights that the adoption of the IAS/IFRS limits the managerial discretion than the domestic accounting standards and enhances stock market efficiency (Kasznik, 1999; Leuz, 2003) in the behalf of the investors. Hence, the adoption (mandatory or voluntary) of the IAS/IFRS seems to improve the quality of the (consolidated) financial reporting of public firms and allows the investors to make informed

financial decisions and predictions of firm's future financial performance (Street, Nichols and Gray, 2000; Iatridis, 2010). However, the high quality of IAS/IFRS is linked to a process costly, complex and burdensome for the firms (Corno, 2006; Jermakowicz and Gornik-Towaszewski, 2006) because they are designed for the protection of the investors (Hope, Jin and Kang, 2005). Given that, based on previous assertion, the research question is summed up: Why the Italian private firms should adopt voluntarily the IAS/IFRS for the preparation of their separate financial statements? In other words, the aim of the paper is to investigate the determinant of the voluntary choice of the IAS/IFRS by these firms.

The main studies investigating the determinants of the voluntary adoption of the IAS/IFRS in the private firms are Francis *et al.* (2008) and, for the Italian environment, Cameran and Campa (2010).

Francis *et al.* (2008) study a sample of private firms of 56 countries and find that the voluntary adoption of IAS/IFRS is affected by both firm (e.g. foreign owners, foreign investors, foreign revenue, ownership or the legal form of the firm and the size, measured by the number of employee) and country (e.g. corruption in countries, general financing constraints, judicial functioning in countries) incentives.

Cameran and Campa (2010), instead, study a sample of Italian private firms and find that these firms have incentives to adopt voluntarily the IAS/IFRS if, among other characters, they're involved in operation of M&A, have one or more foreign shareholders, have foreign revenues (this issue measure the level of internationalization of the firm) and have a high level of leverage (debt/equity ratio).

Our paper extends prior researches on the analysis of the determinants of the voluntary adoption of IAS/IFRS and adds to our understanding of the role of the industry-type.

However, our study differs from Francis *et al.* (2008) which focalizes on the exploration of the role of the firm-specific and the country-level factors in the voluntary adoption of international accounting standards and get data from the World Business Environment Survey (WBES) which information are based on the survey.

Our study differs also from Cameran and Campa (2010) because the Scholars select a two-paired sample (firms that adopt voluntarily the IAS/IFRS; firms that adopt the domestic accounting standards, as control sample) from the AIDA database. In this case, they do not assess the determinant of the adoption of the IAS/IFRS but they compare some characters of the two samples of firms. In their paper, besides, the Scholars do not use the regression analysis to assess the significant factors that in the Italian context could influence the voluntary adoption of IAS/IFRS by private firms.

Finally, the studies before mentioned do not analyze the relationship between the voluntary adoption of the IAS/IFRS and the:

- a) appointment of an external auditor (an audit company or a single auditor) in charge of the financial audit function;
- b) industry-type of the firm.

As explaining background we use the Positive Accounting Theory (Watts and Zimmermann, 1986) because one of its main objectives is the explaining of the firms' choice (Watts and Zimmermann, 1990). A basic assumption in the Positive Accounting Theory (PAT) is that the agents are rational individuals concerned with furthering their own self-interest so the motivation for accounting policy choice studies (in this case, the voluntary adoption of the IAS/IFRS) is to gather evidence about the factors which influence managerial' behavior (Beattie *et al.*, 1994, p. 791).

The remainder of the paper is organized as follow. In section one we provide specification for the theoretical background that are the PAT (§ 1.1) and the accounting literature concerning the voluntary choice of IAS/IFRS by the private firms (§ 1.2). In section two we develop the hypothesis. In the third section we provide details about the sample of firms (descriptive statistic of the sample), the statistical method and results. In the section fourth we provide the research results and, finally we conclude summarizing the main findings and discussing the implications in according to the Positive Accounting Theory hypothesis.

## **Theoretical background**

### **1.1. The Positive Accounting Theory**

The PAT is considered one of the most innovative as well as controversial (Watts and Zimmerman, 1990, p. 131) theories in accounting since mid-1970s. Watts and Zimmermann (1990, p. 148) point out that the reason of the use "positive" was to "emphasize that accounting theory's role is to provide explanations and predictions for accounting practice". With regard to the financial statements, Watts (1977, p. 54) point out that "the financial accounting literature concentrates on prescriptions: on what should be the content of financial statements. Very little attention is given to developing a theory to explain many interesting observed phenomena; in particular to explain why financial statements take their current form". Jensen (1976, p. 7) arguments that the development of the PAT is linked to "explain why accounting is what it is, why accountants do what they do and what effects these phenomena have on people and resources utilization". In other words, the PAT attempts to explain observed phenomena indicating how things should be without indicating how they should be (Schroeder, Clark and Cathey, 2005, p. 113). Finally, Watts and Zimmerman (1978, p. 113) assert that a "... precondition

of a positive theory of standard setting is understanding management's incentives" in choosing among accountant alternatives. As Watts and Zimmerman (1986, p. 7) state, PAT "... is concerned with explaining accounting practice. It is designed to explain and predict which firms will and which firms will not use a particular method ... but it says nothing as to which method a firm should use". Hence, PAT could be produce prescriptions for government accounting policy and/or for the international standard setter, for example, for accounting standards (Watts and Zimmerman, 1986), but the normative aspect is based on positive (i.e. empirical) evidence.

Belkaoui (1992) highlights that "the central ideal of the positive approach is to develop hypotheses about factors that influence the world of accounting practices and to test empirically the validity of these hypotheses".

However, as Watts and Zimmermann (1986, p. 2) bring to light that PAT is based "on the intention to explain and predict accounting practices..." in this study we integrate the PAT background with other variables (compatibles with the Italian environment) to explain the determinants of the voluntary adoption of the IAS/IFRS by the Italian private firms.

The PAT and its hypotheses were originated in the American context and the studies are devoted mainly to the public firms. We extend this approach to the Italian private firms because we believe that it could help us to explain the determinants of accounting policy choices (IAS/IFRS vs. Italian accounting standards) made by preparers of financial accounting.

## **1.2. Literature review and the research question**

In order to understand the market and firm's features behind the internationalization of financial statements, several previous papers concerning the public firms (Dumontier and Raffournier, 1998; El Gazzar *et al.*, 1999; Murphy, 1999; Ashbaugh, 2001; García and Zorio, 2002; Cuijpers and Buijink, 2005; Ortiz, 2005; Francis *et al.*, 2008; Nicoliello, 2009) have analyzed why these firms aim to adopt voluntarily the IAS/IFRS instead of their domestic accounting standards. These studies found that there are some market's and firm's features that influence the voluntary choice of the IAS/IFRS by these companies: e.g. the firm's size, the foreign activities or foreign revenues, the presence of foreign shareholders, the degree of the firm's leverage, and the type of their capital providers.

As concern the private firms, we found only few studies on the matter. Here follow we summarize their main findings and methodology.

Francis *et al.* (2008) investigate the reasons of IAS/IFRS adoption by small and medium-sized private firms from 56 countries. They build their study on prior researches, which posit that higher quality of the financial statements can reduce information asymmetry, and facilitate contracting with external parties. The Scholars, in fact, argue the existence of the agency problem

also in the private firms (see also Eirle and Halle, 2009) and firms that rely more on equity are characterized with higher levels of information asymmetry between managers and stakeholders. This asymmetry could increase the demand for high quality accounting standards. Francis *et al.* (2008) conclude that the voluntary adoption of the IAS/IFRS by these firms is motivated by firm-specific as well as by country-specific factors. Finally, the Scholars point out that larger firms, firmer with more external financing, growth firms, firms with foreign shareholders and firms with foreign revenues (firm-incentives) are more likely to apply IAS/IFRS. Among the firm-specific factors, Francis *et al.* (2008) supposed that the determinant (the independent variables) of the voluntary adoption of IAS/IFRS (a dichotomous dependent variable that assumes the value 1 if the firm adopt the IAS/IFRS) was: the expected growth rate in investment, the proportion of firm's financing in the previous year from external sources; the nationality of the owners, the export sales, the size (measured by the number of employees) and, finally, the ownership (Limited liability corporation, partnership or sole proprietorship).

The study of Cameran and Campa (2010), instead, using the archival data (extracts by AIDA database), explores the determinant of the voluntary adoption of the IAS/IFRS by the Italian private firms. They select two-paired sample of firms that adopt voluntarily/non adopt these accounting standards. Unlike Francis *et al.* (2008), Cameran and Campa (2010) do not utilize the regression analysis to determine the statistical importance of the factors influencing the voluntary adoption of IAS/IFRS by private firms; instead they adopt the univariate analysis methodology as the "Two sample paired T-test" and the "Two proportions T-Test". Here follow, we summarize the two studies cited (Table 1).

Table 1: Summary of studies on voluntary adoption of IAS in private firms.

Authors	Research Question	Dependent Variable	Independent variables	Methodology	Results
Fields <i>et al.</i> (2008)	1) The influence of the firms and countries incentives on the decision to adopt voluntarily the IAS  2) The role of the firm and countries incentives in explaining IAS adoption	Adoption of IAS: 0 = no 1 = yes	1) Firms specific factors: - External financing - Investment growth; - Foreign owners; - Export sales.  2) Country Level variables: - Power-adjusted gross domestic product per capita; - Legal development in countries; - General financing constraints;	Logit Regression analysis	We cannot summarize all the results (see Fields <i>et al.</i> , 2008, p. 345-353) but the Scholars find that the voluntary adoption of IAS by private firms of the 56 countries in the world is affected (in different measure) by both the firm specific and country level factors.

			<ul style="list-style-type: none"> <li>- Corruption in countries;</li> <li>- Judicial functioning in countries;</li> <li>- Financial development in countries;</li> <li>- Common law or civil law variable.</li> </ul>		
Cameran and Campa (2010)	The determinant of the voluntary adoption of IAS/IFRS by Italian private firms	-	<ul style="list-style-type: none"> <li>1) Organizational and governance variables:               <ul style="list-style-type: none"> <li>- Link to a public firm;</li> <li>- Institutional investors;</li> <li>- Strong ownership by one shareholder;</li> <li>- Italian and foreign shareholders;</li> <li>- Export revenues;</li> <li>- M&amp;A operations.</li> </ul> </li> <li>2) Economic and Financial variables               <ul style="list-style-type: none"> <li>- Total assets;</li> <li>- Leverage;</li> <li>- Financial position.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>- Two sample paired T-test;</li> <li>- 2 proportions T-Test</li> </ul>	<p>1) 74% of the firms of the sample adopt the IAS/IFRS if they are subsidiaries of public firms;</p> <p>The decision to adopt voluntarily the IAS/IFRS is influenced by the presence of:</p> <ul style="list-style-type: none"> <li>- Institutional investors (e.g. pension funds; SIM)</li> <li>influence the decision to adopt voluntarily the IAS/IFRS;</li> <li>- One majority shareholder;</li> <li>- Foreign sales;</li> <li>- M&amp;A operations;</li> <li>- High level of leverage.</li> </ul>

Consistent with this argument and considering that the adoption of the IAS/IFRS is a process costly, complex and burdensome for all the firms, the Research Question is:

*Why the Italian private firms should adopt voluntarily the IAS/IFRS for the preparation of their separate financial statements instead of the Italian accounting standards?*

Our study, extending prior researches (Fields *et al.*, 2008 and Cameran and Campa, 2010), investigates the explanatory variables regarding the determinants of the voluntary adoption of IAS/IFRS by the Italian private firms that are allowed by the law (Decree Legislative 38/2005) to this voluntary choice.

## Hypothesis development

Watts and Zimmermann (1990, p. 132) state “it is clear that there is a relation between firm’s accounting choice and other firm variables”. In our study we retain the classical variables issued from the PAT as the firm’ size and its degree of leverage because they are compatible with the aim of our work. However, to these explanatory variables we also add other variables as: the presence of foreign shareholders, the export sales (foreign revenues), the legal form of the firm, the body that the firm can put in charge of the Financial audit function (voluntary or mandatory)<sup>70</sup> of the financial statements and, finally, the industry sector. These indicators are proxies for firms’ incentives that may drive their decision to adopt voluntarily the IAS/IFRS. In the analysis we do not consider as independent variable the membership of the firm in a group: the Italian law allows only to the subsidiaries to adopt voluntarily the IAS/IFRS for the preparation of the firm’s separate financial statements (see the article 2 of the Decree Legislative n. 38/2005).

### Size

Watts and Zimmerman (1986) pointed out that political costs are positively related to firm’ size, hence, larger firms should be more likely to apply IAS/IFRS than smaller firms. Higher political costs (Watts and Zimmerman, 1986) and agency costs of large firms caused by more widely dispersed ownership, may drive these firms to the voluntary adoption of IAS/IFRS and make more disclosure (Meek, Roberts and Gray, 1995) increasing the confidence in their financial statements (Dumontier and Raffournier, 1998). Given that, the compliance of the financial statements with IAS/IFRS improves its quality in behalf of firm’s stakeholders. If, as generally admitted, political costs are positively related to size (Watts and Zimmerman, 1986), large firms should be more likely to apply IAS than small firms (Dumontier and Raffournier, 1998, p. 221). However, Murphy (1999) states that public Swiss companies that adopt IAS/IFRS do not differ in terms of size.

Moreover, compliance with IAS/IFRS implies an increase of disclosure. The literature agrees on the positive relationship between the firm’s size and its information disclosure level. Chavent *et al.* (2006) highlight that there are many reasons according which is possible explain this link. Large firms have more incentives to disclose information to reduce their political costs, since their higher visibility can easily lead to more litigation (Watts and Zimmerman, 1978; Bujaki and Richardson, 1997). Besides, thanks to their more developed internal reporting system, the costs associated with a higher disclosure level are lower for large firms. Finally, because their annual report is the main source of information for their competitors, smaller firms may be reluctant to make additional disclosures which might place them at a competitive disadvantage (Firth, 1979).

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<sup>70</sup> The Italian law allows the private firms to have their financial statements audited by the Board of Statutory Audit (BSA), an inside body appointed by the shareholders, by a single auditor (external) and, finally, by an Audit company (BIG 4 or non BIG 4).

Besides, the compliance process with IAS/IFRS has quite different for large and small firms because large firms have better access to resources and being more able to cope with this adoption (ICAEW, 2007). Kvaal and Nobes (2010) find that size is a key determinant of accounting choice when it comes to deviation from the domestic accounting standards.

As proxy of the SIZE we use the natural logarithm of the net sales (in euros) although it can be measured in numerous different ways (e.g. the number of the employees or the Total of the Assets). We choice the net sales because the number of employees is not always shown in the Notes while in Italy the total of assets could reflect some accounting policy and earnings manipulation (for example, the capitalization of the deferred costs).

Based on these arguments, we state the following null hypothesis:

H0<sub>1</sub>: The voluntary adoption of IAS/IFRS is positively associated with firm size

The coefficient of SIZE is expected to be *positively* associated with the voluntary adoption of IAS/IFRS.

### **Leverage**

External financing gives to the shareholders the opportunity to transfer wealth to the prejudice of firm's creditors. As affirmed by Dumontier and Raffournier (1998, p. 223), borrowing costs are based on a firm's current risk. So, the shareholders have an incentive to invest borrowed finance in projects riskier than current assets in order to improve their expected return on the investment without supporting additional costs. In this case, finance providers (especially the banks and the other capital providers) are penalized considering that they are not compensated for the resulting increase of default risk (Jensen and Meckling, 1976). For this reason, firms have incentives to enhance their transparency (for example by preparing high quality accounting information) and to improve the quality of their financial statements (by using a set of General Accepted Accounting Standards as the IAS/IFRS) in order to attract external financing at lower costs (Durnev and Kim, 2005).

Given that, as the leverage is positively associated with the need for monitoring between shareholders and creditors, it can be argued that high leveraged firms are more wishful to adopt IAS/IFRS in order to reduce borrowing costs compared to firms with a low level of leverage.

Based on these arguments, we state the following null hypothesis:

H0<sub>2</sub>: The voluntary adoption of IAS/IFRS is positively associated with the degree of firm's leverage

The coefficient of LEV is expected to be *positively* associated with the voluntary adoption of IAS/IFRS.



**Foreign shareholder**

Foreign shareholders are less familiar with subsidiaries' national accounting standard: this situation could create an information gap between the firm and their foreign shareholders. The adoption of IAS/IFRS allows foreign shareholders to better monitor the performance and the financial position of the firm (Khanna, Palepu, and Srinivasan, 2004). Since IAS/IFRS are generally of high quality accounting standards (Barth, Landsman and Lang, 2008) and prevent distortion in financial statements by managers, the adoption of IAS/IFRS facilitates the monitoring task of shareholders. The adoption of IAS/IFRS increase the transparency and credibility of the firm (Francis *et al.*, 2008), this in turn increases the attractiveness of the firm for foreign investors (Covrig *et al.*, 2009). Private companies with one or more foreign shareholders, thus, have an incentive to publish their financial statements according to IAS/IFRS in order to reduce the level of information asymmetry.

Based on these arguments, we state the following null hypothesis:

H0<sub>3</sub>: The voluntary adoption of IAS/IFRS is positively associated with the presence of a foreign shareholder

The coefficient of FSHAR is expected to be *positively* associated with the voluntary adoption of IAS/IFRS.

**Export sales (or Foreign revenues)**

Francis *et al.* (2008, p. 339), highlight that adoption of IAS/IFRS can also be affected by export sales. The argument is the same to that for foreign shareholders. Frankel and Romer (1999) show that foreign trade enhances economic growth. Therefore, firms engaging in exports normally experience increase in sales. Moreover, exporters are typically larger and more capital intensive than non-exporters, which creates a need for external financing. Exporters also have contracts with foreign firms so that IAS/IFRS-based financial statements can be relevant in facilitating contracting with these parties. Unlike to Francis *et al.* (2008) we do not detect the existence or the absence of the export sales (by a dichotomous variable). We argue that a firm with a lower level of export revenues than the total amount of the annual revenue, couldn't be regarded as an exporting firm. So, as proxy of the variable Export sales, we consider the weight of the export sales on the total of the sales of the year 2009. We get the information about the export revenues from the mandatory firms' Notes.

Based on these arguments, we state the following null hypothesis:

H0<sub>4</sub>: The voluntary adoption of IAS/IFRS is positively associated with the ratio of export sales

The coefficient of FREV is expected to be *positively* associated with the voluntary adoption of IAS/IFRS.

**Legal form**

Francis *et al.* (2008, p. 339) point out that the legal form of a firm can influence its ability to meet its financing needs. Many private firms are not entirely run by owner-managers, and are organized as limited liability corporations (rather than proprietorships and partnerships) in which agency conflicts create the need for monitoring of management (Ang, Cole and Lin 2000). To limit information risk and agency cost, the limited liability corporations are more likely to adopt IAS/IFRS as a signal of accounting quality and financial transparency (Francis *et al.*, 2008, p. 340).

The Italian civil law requires the preparation and the publication of the financial statements only for the companies and not for the sole proprietorships and partnerships. Also, the companies can be divided mainly in two groups: the Stock company or corporation (in Italian, “Società per azioni” or Spa) and the Limited liability company (in Italian “Società a responsabilità limitata” or Srl). Moreover, in this group are included a little number of Cooperatives and of Consortium. We use a dichotomous variable that takes the value of 1 if the legal form of the firm is the Stock company (Spa) and the value 0 if the legal form of the firm is the Limited liability company, the Cooperative or the Consortium.

Based on these arguments, we state the following null hypothesis:

H0<sub>5</sub>: The voluntary adoption of IAS/IFRS is positively associated with the legal form of the firm

The coefficient of LFORM is expected to be *positively* associated with the voluntary adoption of IAS/IFRS.

**Use of external audit and auditor’s reputation**

The audit verification improves the credibility and the reliability of the financial statements toward the stakeholders (investors and capital providers). In recent years, many researchers argue that the enforcement of accounting standards is as important as the accounting standards (e.g. Sunder, 1997). Strong IAS/IFRS enforcement puts great pressure on management and auditors to act faithfully and truthfully to comply with the accounting standards, and they contributes to comparability of financial statements across countries (FEE, 2002, 29).

DeAngelo (1981) indicated that audit quality is influenced by the size of the external auditing company. The Scholar argued that the value of an external audit depends on how users perceive the report of auditors in the corporate annual report. The perception is formed on the basis of the understanding of users of both the ability of the auditor to discover a material error (auditors’ technical capabilities) and the willingness of the auditor to properly report the error (auditors’

independence). Nowadays, the plan of the Big 4 is to force all countries, all companies and all auditors to use IAS/IFRS.

Moreover, it has been argued that Big Audit companies (now the Big Four are: the PriceWaterHouseCoopers, the KPMG, the Ernst & Young and the Deloitte) may incite their customers to disclose more information (Firth, 1979) because an audit failure could damage their reputation and their brand name (Francis, Maydew and Sparks, 1999; Piot and Janin, 2007; Mariani *et al.*, 2010). Finally, the Audit company has higher competences in IAS/IFRS (Corno *et al.*, 2007) and they create schemes and model for apply the IAS/IFRS worldwide. So, the adoption of the IAS/IFRS by their customers helps them to execute the work of auditing.

Hence, we argue that the firms audited by an Audit company are more likely to adopt voluntarily IAS/IFRS than the firms non audited by these companies. In this way, the firms audited by a Big 4 Audit company seem to improve the quality and the credibility of their financial statements and this credibility toward the capital providers and the other stakeholders.

We expect also that the firms that do not submit their financial statements to the financial auditing adopt the Italian accounting standard.

Based on these arguments, we state the following null hypotheses:

H0<sub>6</sub>: The voluntary adoption of IAS/IFRS is positively associated with the presence of the Financial Audit function and the likelihood to adopt them increases if the firm is audited by a BIG 4 Audit Company.

The coefficient of AUDIT is expected to be *positively* associated with the voluntary adoption of IAS/IFRS.

### **Industry**

As concern public firms, Cuijpers, Buijink, and Maijoor (2003) obtain results regarding the association between voluntary adoption of IAS/IFRS in the European Union and the industry type. The Scholars found that firms in transportation, communications, electric, gas and sanitary services (SIC code 4; two-digit codes 40-49) are more likely to use IAS/IFRS (non-local GAAP). This evidence was found also by Ortiz (2005). However, while Ortiz (2005) found that firms engaged in services operations (SIC code 7; two-digit codes 70-89) are more likely to adopt IAS/IFRS, Cuijpers, Buijink, and Maijoor (2003) found that these firms are less likely to use IAS/IFRS.

Based on these arguments, we want analyze if also in Italy the industry-type influence the voluntary adoption of the IAS/IFRS. The level of voluntary disclosure may differ between industries because of industry-specific accounting regulation, competitive pressures (Cooke, 1992) or proprietary costs (Meek *et al.*, 1995).

We use Industry as control variable to check if a particular industry sector could affect the voluntary adoption of the IAS/IFRS than the others

In summary, we have:

Table 2: Summary of the independent variables (IV) used in the paper

<i>Hypotheses and Label</i>	<i>Name of the independent variable</i>	<i>Expected sign of the coefficient</i>	<i>Source of data</i>	<i>Nature of the IV</i>	<i>Explanatory variable</i>
H1: SIZE	Size	+	AIDA	Continue	Natural logarithm of the annual revenue
H2: LEV	Leverage	+	AIDA	Continue	Financial debt/Net Equity <sup>71</sup>
H3: FSHAR	Foreign shareholder	+	AIDA	Dichotomous	1= Yes; 0=No;
H4: FREV	Foreign Revenue	+	AIDA (Notes or Management report)	Continue	Export sales/Total sales of the 2009
H5: LEGFORM	Legal Form of the firm	+	AIDA	Dichotomous	1=Stock company or Corporation; 0= Otherwise.
H6: AUDIT	Audit	+	AIDA (Report of the Board of Statutory Audit or Report of external auditor)	Categorical	0 = firm not audited 1= Board of Statutory audit; 2= External independent auditor; 3= Non BIG FOUR Audit company; 4= BIG FOUR Audit company.
H7 IND <sup>72</sup>	Industry (Sic classification)	none	AIDA	Categorical	SIC1= sectors up to 10 SIC2= sectors 11 to 17 SIC3= sectors 20 to 40 SIC4= sectors 41 to 50 SIC5= sectors 51 to 69 SIC6= sectors 70 to 90

<sup>71</sup> The Financial Debt is the sum of Debt to shareholders for loans, Debt to banks and Debt to other capital providers (for each item, the AIDA Database considers the debt within 12 months and over).

<sup>72</sup> From the SIC Code, we exclude the sectors: 60 (Depository Institutions); 61 (Non depository credit institutions); 62 (Security and commodity brokers, dealers, exchangers and services); 63 (Insurance carriers); 64 (Insurance agent, brokers and services) because in this sector there are special law that require to comply with IAS/IFRS. So, the choice does not voluntary.

## Research design and methodology

This section describes the method used to select the sample of the firms used in the analysis (§ 3.1) and the procedure followed to test the predicted associations (§ 3.2).

### Sample and Data

The population consists of all Italian private firms that are allowed by law (the Decree Legislative n. 38/2005) to adopt voluntarily the IAS/IFRS in preparing their separate financial statements. For the analysis we consider the year 2009. We choose this year because the Decree Legislative n. 38/2005 allows the Italian private firms to adopt voluntarily the IAS/IFRS only from the 2006. We note that most of the firms of our sample comply with the IAS/IFRS only in the 2007. Some other, instead, adopt these standards in 2008 (we do not include the year of adoption of IAS/IFRS in our study). We remember also that the Italian private firms could adopt voluntarily the IAS/IFRS if they're subsidiaries. So, choosing the 2009 we believe to capture a high number of firms that adopted voluntarily the IAS/IFRS (please note that we do not consider the year of the First Time Adoption of the IAS/IFRS).

For the analysis we extract financial data from the AIDA Database (Bureau Van Dijk) in date 24<sup>th</sup> April 2011. At this date, the population of Italian private firms that meet the legal requirements for the voluntary adoption of IAS/IFRS for their separate financial statements are 46.184: only 479 ( $479/46.184 = 1,04\%$  of the population) of them prepare the separate financial statements compliant with the IAS/IFRS (voluntary adoption).

We decide to extract a sample from the population because we find that the AIDA Database do not publish the Notes of many firms. To extract the sample from this large population, we use the method suggested by Kreicie and Morgan (1970, p. 608). The Scholars suggest that for a population in the range 20.000-50.000 the sample should be of 381 firms:

Table 3: Extraction of a sample from a given population

Population	Dimension of the sample
10	10
100	80
200	132
300	169
...	...
10.000	370
20.000	377
50.000	381
75.000	382
$\geq 1.000.000$	384

Source: Adapted by Kreicie e Morgan (1970, p. 608).

However, considering the proportion between the firms IAS/IFRS compliant and the firms that comply with the domestic accounting standards (479/46.184), in the sample of 381 firms we fear to find a low number of firms which financial statements comply with IAS/IFRS. Such, to improve the sample and to increase the likelihood to find that adopt voluntarily the IAS/IFRS we decide to extract 500 firms (instead of 381) <sup>73</sup>.

<sup>73</sup> The choice of the particular firms to be subjected to empirical analysis was conducted using the random procedure suggested by literature (Collis and Hussey, 2009, pp. 210-212) that we described below. We:

- a) Divide the population (46.184) by the sample size (391):  $46.184/450 = 103$  (rounded);
- b) Using the software Excel 2011 for Mac®, we get a random number between 1 and 103: the result is 12;
- c) The numbers thus selected (12) represent the starting point of an iterative procedure to select randomly sample units from the population (when we export the AIDA result in EXCEL, each firm is identified by a progressive identification number, from 1 to 46.184); the numbers are added to that identified in the previous sub phase a). The procedure is then repeated until when we reach the desired numerosity of the sample. In our case, the first firm selected from the population of 46.184 firms, is in place n. 12 (the random number). The second firm selected is that is in position n. 115 (12+103). The third firm selected in the population is in position n. 218 (115+103) and so on.

Between the 450 firms, we have to eliminate 22 firms that do not adopt voluntarily the IAS/IFRS because the notes do not provide clear information about the nationality of the shareholders (we find the information "do not available"). So our sample is of 428 firms. Between them we find only 37 firms that adopt voluntarily the IAS/IFRS for their separate financial statements. To improve the analysis we decide to select other firms that prepare their separate financial statements compliant by IAS/IFRS. We analyze the information of all the 479 firms in the population that adopt voluntarily the IAS/IFRS at 2009. From this population (of 479) we exclude the 37 already selected in the first step of the sampling and other 65 firms whose notes do not present clear information about the export revenue or the nationality of the shareholders (in many cases, in fact, we find "information not available"). So, we have to extract a sample from 377 firms that adopt voluntarily the IAS/IFRS (479-37-65). From this population (377), we try to draw other 100 firms (the total should be  $37 + 100 = 137$ ).

The choice of the other 100 firms that adopt voluntarily the IAS/IFRS was conducted using the procedure random, described below. We:

- d) Divide the sub-population (377) by the sample size (100):  $377/53 = 7$  (rounded);
- e) Using the software Excel 2011 for Mac®, we get a random number between 1 and 7: the result is 5;

Following the sample' procedure selection shown in note 4, our final sample is composed by 514 firms: N° 123 (37+86) firms that adopt voluntarily the IAS/IFRS; N° 391 firms that do not adopt the IAS/IFRS (but they would be able to adopt it).

However, after a first analysis of the firms, we canceled two firms belonging to the SIC sectors of agriculture (Category 1). Finally, the sample analyzed is composed of 512 firms (both firms belong to the firms that not adopt the IAS/IFRS). Table 4 report the firms after the elimination of the two firms.

*Table 4: Final sample: Firms that adopt/non adopt voluntarily the IAS/IFRS (512 obs.)*

<i>Variable</i>	<i>Frequency</i>	<i>%</i>
<i>NON IAS/IFRS (0)</i>	<i>389</i>	<i>76.00</i>
<i>IAS/IFRS (1)</i>	<i>123</i>	<i>24.00</i>
<i>Total of the sample</i>	<i>512</i>	<i>100.00</i>

## Methodology

We estimate the Binary Logistic Regression model (BLR) because the dependent variable is a dichotomous variable. The model classifies the firms into two groups: IAS/IFRS (1) and NON IAS/IFRS (0) adopters.

The dependent variables is now placed in relationship with the independent variables:

- Firm's size (SIZE): the natural logarithm of the net sales in 2009 (the turnover);
- Leverage (LEV): as stated above, for this measure we considered the amount of debt financing (the sum of the debts to shareholders, the debt to banks and the debts to other capital providers) at the end of 2009 scaled by owner-equity at the same period;
- Foreign shareholder (FSHAR): the variable is dichotomous and it assumes value of 1 if the firm has also foreign shareholder, the value of 0 otherwise;

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*f) The numbers thus selected (5) represent the starting point of an iterative procedure to select randomly sample units; the numbers are added to those identified in the previous sub phase d). The procedure is then repeated until when we reach the desired numerosity of the sample. In our case, the first firm selected from the sample of 377 firms, is that is in position n. 5 (the random number). The second firm selected is that is in position n. 12 (5+7). The third firm selected is that in position n. 19 (12+7) and so on.*

*Between these 100 firms we have to eliminate 14 of them because their financial statements refer to a period that not coincide with the calendar year. So, we find only 86 firms.*

*Finally, our final sample is of 514 firms: N° 123 (37+86) firms that adopt voluntarily the IAS/IFRS; N° 391 firms that do not adopt the IAS/IFRS (but they would be able to adopt it).*

- Export sales (FREV): we consider the amount of foreign (or export) sales of 2009 scaled by the total of the turnaround at the same period.;

- Legal form (LEGFORM): the variable is dichotomous and it assume value of 1 if the legal form of the firm is the Stock company (Spa) and the value 0 if the legal form of the firm is the Limited liability company or a cooperative;

- External audit (AUDIT): the variable is categorical and assume the following values: 0 if the company is not audited; 1 if the company is audited by the Board of the Statutory Audit; 2 if the firm is audited by and external independent single auditor; 3 if the firm is audited by a NON BIG FOUR Audit Company; 4 if the firm is audited by a BIG FOUR Audit Company.

- Industry (IND): this variable is categorical and we refer to the SIC code as stated above in Figure N° 2.

In analytical terms, the statistical model used in the Binary Logit Regression (BLR) analysis can be defined as:

$$\text{Prob (IAS/IFRS} = 1) = \alpha_i + \beta_{1i} \text{ SIZE} + \beta_{2i} \text{ LEV} + \beta_{3i} \text{ FSHAR} + \beta_{4i} \text{ FREVE} + \beta_{5i} \text{ LEGFORM} + \beta_{6i} \text{ AUDIT} + \beta_{7i} \text{ IND} + \varepsilon_{ni} \quad (1)$$

Where:

$\alpha_i$  = is the intercept of the model (constant)

$\beta_{ni}$  = are the coefficients of the “n” independent variables (n= 1 to 6) and of the “i” firms (i= 1 to 512)

$\varepsilon_n$  = is the error of the regression (unobserved variables)

For the BLR analysis we use the software IBM SPSS<sup>®</sup>.

## Research results

The results section of the research discusses the empirical results on the determinants of the voluntary adoption of the IAS/IFRSs by the Italian private firms (allowed by the Italian law to adopt voluntarily these accounting principles for the preparation of their separate financial statements).

Section 4.1 presents the descriptive and univariate statistics. Section 4.2 reports multivariate regression on the hypothesized associations between the dependent variable and the independent variables.



### Descriptive statistics

Table 5 reports the descriptive statistics of our sample (Confidence Interval = 95%).

*Table 5: Descriptive statistics of all the sample (NON IAS/IFRS and IAS/IFRS adopters)*

	IAS/IFRS	SIZE	LEVERAGE	FSHAR	FREV	LEGFORM	AUDIT	INDUSTRY
N= 512								
Mean	.24	10.466	1.025	.74	.191	.521	1.982	4.11
S.E. Mean	.019	.0728	.313	.019	.0137	.022	.060	.054
Median	.00	10.207	0.100	1	.000	1	1	4
Mode	0	8.655	.00	1	.00	1	1	3
Std. Deviation	.428	1.648	7.093	.438	.311	.500	1.364	1.219
Variance	.183	2.715	50.310	.193	.097	.250	1.861	1.487
Minimum	0	3.69	-37.51	0	.00	0	0	2
Maximum	1	16.51	127.69	1	1.00	1	4	6

Table 6, 7, 8 and 9 report the frequency of the independent variables LEGFORM, FSHAR, AUDIT and INDUSTRY for all the firms in the sample (N=512). The frequency of the independent variables SIZE, FREV and LEVERAGE are reported in Appendix A because they require a lot of pages.

*Table 6: Frequency of the independent variable LEGFORM*

	Frequency all sample	Percentage
0 = Otherwise	245	47.9
1 = Company	267	52.1
Total	512	100.0

*Table 7: Frequency of the independent variable FSHAR*

	Frequency all sample	Percentage
0 = No	132	25.8
1 = Yes	380	74.2
Total	512	100.0

Table 8: Frequency of the independent variable AUDIT

	Frequency all sample	Percentage
0 = Non Audited	12	2.3
1 = Board of Statutory Audit	306	59.8
2 = Single independent auditor	11	2.1
3 = Non Big Four	45	8.8
4 = Big Four	138	27.0
Total	512	100.0

Table 9: Frequency of the independent variable INDUSTRY

	Frequency all sample	Percentage
1 = 0 to 10	--	--
2 = from 11 to 17	14	2.7
3 = from 21 to 40	222	43.4
4 = from 41 to 50	61	11.9
5 = from 51 to 59	124	24.2
6 = from 69 to 90	91	17.8
Total	512	100,0

The descriptive statistics show that the firms have the legal form of company (47.9% of IAS/IFRS) and the 74.2% of them have at least a foreign shareholder. Besides, only the 27% of the firms have their financial statements audited by a BIG 4 Audit company. Finally, the 43.4% of the firms of the sample belongs to the SIC code (two digit) from 21 to 40 (Manufacturer) and the 24.2% to the SIC code from 51 to 59 (Wholesale and retail trading).

#### Regression results (Full sample BLR)

Before starting with the regression analysis, we provide finding of the inexistence of multicollinearity (MC) among the independent variables of the model. To intercept cases of MC we perform the analysis for Tolerance and VIF (Variance Inflation Factor). Since these values do not exceed 2 for any independent variable, we conclude that multicollinearity does not present a problem in our analysis.

*Table 10: Tolerance' and VIF' results*

<i>Variables</i>	<i>Tolerance</i>	<i>VIF</i>
<i>Constant</i>	-	-
<i>LEGFORM</i>	.921	1.086
<i>SIZE</i>	.543	1.841
<i>FSHAR</i>	.978	1.022
<i>FREV</i>	.878	1.138
<i>AUDIT</i>	.562	1.781
<i>LEVERAGE</i>	.988	1.012
<i>INDUSTRY</i>	.885	1.130

The VIF and Tolerance findings show that among the independent variables (Table 11) there is not Multicollinearity and all them could explain the model (voluntary adoption of the IAS/IFRS by the private firms). The finding is support by the consideration that four out of seven independent variables are categorical.

In table 11 the Spearman Correlation Matrix.

Table 11: (Rho) Spearman Correlation Matrix (2-Tailed)

		LEGFORM	SIZE	FSHAR	FOREV	AUDIT	LEV	IND
LEGFORM	Correlation coefficient	1.000	<b>.261**</b>	.061	.064	<b>.201**</b>	<b>.118**</b>	-.071
	Sig. (2-Tailed)	.	.000	.167	.149	.000	.008	.109
	Obs.	514	514	514	514	514	514	514
SIZE	Correlation coefficient	<b>.261**</b>	1.000	.010	.057	<b>.671**</b>	.058	-.042
	Sig. (2-Tailed)	.000	.	.829	.199	.000	.189	.349
	Obs.	512	512	512	512	512	512	512
FSHAR	Correlation coefficient	.061	.010	1.000	<b>.150**</b>	-.022	-.068	-.034
	Sig. 2-Tailed)	.167	.829	.	.001	.615	.123	.437
	Obs.	512	512	512	512	512	512	512
FREV	Correlation coefficient	.064	.057	<b>.150**</b>	1.000	.018	.034	<b>-.341**</b>
	Sig. (2-Tailed)	.149	.199	.001	.	.688	.440	.000
	Obs.	512	512	512	512	512	512	512
AUDIT	Correlation coefficient	<b>.201**</b>	<b>.671**</b>	-.022	.018	1.000	<b>.131**</b>	.008
	Sig. (2-Tailed)	.000	.000	.615	.688	.	.003	.849
	Obs.	512	512	512	512	512	512	512
LEV	Correlation coefficient	<b>.118**</b>	.058	-.068	.034	<b>.131**</b>	1.000	-.044
	Sig. (2-Tailed)	.008	.189	.123	.440	.003	.	.326
	Obs.	512	512	512	512	512	512	512
IND	Correlation coefficient	-.071	-.042	-.034	<b>-.341**</b>	.008	-.044	1.000
	Sig. (2-Tailed)	.109	.349	.437	.000	.849	.326	.
	Obs.	512	512	512	512	512	512	512

This table provides the Spearman (Rho) correlation matrix for the explanatory variables. Values indicated in bold show statistically significant relationship between variables. \*\* indicates statistical significance at less than 1% levels (two-tailed).

LEGALFORM = legal form of the firms; SIZE = the natural logarithm of the annual turnaround; FOREIGNSHA = foreign shareholder; FOREIGNREV = foreign revenue; AUDIT = the form of audit choice by the firm (0 = not audited; 1 = audited by Board of Statutory Audit; 2 = audited by an independent external single auditor; 3 = audited by NON BIG FOUR Audit company; 4 = Audited by a BIG FOR Audit company); LEVERAGE = financial debts/Equity; INDUSTRY = dummy variable.

Tables 12 and 13 reports the result of the first regression analysis that include only the constant.

Table 12: Binary Logistic Regression analysis including only the constant

Classification Table <sup>1,2</sup>					
			Predicted		
			IFRS		Percentage Correct
			Observed	NON IAS/IFRS	
Step 0	IFRS	NON IAS/IFRS	389	0	100.0
		IAS/IFRS	123	0	.0
	Overall Percentage				76.0
1. Constant is included in the model.					
2. The cut value is ,500					

Table 12 reports that the 76.0% (overall percentage) of the observations are correctly classified with a single model with the intercept (hence, a model that considers all the firms as non adopters of IAS/IFRS). Table 13 reports the results of estimating equation including only the constant. We find a negative coefficient of the constant (p-value .000).

Table 13: Binary Logistic Regression analysis: variables in the equation (only the constant)

		Variables in the Equation					
		B	S.E.	Wald	df	Sig.	Exp(B)
Step 0	Constant	-1.151	.103	123.889	1	.000	.316

Then, we include in the Binary Logit Regression model all the independent variables (tables 14 and 15).

Table 14 shows that the 88.1% (overall percentage) of the observations are correctly classified with a model including all the independent variables (covariates). In this circumstance, the model including all the independent variables (table 14) improve the predictability of the model used in the analysis.

Table 15 reports the results of estimating equation with which we test the seven null hypotheses. This model assesses the importance of the explanatory variables we isolate in according to previous studies in explaining the voluntary choice of IAS/IFRS. In table 16 we report: the -2 Log likelihood; the Cox & Snell R<sup>2</sup>, the Nagelkerke R<sup>2</sup> and the statistical significance of the binary LOGIT model. Finally, we report the Hosmer and Lemershow Test for the model.

In the analysis, we consider the variable Audit and the variable Industry as categorical variables. The Confidence Interval we choice for the regression analysis is the 95%.

Table 14: The Binary Logistic Regression analysis including all the independent variables

Classification Table <sup>a</sup>					
			Predicted		
			IFRS		Percentage Correct
			NON IAS/IFRS	IAS/IFRS	
Observed					
Step 1	IFRS	NON	362	27	93.1
		IAS/IFRS			
		IAS/IFRS	34	89	72.4
	Overall Percentage				88,1
a. The cut value is ,500					

Table 15: Binary Logistic regression results ( $\alpha = 0.05$ )

Variable	Expected sign	B	S.E.	Wald	df	Sig. (p-value)	Exp(B)
SIZE	+	.166	.123	1.816	1	.178	1.180
LEVERAGE	+	.007	.018	.147	1	.701	1.007
FSHAR	+	3.546	.315	126.627	1	.000	34.677
FREV	+	-.441	.533	.683	1	.408	.643
LEGFORM (1)	+	-.585	.317	3.401	1	.065	.557
AUDIT : 4	+			9.363	4	.041	
AUDIT(1): 0	-	-2.042	.980	4.344	1	.037	.130
AUDIT(2): 1	-	-2.779	1.669	2.773	1	.096	.062
AUDIT(3): 2	-	-1.159	1.059	1.199	1	.273	.314
AUDIT(4): 3	-	-1.261	1.082	1.358	1	.244	.283
INDUSTRY: SIC 6	none			13.113	4	.011	
INDUSTRY(1): SIC 2	none	1.016	.793	1.641	1	.200	2.763
INDUSTRY(2): SIC 3	none	-.342	.412	.691	1	.406	.710
INDUSTRY(3): SIC 4	none	-.471	.508	.857	1	.355	.625
INDUSTRY(4): SIC 5	none	-1.548	.512	9.151	1	.002	.213
Constant		-1.836	1.453	1.595	1	.207	.160
- 2 log likelihood				325.133	Hosmer-Lemeshow test:		
Cox and Snell R <sup>2</sup>				.374	Chi-square		9.370
Nagelkerke R <sup>2</sup>				.559	Sig (df= 8)		.312

Finally, in table 16 we report the correlation matrix between the independent variables.

Table 16: Correlation matrix

	LEG										IND	IND	IND	IND
	ALF			FOR	FRE					LEVE	UST	UST	UST	UST
	Const	ORM		SHA	VEN	AUD	AUD	AUD	AUD	RAG	RY(1	RY(2	RY(3	RY(4
	ant	(1)	SIZE	R(1)	UE	IT(1)	IT(2)	IT(3)	IT(4)	E	)	)	)	)
Constant	1,000	-,303	-,727	-,154	-,031	-,496	-,288	-,469	-,275	-,127	-,142	-,041	-,022	-,064
LEGALFO	-,303	1,000	-,158	-,215	-,028	-,132	-,116	-,150	-,126	-,099	-,026	-,029	-,010	-,110
RM														
SIZE	-,727	-,158	1,000	-,153	-,053	-,170	-,135	-,157	-,407	-,082	-,106	-,115	-,161	-,231
FORSHAR	-,154	-,215	-,153	1,000	-,058	-,109	-,083	-,056	-,074	-,053	-,101	-,011	-,128	-,064
FREVENU	-,031	-,028	-,053	-,058	1,000	-,060	-,067	-,032	-,062	-,118	-,019	-,315	-,012	-,026
E														
AUDIT(1)	-,496	-,132	-,170	-,109	-,060	1,000	-,567	-,889	-,914	-,091	-,082	-,044	-,056	-,022
AUDIT(2)	-,288	-,116	-,135	-,083	-,067	-,567	1,000	-,526	-,550	-,049	-,011	-,090	-,117	-,051
AUDIT(3)	-,469	-,150	-,157	-,056	-,032	-,889	-,526	1,000	-,853	-,092	-,056	-,050	-,043	-,014
AUDIT(4)	-,275	-,126	-,407	-,074	-,062	-,914	-,550	-,853	1,000	-,081	-,062	-,034	-,049	-,023
LEVERAG	-,127	-,099	-,082	-,053	-,118	-,091	-,049	-,092	-,081	1,000	-,084	-,066	-,085	-,035
E														
INDUSTR	-,142	-,026	-,106	-,101	-,019	-,082	-,011	-,056	-,062	-,084	1,000	-,296	-,223	-,204
Y(1)														
INDUSTR	-,041	-,029	-,115	-,011	-,315	-,044	-,090	-,050	-,034	-,066	-,296	1,000	-,514	-,522
Y(2)														
INDUSTR	-,022	-,010	-,161	-,128	-,012	-,056	-,117	-,043	-,049	-,085	-,223	-,514	1,000	-,448
Y(3)														
INDUSTR	-,064	-,110	-,231	-,064	-,026	-,022	-,051	-,014	-,023	-,035	-,204	-,522	-,448	1,000
Y(4)														

*et al.* (2008) investigate the reasons of IAS/IFRS adoption by small and medium-sized private firms from 56 countries.

Conversely, Cameran and Campa (2010), using archival data, explore the determinant of the voluntary adoption of the IAS/IFRS by the Italian private firms. They select two-paired sample of firms that adopt voluntarily/non adopt the IAS/IFRS. Unlike Francis *et al.* (2008) the Scholars do not utilize the regression analysis to determine the statistical importance of the factors influencing the voluntary adoption of IAS/IFRS by private firms.

The studies mentioned above stated that size, leverage, foreign shareholder can explain the voluntary adoption of the IAS/IFRS by the private firms (the dependent variable – adoption/non adoption of IAS/IFRS – is associated with the independent variable – the determinants).

In this work we have extended the studies of Francis *et al.* (2008) and Cameran and Campa (2010).

In according with the Positive Accounting Theory and prior literature (concerning public firms in the preparation of the consolidate financial statements) we also argue that explanatory variables like size (measured, however, by the turnover), leverage, foreign shareholder, the character of the financial audit body and industry-type could explain and predict the voluntary adoption of the IAS/IFRS also by the Italian private firms.

Our work differs from prior studies (Francis *et al.*, 2008 and Cameran and Campa, 2010) because we hypothesize that the voluntary adoption of IAS/IFRS is influenced by the presence of a BIG 4 Audit Company in charge of the financial audit function.

The adaptability of the model does not appear very high (Cox and Snell R<sup>2</sup>: 37.4%; Nagelkerke R<sup>2</sup>: 55.9%) but it seems statistically significant.

We performed the regression analysis for each group of firms (adopt/non adopt IAS/IFRS) and the results, partially consistent with prior literature (Francis *et al.* 2008; Cameran and Campa, 2010), confirm only partially our hypotheses (Confidence Level of the analysis: .05) as stated below:

H0<sub>1</sub>: The voluntary adoption of IAS/IFRS is positively associated with firm' **size** (*p-value*: .178). As the *p-value* > .05 the null hypothesis should not be rejected. This means that the firm's size could influence the voluntary adoption of IAS/IFRS.

H0<sub>2</sub>: The voluntary adoption of IAS/IFRS is positively associated with firm **leverage** (*p-value*: .701). As the *p-value* > .05 the null hypothesis should not be rejected. This means that the degree of the leverage could influence the voluntary adoption of IAS/IFRS. Probably, this still means that firms with a high level of leverage improve the quality of their financial statements to facilitate the bank' loan;



H0<sub>3</sub>: The voluntary adoption of IAS/IFRS is positively associated with the presence of a **foreign shareholder** (*p-value*: .000). As the *p-value* < .05 the null hypothesis may be rejected. This means that the presence of the foreign shareholder couldn't influence the voluntary adoption of IAS/IFRS;

H0<sub>4</sub>: The voluntary adoption of IAS/IFRS, in contrast with our hypothesis, is *negatively* associated with the presence of **export sales** (*p-value*: .408). As the *p-value* > .05 the null hypothesis should not be rejected. This means that the export sales could influence the voluntary adoption of IAS/IFRS but with opposite effect;

H0<sub>5</sub>: The voluntary adoption of IAS/IFRS is *negatively* associated with the **legal form** of the firms (*p-value*: .065). As the *p-value* > .05 the null hypothesis couldn't be rejected. This means that the legal form of the firm could influence the voluntary adoption of IAS/IFRS but with opposite effect;

H0<sub>6</sub>: The voluntary adoption of IAS/IFRS is positively associated with the presence of a **BIG 4** Audit Company (and negatively associated with the presence of the other auditor or in absence of the financial audit function). AUDIT is a categorical variable that assume value 0 if the firm is not audited; value 1 if the firm is audited by the Board of Statutory Audit; the value 2 if the firm is audited by an external independent single auditor; the value 3 if the firm is audited by a NON BIG 4 Audit Company and, finally, the value 4 if the firm is audited by a BIG 4 Audit company. So, in SPSS the last value (4) is fixed as a reference variable and its constant conventionally assumes value 1 (SPSS do not report this value in the table 16) and *p-value* = .041. The constant and the *p-value* of the other forms of auditing are compared with this audit type. So these individual coefficients and *p-values* are meaningful only when they are compared with the reference variable (AUDIT = 4) and not with the regression model. Given that, the table 16 shows that the sub-hypothesis HP<sub>6.1</sub> (AUDIT = 0), HP<sub>6.2</sub> (AUDIT = 1), HP<sub>6.3</sub> (AUDIT = 2), HP<sub>6.4</sub> (AUDIT = 3) have negative coefficient (compared to the reference variable, AUDIT = 4). This means that in contrast with our hypothesis, the presence of the financial audit function is negatively associated to the voluntary adoption of IAS/IFRS. The *p-value* is statistically significant (*p-value* < .05) in AUDIT = 0 (.037) and statistically not significant in AUDIT 1 (.096), in AUDIT 2 (.273) and in AUDIT 3 (.244). These findings could be interpreted as a moderate evidence to reject the hypothesis HP<sub>6</sub> (*p-value* .041). Probably, this means that the presence of an auditor do not influences the voluntary adoption of IAS/IFRS by private firms.

The table 16 reports the association by the accounting choice of the firms (IAS/IFRS versus. NON IAS/IFRS) and the appointment of the body of financial audit.

Table 16: Association by firm' accounting choice and audit body

Type of audit	Accounting choice			
	IAS/IFRS=0	%	IAS/IFRS=1	%
0	5	41,67%	7	58,33%
1	251	82,03%	55	17,97%
2	10	90,91%	1	9,09%
3	30	65,22%	16	34,78%
4	93	67,88%	44	32,12%
Total	389		123	

As concern the influence of the industry-type, we consider the association between the accounting choice (IAS/IFRS-NON IAS/IFRS) with the industry sector to which the firms belong. Industry-type (IND) is a categorical variable that assume value 2, 3, 4, 5 and 6 corresponding to the different sector identified by the SIC code. So, in SPSS the last value (6) is fixed as a reference variable and its constant conventionally assumes value 1 and  $p$ -value = .011. The constant and the  $p$ -value of the other form of auditing are compared with this reference value. So these individual coefficients and the  $p$ -value are meaningful only when they are compared with the reference variable (IND = 6, SIC Code from 69 to 90) and not with the regression model. We note a relative direct association by the accounting choice of the IAS/IFRS and the IND 2 (SIC Code from 11 to 17) and a  $p$ -value statistically not significant (0.200). IND code 3 (SIC from 21 to 40), 4 (SIC code from 41 to 50) and 5 (SIC Code from 51 to 59) have negative coefficient (compared to the reference variable, IND = 6). The  $p$ -value is statistically not significant in IND = 3 (.406) and in IND = 4 ( $p$ -value .355) and statistically significant in IND = 5 ( $p$ -value .002). This result could be interpreted as a confirmation of the hypothesis HP<sub>7</sub> ( $p$ -value .011). Table 17 reports the association by the accounting choice of the firms (IAS/IFRS vs. NON IAS/IFRS) and the SIC sector to which the firm belong.

Table 17: Association by firm' accounting choice and SIC sector

SIC sector	Accounting choice			
	IAS/IFRS=0	%	IAS/IFRS=1	%
2	8	57,14%	6	42,86%
3	174	77,68%	50	22,32%
4	37	60,66%	24	39,34%
5	110	90,16%	12	9,84%
6	60	65,93%	31	34,07%
Total	389		123	

Given that, in conclusion we find that our hypotheses are partially confirmed by the analysis (BLR). The firm's size, the degree of the financial debt (scaled to the net equity), the legal form, the export sales (even if the sign of the regression is negative) are more important and influence the voluntary adoption of the IAS/IFRS by the Italian private firms. Conversely, it seems that the presence of the foreign shareholders (at least one) and the presence of an auditor (Board of Statutory Audit, BIG 4, Non BIG 4, single auditor) seem do not influence significantly IAS/IFRS by the Italian private firms. Finally, the firms of the sample are distributed between the different industry-type as shown in Table 17. The table shows that the firms belonging to the SIC sector code 5 are less likely to adopt voluntarily IAS/IFRS than the firms belonging to other industry sectors. At the same time, we can note also that there are no significant differences for firms in the other sectors.

### Limits of the analysis

The model we use in this first analysis does not seem to explain very well the voluntary adoption of the IAS/IFRS by the Italian private firms. Probably, one of the reasons is that, in 2009, Italian private firms have not yet chosen to adopt voluntarily the IAS/IFRS (the law that gives the option to adopt voluntarily the IAS/IFRS is dated 2005). So, in next step of the research, we think to improve the model considering the year 2010 as soon as it is available on AIDA Database.

Finally, our study could be improved considering the years beyond the 2009 for monitoring if all firms continue to use IAS/IFRS also in the future or they downgrade to the domestic accounting standard.

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## **IP MULTIMEDIA SUBSYSTEM AND INTERACTIVE BROADCASTING CONVERGENCE: A NOVEL APPROACH ADOPTED IN INTERACTIVE MARKETING**

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### **Abstract**

Interactive broadcasting elaborates on the study and realization of novel television networks, able to provide multiple interactive multimedia and Internet based services, utilizing Digital Video Broadcasting advances. On the other hand, IP Multimedia Subsystem (IMS) is a promising solution, that may be adopted in next generation networks and broadcasting systems, providing advanced capabilities and added value data services. In this context, this paper investigates interactive broadcasting systems and IMS convergence and proposes a novel research approach, which could be adopted in interactive marketing, enabling for a more efficient process of collecting and analyzing feedback data from users/viewers. This process may be vital for optimum marketing and advertising purposes. This potential information data may be used to target customers in more efficient and effective ways, i.e. geographical segmentation, increasing the possibility of impulse sells through t-commerce or allow audience to require more information for a company, brand or product, enhancing the experience a customer have with specific brands.

**Keywords:** Interactive Marketing, Interactive Broadcasting, IP Multimedia Subsystem

### **Introduction**

Interactive communication is vital in marketing, enabling the real needs of customers/users to be successfully met. Traditionally, enterprises try to maintain contact with customers/users via phone, emails and Internet based networks. Nowadays, sophisticated advances may be the mean, enabling for a vital interactive contact between the enterprise and its customers. In order for a



more efficient cooperation and relationship to occur between these two parties, a first part of an IT strategy in an enterprise, is to integrate business systems using a common interface, so that customers can interact and report back directly their needs. The second component of this strategy is a database analysis. The results may define the basis for models aimed at understanding the real customers' needs. In this context, advances in interactive broadcasting systems (Crinon et al., 2006), IP Multimedia Subsystem (IMS) (Camarillo et al., 2007), web technologies and their convergence could contribute efficiently towards optimizing the process of collecting and analyzing data, useful in interactive marketing (Barwise and Farley, 2005).

Interactive marketing enables customers' collaboration utilizing a digital media and allows a company to use direct response communication in order to build a relationship with them. In a general context, long-term communication strategies should be planned carefully, otherwise the client can develop a negative view of the company. For instance, if a company has come into contact very often with the clients with no real purpose, the customers will likely ignore the notices in the future, when the company needs to communicate with them. In order to avoid this, potential customers are asked for feedback regularly. Despite the promotion of risks taken by companies, they wish to have great opportunities to promote their products to individual customers. Some companies' websites utilize already «call back» images giving the opportunity for customers to contact them. Such information can be delivered directly to the company through fast and easy to complete research or through an independent third party.

Moreover, interactive broadcasting elaborates on the realization of novel television networks, able to provide multiple interactive multimedia and Internet services utilizing Digital Video Broadcasting (DVB) advances (Reimers, 2006). The first existing networking architectures based on interactive broadcasting enabled the provision of IP datacasting offering offline interactivity (Linder et al., 2000; Kellerer et al., 2000). According to these infrastructures, a large volume of data is pushed with constant bit rate to the end user's terminals through DVB channels (Reimers, 2006) with a repeated process (data carousel). Data is then received offline by the end user via a graphic interface. There is no real interactivity in such systems, since the end user is not able to request for real time services (e.g. Internet based services) and to provide his own services due to lack of an interaction channel. The utilization of an interaction channel according to the generic interactivity model (ETSI, 1997), was essential in order to transfer end user's requests to the service provider, enabling for the provision of real interactive services (Gardikis, 2004).

Furthermore, the IP Multimedia Subsystem (IMS) (Poikselka and Mayer, 2009) is considered as a promising solution to fulfill a number of requirements in next generation networks and broadcasting systems. IMS refers to a functional architecture for providing multimedia services based on Internet Protocols (Bertrand, 2007). The goal is to merge Internet technologies and wireless networks, to enable rich multimedia communications as well as a number of other

functionalities. The first version of IMS was focused on facilitating the development and deployment of new services in mobile networks. It was later extended by the European Telecommunications Standards Institute (ETSI) (Sultan, 2009), including utilization in Next Generation Networks (i.e. NGN). A standardization body of ETSI, namely the Telecommunications and Internet converged Services and Protocols for Advanced Networking (i.e. TISPAN) standardized a subsystem of IMS, regarding NGN.

In this context, this paper studies the convergence of interactive broadcasting systems with IMS and proposes a novel research rationale, which could be utilized in interactive marketing, towards a more efficient process of collecting and analyzing feedback results from potential users/viewers of an interactive television enterprise. Following this introductory section the rest of the paper is as follows: Next section analyzes interactive marketing and investigates interactive broadcasting advances. Also, last two sections elaborate on IMS and finally conclude this paper respectively, by indicating research contributions.

### **Interactive Marketing and Digital Video Broadcasting**

The overall target of interactive marketing is to enable advertisers to target customers' needs more successfully. Towards this scope, a number of advances/developments have been achieved, that may change the role of advertising on television in the future. Currently, viewers are invited to move to a more interactive world of television or are invited to visit a Web address or call a phone number. This means that the signals from the enterprises may become more personalized and interactive with their customers. The most of the features of the media are not able to achieve this personalization. However, they encourage viewers to participate in more reactive, interactive or personalized channels. They are able to ensure, that such disclosures would be consumed by interested customers.

Other communications with customers are dynamic including, that digital or physical location of a person is enough to achieve communication. Digital communication can be identified when a person has visited a page and this information is able to be used in order to find out what viewers are now interested. In a general context, interactive marketing systems were developed to such an extent, that allow large companies to achieve the best possible relationship with their customers, offering numerous choices to meet their needs (Chaffey and Smith, 2008).

More familiar with the TV concept and without the need of being an IT expert, the audience has the ability to interact easily with the concept and content of iDTV (Lee and Lee, 1995). This interaction is mostly concerned with shopping, browsing through VOD and advertising concepts, banking, gambling, playing games sponsored by brands, participating instantly to broadcasting programmes like voting or expressing their opinions as members of a community, completing questionnaire and chatting. Text information services, e-mail (with IPTV) and offline contact

options are available to users /viewers to communicate with other viewers (i.e. dating) or companies, and they also present a good way to advertisers to count the impact of their campaign as they get the permission “contact me” from the user.

It is very important to create an interactive community and target this niche market with new forms of advertisements like microsites, logos / banners or websites’ illustration on screen or Dedicated Advertising Location (DAL, mini-DAL) formats that enable impulse response to direct marketing promotional material like coupons, samples or brochures. Furthermore, the old forms of advertising like product placements in programmes, sponsoring, virtual advertising, on-screen banner advertisement during programs (with the option to bookmark and expose to them with a lag), and advertainment (a program totally made by an advertiser) or long commercials on demand are also essential to increase brand awareness of a product and improve costumers’ experience with a brand (Boddy, 2004; Deighton and Blattberg, 1991; Deighton and Barwise, 2000; Smilansky, 2009; McDonald and Wilson 2002;).

People using the TV box-set as a mean to calm and relax which is usually arouse their emotions. For them its interaction aspect is not only a convenient and instant way of buying or responding to a promotional or informational content, it lets them to have the sense of control in marketers’ “beleaguerment” which take place in traditional media (Stewart, 2004). On the other hand, the emerged data of personal and household interests gives to marketers a significant amount of advantages to turn in account such as direct response to mass market advertising, highly accuracy to targeted audiences according to the ad – hoc strategy of the company, access to those who adopt an impulse decision making process to complete instantly their buying, increase the engagement of viewers, building positive brand image and enhance the brand’s world of mouth impact in the formed community, reformulate an ineffective advertising strategy by measuring the achieved goals, offer better promotional and customer service in a “walled-garden” platform (as TV is perceived) in contrast to websites and finally they are allowing to manage the primary objective of better money allocation avoiding the waste of money on disinterest viewers or improper contents (Chaffey and Smith, 2008). Nevertheless, advertisers seem to be mistrustful against these opportunities mainly due to audience unfamiliarity with them, the lack of their technology experience and the high cost these new advertising forms are presented (Cauberge and De Pelsmacker, 2006).

Additionally, interactive DVB systems may enable end users to interact with service provider by utilizing interactivity channels established between customers’ premises and the broadcasting system. More specifically, interactive DVB-T (i.e. terrestrial systems) networking architectures (Xilouris *et al.*, 2002) have been realized based on a generic interactivity model, enabling for the provision of asymmetric data transfer among the service provider and the end users. In such cases, DVB-T channel provides forward data traffic, while reverse data traffic is transferred

through several interaction channels (e.g. PSTN, ISDN, DECT, GSM, GPRS, UMTS, xDSL, LMDS, MMDS) (Gardikis *et al.*, 2002; Gardikis *et al.*, 2003). According to these configurations, the service provider's side may incorporate both an interactive service provider and a broadcast one. The former may enable access to interactive multimedia services such as video and audio on demand or may provide Internet facilities such as WWW access, e-mail services etc. The latter is responsible for the distribution of broadcast services, such as TV programmes, that utilize digital transmission formats (i.e. MPEG-2). Both interactive and broadcast services are multiplexed into one transmission stream and distributed to the users via the broadcasting delivery media according to the DVB-T standard. Each user receives the multiplexed broadcasts via a broadcast interface module (e.g. antenna, front-end amplifier etc.) that passes the appropriate data to an end user module (TV receiver, PC screen, PC station etc.) via a Set Top Unit (de-multiplexer, decoder etc.). The user's requests for interactive services are forwarded by the Set Top Unit to an interactive interface module that may utilize wired or wireless access technology depending on the interaction media's specifications. The interaction media, in turn, passes the user's requests to the integrated service provider via the interactive network adapter that forwards them to the interactive service provider.

An interactive DVB-T system may be also utilized to provide interactive services to mobile users. UMTS Forum and DVB-UMTS Ad-Hoc Groups define proposals and reports studying interactivity among DVB-T and UMTS for the provision of broadband interactive multimedia and networking services (Cosmas *et al.*, 2002). Alternative solutions for the return channel in an interactive DVB system may utilize LMDS or DVB-RCT (Faria and Scalise, 2001) in order to support interactivity to fixed users. Further GPRS has also been proposed to be utilized together with broadcasting networks (Rauch *et al.*, 2001).

### **IP Multimedia Subsystem (IMS)**

While the first generation of the Internet was mainly devoted to the transfer of data to non-real time services, sophisticated systems and new services now require interactivity and strict Quality of Service (QoS). Moreover, the requirements for the provision of multimedia services are expected to increase in coming years. The move towards an all IP architecture for services and applications appears to be a strong trend. In this context, customers seem to wish access to personalized interactive multimedia services on any device, anywhere. This trend introduces new requirements for a network infrastructure.

Towards fulfilling this requirement, the IP Multimedia Subsystem (IMS) was originally defined by the 3GPP and 3GPP2 wireless operators working bodies. The main focus was to provide a new mobile network architecture that enables convergence of data, voice and technology in a mobile network over an IP-based network infrastructure (Kinder, 2006). The IMS was designed to bridge

the gap between existing traditional telecommunications technologies and Internet technology and support operators to offer new and innovative services that will attract new subscribers and maintain its existing base.

IMS is a core network architecture that enables communication between servers and clients using open standards that support IP network interfaces and fixed-mobile convergence. IMS consists of a layered and integrated architecture that manages the media as it moves through the network and provides the systems integration required to provide any IP multimedia services for and between any combination of wired and wireless end users. The core network contains reusable functions that manage media services in application servers. Application servers host the services and IMS defines monitoring services, routing, protocols, and the loading processes across the network. The development of the IMS framework defines how services connect and communicate with the underlying telecommunications network. IMS also defines how services are integrated with the provider of systems back-end (IP Unity, 2005).

One aim of IMS is to make the network management easier. Therefore, it separates control and bearer functions. This means that IMS features an overlay service delivery network on top of a packet switched infrastructure. Moreover, IMS should allow the migration of Circuit Switched services like voice telephony to the Packet Switched domain. As a result, IMS should lead to network administration savings, because an all-IP integrated network is easier to manage. IMS is an end-to-end architecture that must support several kinds of equipment. In addition, IMS is intended to be “access agnostic”, which means that service delivery should be independent of the underlying access technology. Thus, the use of open Internet Protocols is specified in IMS for better interoperability. The level of QoS that can be provided in IMS networks determines the services that can be deployed in such networks. QoS delivery is therefore critical in IMS networks. As a result, QoS management functionalities are integrated in the IMS architecture (Bertrand, 2007).

Today's telecom users are increasingly demanding. They are more individualistic, independent, informed and involved than ever before, and they welcome services that appeal to their emotions as well as their practical needs. New, exciting services and enhancements to existing services have a key role to play in making the communications experience much more like interacting face-to-face. New advanced terminals and communication mechanisms adapted for user needs will enable this and hide technical complexity (Ericsson, 2004). Users are now used to access information, entertainment and other content-rich services through a variety of channels. Telecom operators have a great opportunity to integrate and extend the multimedia experience through new highly personalized person-to-person, person-to-content and group services. The widespread adoption of mobile telephony, SMS and Instant Messaging shows how readily users adopt services that fulfill an emotional need to communicate in a variety of ways.

Commercially available IMS services are still in their infancy and providers are working on the implementation of IMS in both network's and user's side. As usually, implementations may face interoperability issues since the IMS specification is flexible to allow differentiation, as stated in. In particular, QoS solutions are not enforced by the specification, although QoS requirements are well defined. Other non technical challenges include defining the business model. As IMS enables the provision of commercial services by the operator and third parties, another challenge is defining billing schemes for charging services, as the value chain and impact on final services' price have to be determined. Operators are likely to create an "IMS broker", interconnecting operators and third-party service providers via SLAs (Service Level Agreements), so agreements would only take part between the IMS broker and each operator and service provider, simplifying the commercial scenario.

However, the success of IMS or any other convergence enabler technology depends on the provision of value-added services that take advantage of all the core services it provides (presence information, session transfer, QoS, etc.). Currently, all the IMS services planned are ports of existent services like the voice service, walkie-talkie ("Push To Talk"), presence and instant messaging, etc. thus not showing the advantages of the convergence yet. Maybe new highly interactive multiuser multimedia applications like online gaming and collaborative work will unleash the power of IMS.

## Conclusion

This paper investigates novel interactive broadcasting systems, able to provide multiple interactive multimedia and Internet based services utilizing Digital Video Broadcasting advances. Additionally, it elaborates on the study of IP Multimedia Subsystem (IMS) as a promising solution, that may be adopted in next generation networks and broadcasting systems, providing advanced capabilities and added value data services. Taking into account the advances in both research fields, it proposes the convergence of interactive broadcasting systems with IMS, which may result to a novel research paradigm, able to be adopted in interactive marketing field. The proposed concept may enable for a more efficient process of collecting and analyzing feedback data from users/viewers, which is vital for optimum marketing purposes. It might be the answer to the one of the top priorities in the marketers' wishing list; to move forward to one to one marketing communication with the desired audience, gain their attention and interest, create their desire and end in the covetable impulse or well thought-out action of buying.

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## UKRAINIAN ENTREPRENEURSHIP IN CASERTA: AN EMPIRICAL INVESTIGATION

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### **Abstract**

The main aim of the present work is to investigate which approach is made by Ukrainians entrepreneurs to launch ethnic ventures in Caserta city.

Four factors are relevant in reference to ethnic ventures: sources of funding, nationality of employees, of suppliers and of consumers. They can be affected by the socio-cultural aspects of the origin country or by the socio-economic context in the destination country. According to the influence exercised on the four factors, it is possible to derive and frame four main approaches to ethnic entrepreneurship: supply-based, demand-based, mix-based and vacancy-chain.

A sample of forty-two Ukrainian entrepreneurs in the Caserta Region was asked to fill in a questionnaire and the results are presented and discussed in the last part of the work.

### **Introduction**

According to data provided by Unioncamere (Infocamere) and referred to 2008, ethnic entrepreneurship in Italy involves nearly 300.000 immigrants: 165.114 are entrepreneurs; the remaining ones are partners with different roles.

According to estimations included in the *Sedicesimo Rapporto sulle Migrazioni 2010* provided by Fondazione ISMU, this phenomenon is growing up constantly. Despite political and normative reasons at the basis of the phenomenon, there is still so much to inquire about origins of ethnic entrepreneurship. This is the reason why the main goal of the present work is to propose different approaches made by ethnic entrepreneurs in order to launch a new venture and, then, to analyze some cases. Actually, the present work is just a part of a bigger research project aiming to compare Ukrainians, Brazilians and Senegalese entrepreneurs in the Caserta city. Surveys are still ongoing, so by now the results just deal with Ukrainians entrepreneurs in Caserta.

In the next section, attention is focused on the factors determining the launch of a new venture: sources of funding, nationality of employees, of suppliers and of consumers. By considering that these factors can be affected by the socio-cultural aspects of the origin country or by the socio-economic context in the destination country, four different approaches to entrepreneurship are going to be explained and framed (the supply-based, the demand-based, the mix-based and the

vacancy-chain approach). In the last part of the paper, the results of an empirical research, about the Ukrainians in the Caserta Region, will be presented and discussed.

### **Factors to inquire**

Ethnic entrepreneurship in Italy seems to be more similar to self-employment than to entrepreneurial activity properly meant (Codagnone, 2003). It derives that some factors, which are usually considered when talking of new ventures (R&D, innovation, and strategic management), are excluded. Consequently, attention moves towards other factors that are at the basis of ethnic ventures:

- Financiers;
- Employees;
- Suppliers;
- Consumers.

Financiers. Sources of capital to invest can be divided into two main groups. If capital consists of savings (by the entrepreneurs themselves or by their relatives) or loans by members of the ethnic group, ethnic aspects are determinant for the new entrepreneurship. On the contrary, if local banks or special projects to foster immigrants' involvement in entrepreneurship (for example European projects) can guarantee loans to ethnic entrepreneurs, then the entrepreneurial aspects are determinant.

Employees. The choice to assume employees of the same ethnic group, sharing the same culture and value, underlines that ethnic aspects are determinant for ethnic entrepreneurship. By the choice to assume employees of the local group or even of another ethnic group, instead, entrepreneurial aspects become more relevant for the new venture.

Suppliers. By referring to suppliers of the same ethnic group, loyalty and trust are at the basis of economic exchange and, moreover, acquired resources are well known to the entrepreneur. On the contrary, by referring to suppliers out of the ethnic group, relationship is ruled by contractual aspects and ethnic entrepreneurs try to sell different products to consumers.

Consumers. The choice to sell products only to the ethnic group or even to the mainstream market is not arbitrary. In the first case, the ethnic aspects identify a niche market in which ethnic products can be easily sold since there is no or scarce competition. In the second, instead, competition is stronger and some risks are due to the competition with big players of the mainstream market.

## Ethnic Entrepreneurship

Interest about ethnic entrepreneurship can be dated back to the end of Eighties and the beginning of Nineties (Aldrich and Waldinger, 1990; Aldrich *et al.*, 1990; Waldinger *et al.*, 1990; Waldinger, 1989; Light and Bonacich, 1988).

Since then, some difficulties have emerged in order to define ethnic entrepreneurship (Drori *et al.*, 2009; Stiles and Galbraith, 2003; Ambrosini, 1999, 2001; Light and Gold, 2000; Teixeira, 1998). These difficulties are mainly due to the trial to mix entrepreneurial and ethnic aspects.

Some authors assume that ethnic aspects are more relevant than entrepreneurial ones. Volery (2007), for example, supports the idea that ethnic entrepreneurship strongly depends on the immigrants and on the ethnic group they belong to. According to Aldrich and Waldinger (1990) and Pécoud (2004) it is the ethnic origins of entrepreneurs to determine ethnic entrepreneurship; according to Waldinger (1995) and Cobas and DeOllos (1989) it is the ethnic network to be more relevant. Pécoud (2004), Razim and Langlois (1996), Aldrich *et al.* (1989), Sanders and Nee (1987) support the idea that localization gives an ethnic connotation to the ventures created by immigrants.

As an alternative, there are some authors who consider entrepreneurial aspects as determinant for ethnic entrepreneurship, more than ethnic aspects are. Masurel *et al.* (2002), for example, consider that ventures created by immigrants embody an ordinary example of the entrepreneurial phenomenon. Ethnic aspects, even if not questionable, are not so relevant to differentiate ethnic entrepreneurship.

Ethnic and entrepreneurial aspects, whether combined or excluding each other, stress the idea that ethnic entrepreneurship cannot focus on some aspects and exclude others.

## The theoretical framework

Choices about financiers, employees, suppliers and consumers can be “scarcely” or “strongly” affected by:

- Ethnic aspects: the socio-cultural aspects of the origin country;
- Entrepreneurial aspects: the socio-economic context in the destination country.

Beyond the classification between “opportunity” and “necessity” entrepreneurs (Chrysostome, 2010), four possible approaches to ethnic entrepreneurship are shown in Table N.1.

	<i>Strong influence of socio-economic context in the destination country</i>	<i>Scarce influence of socio-economic context in the destination country</i>
<i>Strong influence of socio-cultural aspects of the origin country</i>	<i>The mix-based approach</i> 1	<i>The supply-based approach</i> 2
<i>Scarce influence of socio-cultural aspects of the origin country</i>	4 <i>The demand-based approach</i>	3 <i>Vacancy Chain</i>

Table N. 1 - Four different approaches to ethnic entrepreneurship. Personal Elaboration.

**The supply-based approach.** Ethnic entrepreneurship can be the result of socio-cultural aspects typical of the origin country. By “socio-cultural aspects” it is generally meant the whole background (cultural, social, psychological and religious) that can foster the individual involvement in entrepreneurship.

This approach has been largely investigated in entrepreneurial literature and it has been developed according to different perspectives. A trend of studies focused on the economic capital to invest. To have some savings (Kim and Hurh, 1985) or to obtain credit by other members of the same ethnic group (Deakins, 1999; Lee, 1999; Lee et al., 1997; Deakins et al., 1997) strongly affect the creation of new ethnic ventures. Another trend of studies, instead, focused on human capital (Lee et al., 1997; Waldinger et al., 1990). Level of education, ability to speak other languages (Johnson, 2000), previous working or migration experiences to other countries (Basu, 1998) can affect immigrants’ choice to launch a new venture. Eventually, a different trend of studies focused on social capital (Perreault et al., 2007). Solidarity (Zhou, 2004; Portes and Zhou, 1992), trust (Van Delf et al., 2000; Kloosterman et al., 1998; Ram, 1994; Johannisson, 1993) and informal linkages (Guarnizo et al., 2003; Gold, 2001; Yoon, 1995) between members of the same ethnic group can determine new ethnic entrepreneurship.

The demand-based approach. The supply-based approach, based on the socio-cultural aspects of the origin country, has been strongly criticized since it seems to be a deterministic approach. The main critique, in fact, deals with the limited importance given to the external context in which immigrants live and, consequently, entrepreneurship takes place. According to Razin (2002), to study origins of ethnic entrepreneurship both constraints and opportunities typical of the socio-economic context in the destination country need to be considered.

Attention has always been paid on constraints but the possibility to obtain credit by local banks, the availability of local employees, and the chance to establish contacts with local suppliers are opportunities, offered by the local context, which cannot be ignored. Very

interesting studies have tried to point out the missing links with local socio-economic context (Daniels and Lever, 1996; Daniels, 1993, Sassen, 1991).

The mix-based approach. If both the socio-cultural aspects of the origin country and the socio-economic context in the destination country affect ethnic entrepreneurship, then it is possible to refer to the mix-based approach (Palidda, 2000; Waldinger *et al.*, 1990). A very interesting way to explain this approach is the reference to the theory of the *enclave economy* (Portes, 1995). *Enclaves* are sub-systems of the mainstream economy, referring to limited geographical parts, in which there is a very high density of ethnic ventures that are managed by immigrant entrepreneurs, employ immigrants and offer goods to consumers of the same ethnic group (Wang, 1999; Nee and Nee, 1986).

According to Zhou (2004), *enclave economy* is a peculiar case of ethnic entrepreneurship characterized by the co-ethnicity of members and by geographically limited space.

The mix-based approach has caused a noticeable approach in economic literature (Volery, 2007; Zhou, 2004; Kloosterman, 2003; Kloosterman and Rath, 2003, 2001; Kloosterman *et al.*, 1999; Basu, 1998; Peterson and Roquebert, 1993).

The vacancy-chain approach. The last approach, namely the vacancy chain approach, is due to a scarce influence exercised by the socio-cultural aspects of the origin country and by the socio-economic context in the destination country. It can be referred to the theory proposed by Bonacich (1972) about *middleman minorities*. They are groups of immigrants who are not oriented to a definitive settlement in the destination country but only to a temporary one. It derives that:

- *Middleman minorities* do not consider and evaluate all the opportunities offered by the socio-economic context in the destination country. They are only interested in some kinds of entrepreneurial activities like the ones exploiting manual tasks or basic technical competences (Zenner, 1991).
- *Middleman minorities* (Bonacich, 1972) do not aim to develop their own community in the destination country or to integrate with local people.

In sum, choices by *middleman minorities* depend neither on the socio-cultural aspects of the origin country nor on the socio-economic context in the destination country.

## Research Methodology

Surveys about Ukrainians in the Caserta Region were conducted through a questionnaire divided into five sections dealing with:

- The entrepreneur: generic information about origin country, time spent in Italy, reason to leave the origin country and involvement in ethnic or local organizations;

- The venture: the core activity, year of foundation, the main language used at work, previous working experiences if any;
- The start-up phase: the main reason and the main difficulties affecting the choice to launch the new venture;
- The business practices: nationality of financiers, employees, suppliers and consumers;
- The social practices: where immigrants live, how they move in city, which are the places they attend or they miss in the city.

A pilot test was conducted by submitting the questionnaire to a few Ukrainian entrepreneurs not included in the final sample. Some criticalities emerged in reference to section five (social practices). After improvements, the questionnaire was sent out to all the Ukrainian entrepreneurs working in the Caserta Region and 42 of them decided to join the research. The questionnaire is mainly based on descriptive answers and, wherever possible, on yes/no answers that make the analysis of results much easier.

## Findings

As a part of a bigger research project, involving Ukrainians, Brazilians and Senegalese entrepreneurs, the results of the empirical research will be shortly discussed.

For a start, attention is focused on the socio-cultural aspects of the origin country. Ukrainians live in the city-center of Caserta, or in the very close neighborhoods, and all the entrepreneurial activities are established there as well. The choice is not casual: all the entrepreneurial activities, in fact, are easily reachable by all the Ukrainians. The ethnic community is very strong in fact when entrepreneurs were asked to show the main reasons why they started the entrepreneurial activity, nearly 60% of them answered: “to satisfy the already existing demand of products/services”. Another important signal of the strength of ethnic group is that business partners and employees, if any, belong to the same ethnic group.

According to these results, Ukrainians approach to entrepreneurship can lay in the first or second quadrant of the framework. According to the strong influence of the socio-cultural aspects of the origin country, in fact, the possible approaches to entrepreneurship are the supply-based or the mix-based one.

As for the socio-economic context in the destination country, instead, some reflections are necessary. Ukrainians entrepreneurs do not leverage on opportunities offered by the context they live in: for example they do not get loans by Italian banks, close contracts with Italian suppliers nor assume Italian employees. However, it is interesting to point out that Ukrainians do not refer only to Italian consumers but to Romanians, Russian, Bulgarian, Estonian, Polish,

Czechoslovakian as well. Despite apparent similarities, these ethnic groups do not share the same culture as Ukrainians' and there are many differences intra them (some of these ethnic groups have an Asian culture, use a Slavonic alphabet and embrace the Orthodox religion; other groups have an European culture, use a Latin alphabet and embrace the Catholic religion). The ability to keep relationships with ethnic communities of the first group and, at the same time, to implement new relationships with the communities of the second group represents a signal of opening to different ethnic groups who live in the same external context.

In conclusion, it seems that the Ukrainians in Caserta city decide to launch new ventures according to the supply-based approach but, because of their opening to other ethnic groups, they could be driven toward the mix-based one (as shown in Table N.2).

	<i>Strong influence of socio-economic context in the destination country</i>	<i>Scarce influence of socio-economic context in the destination country</i>
<i>Strong influence of socio-cultural aspects of the origin country</i>	1	■ Ukrainians 2
<i>Scarce influence of socio-cultural aspects of the origin country</i>	4	3

Table N. 2 – Ukrainian approach to entrepreneurship

## Conclusions

The findings related to Ukrainian entrepreneurship in the Caserta Region suggest that the supply-based approach is the one followed. However, by referring to other ethnic groups (with different culture but living in the same context) a kind of influence by the socio-economic context can be hypothesized.

The reference to the supply-based approach could be already expected but the integration with different ethnic groups was not. It would be interesting to know whether it is due to the context (the survey was conducted in Caserta) or to a social inclination by the ethnic group.

To reach this goal, it is useful to compare Ukrainian, Brazilian and Senegalese approaches to entrepreneurship (in order to understand whether the inclination toward other ethnic groups is forced by a small context, like Caserta is, or is typical of a certain ethnic group) that, as already anticipated, is the final aim of a whole research project.

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## STATISTICAL ARBITRAGE STRATEGIES ON GREEK BANKS' EQUITY SHARES

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### Abstract

Compared with previous research, the present work extends existing literature by considering pair-wise long-run relations between banks' shares trading in the Greek stock market, under different market conditions, and the implications of these relations on the implementation of pairs trading strategies. The examined data contain one bust phase followed by a mild bullish period. Employing cointegration analysis, reported results initially indicate that changes in market performance affect stability of long-run relations, therefore suggesting that arbitrageurs should perform rebalancing between the examined stocks, in each pair, when a change in market trend is evident. Furthermore, extreme market performance harms the mean-reverting properties of the long-run relations while moderate market performance points to one cointegrating vector which retains the characteristics implied in full-sample analysis. The applicability of our results may be of importance to market participants since the cointegration approach has recently received considerable attention from hedge funds adopting pairs trading strategies.

**Keywords:** Cointegration, Pairs Trading Strategies

### Introduction and Literature Review

Present study pertains to the examination of a market efficiency issue, considering pair-wise long-run relations between banks' shares trading in the Greek stock market, under different market conditions, and the implications of these relations on the implementation of pairs trading strategies. There is considerable literature in financial economics concerning the validity of various forms of the Efficient Market Hypothesis (EMH), Cuthbertson (1996) provides a thorough review. EMH implies that in liquid markets, where asset prices will be the result of unconstrained demand and supply equilibria, the current price should accurately reflect all the information that is available to the players in the market. In other words, the price of an asset at time  $t$  is equal to the price of the asset at time  $t-1$  plus a random term which reflects the impact of new unpredictable information. This is why the model that is most commonly assumed for stock price movement is a log-normal process; that is, the logarithm of the stock price is assumed to exhibit a random walk. However, because the random walk is a martingale, the mean value of the predicted increment is zero. Therefore, knowing the past history of a random walk is not much help in predicting the forward-looking increments. The condition is very different for stationary processes. Armed with the knowledge that stationary

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processes are mean reverting, one can predict the increment to be greater than or equal to the difference between the current value and the mean. The prediction is guaranteed to hold true at some point in the future realizations of the time series.

Given that stock price predictability may lead to abnormal returns, testing mean reversion has been the objective of many researchers since 1960. While initial studies (Fama, 1965; Samuelson, 1965; Working, 1960) could not reject the random walk hypothesis, later findings are mixed. Some studies suggest stock prices are either mean reverting (Chaudhuri and Wu, 2004, 2003; Balvers et al., 2000; Grieb and Reyes, 1999; Urrutia, 1995; Fama and French, 1988; Lo and MacKinlay, 1988; Poterba and Summers, 1988) or random walk (unit root) processes (Narayan and Narayan, 2007; Narayan and Smyth 2007, 2004; Kawakatsu and Morey, 1999; Zhu, 1998; Choudhry, 1997; Huber, 1997; Liu et al., 1997).

Since there is no consensus as to whether stock prices are mean reverting or unit root processes, assuming that the joint hypothesis of risk neutrality and market efficiency holds (and thus lack of stock price mean-reversion property), we cannot apply trading strategies that rely upon unconditional variance in order to realize excess returns. However, previous research suggests the existence of stationary linear relations among log data of share prices. Based on this result, prior literature suggests the construction of Statistical Arbitrage (SA) strategies exploiting the mean-reverting properties of linear relations among financial data (Jacobsen, 2008; Canjels et al., 2004; Hogan et al., 2004; Bondarenko, 2003; Laopodis and Sawhney, 2002; Tatom, 2002; Harasty and Roulet, 2000; Forbes et al., 1999; Wang and Yau, 1994).

Reviewing relevant literature, Gori (2009), Gatev et al. (2006) and Vidyamurthy (2004) mention that SA is attributed to Nunzio Tartaglia, a Wall Street quant who was at Morgan Stanley in the mid 1980s. Tartaglia's group of former academics used statistical methods to develop trading programs, executable through automated trading systems, which replaced traders' intuitions and skills with disciplined, consistent filter rules. SA techniques are widely used by hedge funds, Wall Street companies, and even sophisticated independent investors trying to profit from temporary deviations of equity prices from their fundamental value. In academic literature, SA is opposed to arbitrage (deterministic). In deterministic arbitrage a sure profit can be obtained from being long in some securities and short in others. In SA there is a statistical mispricing of one or more assets based on the expected value of these assets. In other words, SA conjectures statistical mispricings or price relationships that are true in expectation, in the long run, when repeating a trading strategy. One of the most popular trading strategies is Pairs Trading (PT). PT is a very simple technique: "find two stocks whose prices have historically moved together, when the spread between the two widens, short the winner and buy the loser; if history repeats itself, prices will converge and the arbitrageur will profit" (Pole, 2007). PT is a trading strategy that aims to exploit temporal deviations from an equilibrium price relationship between two securities. This is given by a long position in one

security and a short position in another security in such a way that the resulting portfolio is market neutral (which typically translates in having a beta equal to zero). This portfolio is often called a spread. According to Gori (2009), in the framework of spread modelling, among the more recent techniques we find that cointegration is probably the most popular approach in quantitative trading strategies adopted by hedge funds and a reasonable amount of literature has been published on it.

The main objective of this study is to examine pair-wise cointegrating relations between banks' shares, trading in the Greek stock market, with the implementation of PT strategies exploiting the mean-reversion property of the implied long-run relations. Bondarenko (2003) and Hogan et al. (2004) defined SA as an attempt to exploit the long-horizon trading opportunities revealed by cointegration relationships. Furthermore, according to Alexander and Dimitriu (2005), compared with other conventional methods, cointegration performs better as a way of applying SA strategies. Overall, cointegration methodology is a powerful tool for long-term investment analysis. A number of asset management firms now base allocations on cointegration analysis. In addition, when portfolios are constructed on the basis of returns analysis, frequent rebalancing will be necessary.

As suggested by Alexander (2001), the power of cointegration analysis is that optimal portfolios may be constructed on the basis of common long-run trends among asset prices, and they will not require extensive rebalancing. On the contrary, according to Lin et al. (2006), arbitrage trading of the "convergence trade" type is rarely riskless. Market events or structural price changes may invalidate statistical pricing models, confound future price expectations or require parameter re-estimation. Price spreads, after position opening, may escalate rather than revert, or the equilibrium position may shift.

So far, in the relevant literature, there are rather conjectures (Lin et al., 2006; Alexander and Dimitriu, 2002) than evidences supporting the argument that changes in market performance alternate the mean-reverting properties of long-run relations between financial assets and, as a result affect implementation of SA strategies on the variables under consideration. That is, there is small empirical evidence suggesting that arbitrageurs should perform rebalancing among the traded assets when a change in market performance is evident. Main objective of the present study is to contribute in the relevant literature shedding more light on the effects of changes in market performance on the implementation of SA strategies which rely on the cointegration approach.

Compared with previous research, the present work aims to extend existing literature by considering if changes in market performance alternate the mean-reverting properties of long-run relations between equities and, as a result, affect implementation of PT strategies on the variables under consideration. In order to evaluate the validity of our main hypothesis we examine stock prices data of six banks quoted in the Athens Stock Exchange. The examined data contain a bust phase followed by a mild bullish period. Employing cointegration analysis,

reported results initially indicate that changes in market performance affect stability of long-run relations, therefore suggesting that arbitrageurs should perform rebalancing among the examined shares when a change in market trend is evident. Furthermore, “extreme” market performance harms the mean-reverting properties of the long-run relations, which have been identified in our full-sample analysis, while “moderate” market performance points to cointegration between the examined stocks in each pair. Moreover, considering the second sub-period of “moderate” market performance, the presence of a stationary spread suggests the potential of abnormal returns realization, in the short-run, through exploitation of deviations from its mean value. Since the cointegration approach is widely used by hedge funds adopting SA or PT strategies, we believe our results are of significant importance, suggesting that when a change in market performance is evident then fund managers should keep in mind the necessity of rebalancing.

The remainder of this paper includes a description of the examined data, in Section II, and research organization along with the employed methodology, in Section III, followed by model specification and results on cointegration rank tests as well as tested hypotheses, in Section IV. Finally, Section V provides a summary and conclusions.

## Data Description

Data employed in this paper include weekly closing prices of six banks’ equity shares quoted in the Greek stock market. In order to leave out any structural effects arising from the introduction of Euro, we choose to examine a seven-year period: 2001:01:05-2007:12:28. The examined Greek stocks are the equities of the National Bank, the Alpha Bank, the Cyprus Bank, the EFG Eurobank Ergasias, the Piraeus Bank, and the Marfin Bank. Our choice of stock prices variables relies on our objective to examine all shares constituting the banks’ sector index in the Greek market as well as on the availability of data for the examined seven-year period. Apart from the banks’ sector index, the examined shares are also constituents of one popular market performance index namely, the FTSE/ASE 20 for the Greek market.

In order to examine pair-wise cointegrating relations between the examined equity shares under different market conditions, we have split the sample into two sub-samples. We can visually examine, in Fig. 1, the performance of the FTSE/ASE 20 index for the examined seven-year period. Although structural change is obvious from visual inspection of data in Fig. 1, in order to further justify our choice to split the sample, we apply a breakpoint test suggested by Chow (1960). The breakpoint test is applied on a linear regression of the relationship between log price data of those pairs of stocks that appear to be cointegrated in the first part of our econometric analysis where we have employed full-sample data.<sup>1</sup> According to the results of the Chow test in Table 1, with a zero p-value, we reject the null of no breaks at the starting

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*1 Our choice to apply Chow breakpoint test on two bivariate linear regressions between log data of the examined shares is justified by the results of our analysis in Section III where, employing full-sample data, Tables 2a-e indicate two existing pair-wise cointegrating relations among the examined variables.*

point of the second sub-sample, in all cases. In addition to the latter documentation of the two sub-samples, in order to reveal market performance, we define positive (negative) weekly index returns as Up (Down) market returns. Furthermore, following Fabozzi and Francis (1977), we redefine Up (Down) market returns as Substantially Up (Substantially Down) market returns when the weekly return of an index is larger (lower) than the sum (difference) between average market return and half of one standard deviation measured over the full sample.

Examining market performance of the Greek FTSE/ASE 20 index, in the first sub-sample there are 47 Up and 68 Down market returns while 73.53% of the Down returns are also Substantially Down market returns. In the second sub-sample there are 149 Up and 101 Down market returns while 53.69% of the Up returns are also Substantially Up market returns.

While there is no commonly agreed-upon definition for a “bear” market, broadly defined, a “bear” market represents a substantial decline of at least 20% in stock prices over a period of several months. This characteristic is met in market performance of the FTSE/ASE 20 index in the first sub-sample. Furthermore, in the first sub-period, we find that the number of Down returns characterized as Substantially Down returns is sufficiently higher than 50%. In this way we identify the first sub-sample as an “extreme” period.

According to market analysts, a “bull” market is a prolonged period in which share prices raise faster than their historical average. Considering market performance of the Greek FTSE/ASE 20 index, in the second sub-period we find that the number of Up returns characterized as Substantially Up returns is 53.69%. That is, the number of Up returns characterized as Substantially Up returns is slightly higher than 50%. In this way, we identify the second sub-sample as a “moderate” period.

Overall, the sample under consideration contains a period of “extreme” market performance followed by a period of “moderate” market performance. The “extreme” period falls within the sub-sample of 2001:01:05-2003:03:14 and the data include 115 observations. The “moderate” period falls within the sub-sample of 2003:03:21-2007:12:28 and the data consist of 250 observations.

## **Methodology and Research Organization**

Our research schedule is comprised of three parts. First, employing full-sample data we investigate if there are bivariate cointegrating relations among all the possible pairs of the examined shares. In the second part of our analysis, splitting the sample in two sub-periods, we examine if market performance affects the statistical evidence of possible cointegrating relations, indicated by the results of the first empirical part. Finally, as indicated by the results of the second part, in the third empirical part we shed more light on the second sub-sample, characterized as “moderate” period, in order to reveal differences between cointegrating relations from full-sample and second sub-sample data.

We apply the Johansen (1988, 1996) and Johansen and Juselius (1990) methodology of the Cointegrated VAR Model. As noted by Gonzalo (1994) and Kremers et al. (1992), the Johansen and Juselius approach performs better, or at least as well as, the Dickey-Fuller cointegration test of Engle and Granger (1987). In addition, the selected procedure is invariant to different normalizations (Hamilton, 1994) and thus the test outcome does not depend on the chosen normalization. Our results were obtained using CATS in RATS version 2 (Dennis et al., 2005). We choose to restrict the constant term,  $\mu_0$ , to lie in the cointegrating space and in addition, when proper, we include dummy variables,  $D_t$ , as unrestricted to the cointegrating space.

The error correction form of the examined unrestricted VAR model is described here:

$$\Delta x_t = \Pi x_{t-1} + \sum_{i=1}^{k-1} \Gamma_i \Delta x_{t-i} + \mu_0 + \phi D_t + \varepsilon_t, \quad \varepsilon_t \sim N_p(0, \Sigma), \quad t = 1, \dots, T \quad (1)$$

where:  $x_t$  is a vector of two variables:  $[l_{it}, l_{jt}] \sim I(1)$ , (2)

- $l_{it}$ : weakly closing prices (in logs) of bank i,
- $l_{jt}$ : weakly closing prices (in logs) of bank j,

and  $D_t$  is a vector of deterministic variables such as intervention dummies.

Notation of the examined banks' shares is:  $lgr_{1t}$  for National Bank,  $lgr_{2t}$  for Alpha Bank,  $lgr_{3t}$  for Cyprus Bank,  $lgr_{4t}$  for EFG Eurobank Ergasias,  $lgr_{5t}$  for Piraeus Bank, and  $lgr_{6t}$  for Marfin Bank.

Our choice to employ a model with a constant term and exclude the presence of a trend, in the examined log-run relations, is implied by the nature of PT as a SA strategy. That is, implementing a PT strategy, an arbitrageur forms a long/short portfolio of two assets, where the weights in each asset depend on the coefficients of the implied long-run relation between them. However, his initial decision to set up as well as the follow up of such a portfolio relies on the statistical properties of the spread between the prices of these assets. Therefore, in order to set up such a strategy the trader should initially verify the existence of a long-run relation as the one described in Equation (3).

$$l_{it} = \beta \cdot l_{jt} + Spread + stat.error. \quad (3)$$

In other words, what an arbitrageur looks for is a stationary spread  $(l_{it} - \beta \cdot l_{jt})$ . As stated by Pole (2007), relying on the stationarity of the spread between two assets, when detecting a divergence from its mean value then, the arbitrageur shorts the winner and buys the loser: if history repeats itself, prices will converge and the arbitrageur will profit. Alternatively, let us assume that, instead of employing the model described in Eq. (1), we choose to include a trend in the cointegrating relation. Although we could have found a stationary long-run relation,



however in that case the arbitrageur could not set up a strategy based on the stationarity of the spread ( $l_{it} - \beta l_{jt}$ ).

Implementing PT strategies and assuming that we have already choose the pairs of stocks then; we should identify the weights of the two assets, the so called pair's ratio. According to Gori (2009), this ratio should meet two requirements. First, it should make the strategy zero cost, and second it needs to make the strategy market neutral (which typically translates in having a beta equal to zero). Consequently, in an estimate of a long-run relation as the one described in Eq. (3), the presence of a slope coefficient significantly different from unity is justified and can be interpreted by the pair ratio.

Performing model specification, we choose the optimal number of lags using Schwarz, Hannan-Quinn and Akaike Information Criteria along with a Likelihood Ratio (LR) test. Following Juselius and MacDonald (2003), in order to secure valid statistical inference we need to control for the largest of observations by dummy variables or omit the most volatile periods from our sample. Since the volatile periods could potentially be highly revelatory, we followed the Juselius and MacDonald approach. The dummy variables used in our models are permanent impulse dummies  $D_{yyyy.mm.dd}$  (equal to one at  $yyyy:mm:dd$ , and equal to zero otherwise).

Performing cointegration tests, our main objective is to investigate if there is a long-run relation, with a non-zero intercept, between the examined banks' shares in each pair. Applying Johansen (1988, 1996) and Johansen and Juselius (1990) methodology of the cointegrated VAR model, we examine the existence of a long-run relation with a non-zero intercept based upon the estimated eigenvalues,  $\hat{\lambda}_i$ , and the trace test,  $\tau_{p-r}$ .

In addition, we perform hypotheses testing regarding multivariate stationarity, univariate normality, and variable exclusion. In the presence of I(1) series, Johansen and Juselius (1990) developed a multivariate stationarity test which has become the standard tool for determining the order of integration of the series within a multivariate context. The multivariate stationarity test is a LR test distributed as chi-square with  $(p-r)$  degrees of freedom,  $[\chi^2(1)_{95\%}=3.841]$ . Testing univariate normality, we apply the Doornik and Hansen (2008) test, distributed as  $\chi^2(2)$ ,  $[\chi^2(2)_{95\%}=5.991]$ . In order to test variable exclusion, we apply a LR test distributed as chi-square with  $r$  degrees of freedom.

Furthermore, focusing on the cointegrated pairs of banks' shares, we perform long-run identification of the existent cointegrating relations through testing the validity of over-identifying restrictions. First, we test the null hypothesis of long-run weak exogeneity for each stock constituting the examined pair. According to Juselius (2006), the hypothesis that a variable has influenced the long-run stochastic path of the other variables of the system, while at the same time has not been influenced by them, is called the hypothesis of "no levels feedback" or long-run weak exogeneity. The long-run weak exogeneity test is a LR test

distributed as chi-square with  $r$  degrees of freedom. Second, testing if cumulating shocks driving the system have exactly the same influence on both variables ( $li_t$  and  $lj_t$ ), we examine if the hypothesis of long-run homogeneity holds. That is, we examine if the cointegrating vector is (1, -1). Third, in cases where results, of long-run weak exogeneity test, point to the identification of the common stochastic trend, we apply a joint test of long-run weak exogeneity and long-run homogeneity hypotheses. Finally, in order to further justify our suggestions, we apply the Augmented Dickey-Fuller (ADF) technique (Dickey and Fuller, 1981) to test the null hypothesis that the spread has a unit root.

### Model Specification and Results on Cointegration Rank and Tested Hypotheses

As mentioned, performing model specification, we choose the optimal number of lags using Schwarz, Hannan-Quinn and Akaike Information Criteria along with a LR test while, in order to secure valid statistical inference, we choose to control for the largest of observations with the use of dummy variables.

In the first part of our analysis, examining full-sample data, for fifteen pairs of banks' shares, we have employed a model with either one or two lags, described in Equation (4).

$$\Delta x_t = \alpha(\beta', \rho') \begin{pmatrix} x_{t-1} \\ 1 \end{pmatrix} + \sum_{i=1}^{k-1} \Gamma_i \Delta x_{t-i} + \mu_0 + \phi D_t + \varepsilon_t \quad (4)$$

where:  $k$  equals the number of lags minus 1.

Being sufficiently confident about the specification of our model, we shall try to determine the rank. Reported results, in Tables 2a-e, suggest in two cases rejection of the null hypothesis of  $r=0$  while a cointegration rank equal to one is accepted, with 95% significance. Overall, for the pairs of (i)  $lgr_{3t}-lgr_{4t}$ , and (ii)  $lgr_{3t}-lgr_{5t}$ , we have evidence that our system contains one cointegrating relation and, as a result, one common trend.

Considering results reported in Tables 2a-e, further analyzing the two cointegrated pairs [(i)  $lgr_{3t}-lgr_{4t}$ , and (ii)  $lgr_{3t}-lgr_{5t}$ ], with rank=1, we cannot accept the exclusion of any of the variables of the system. Overall, in both cases, we have a system where the employed variables are non-stationary and significant, therefore they cannot be excluded. Univariate normality test outcomes suggest that residual properties are within acceptable levels. The rest of our analysis, in this part, is focused on the two cointegrated pairs. That is, as described below, performing detailed long-run identification we shall test the validity of over-identifying restrictions on the implied cointegrated vectors.

Examining the dynamics of each system, we perform hypotheses testing. We begin our analysis, in Tables 3a-b, with the unrestricted model  $H_1$ . We choose to normalize the  $\beta$  vector to  $lgr_{4t}$  in the first case (Table 3a), and to  $lgr_{5t}$  in the second case (Table 3b). Although

normalization of these cointegrated vectors leads to two identified cointegrating relations, we choose to impose over-identifying restrictions.

First, employing models  $H_2$  and  $H_3$ , given the importance of a zero error correction term, we test the validity of long-run weak exogeneity hypothesis for both shares constituting each pair. Estimated coefficients of the error correction terms represent the short-run speed of adjustment; their magnitude and significance are of great importance regarding the results of our study. If the coefficient of a term is zero, then the error correction does not come from that variable. Considering results reported in Tables 3a-b, we cannot reject the hypothesis of long-run weak exogeneity for  $lgr_{4t}$  (EFG Eurobank Ergasias) in pair (i), as well as for  $lgr_{5t}$  (Marfin Bank) in pair (ii). Overall, Cyprus Bank is identified as the adjusting variable in both cases, where we identify EFG Eurobank Ergasias and Piraeus Bank as the pushing forces in pairs (i) and (ii), respectively.

Regarding the second over-identifying restriction, employing model  $H_4$ , we test the null hypothesis of long-run homogeneity between share prices in each pair. Reported results, considering model  $H_4$  (in Tables 3a-b), indicate rejection of long-run homogeneity hypothesis in both pairs [(i)  $lgr_{3t}$ - $lgr_{4t}$ , and (ii)  $lgr_{3t}$ - $lgr_{5t}$ ]. Moreover, examining model  $H_5$ , we reject as well the null joint hypothesis of long-run weak exogeneity and long-run homogeneity.

Summing up, we detect two well established cointegrating relations. The cointegrating relations  $\beta_1$ , and  $\beta_2$ , implied by model  $H_3$  (in Tables 3a and 3b, respectively), are:

$$\beta_1 : lgr_{3t} = -5.088 + 2.471 \times lgr_{4t} + \text{stat.error.} \quad (5)$$

(-6.383) (8.149)

$$\beta_2 : lgr_{3t} = -1.518 + 1.249 \times lgr_{5t} + \text{stat.error.} \quad (6)$$

(-6.039) (11.803)

The above described cointegrating relations ( $\beta_1$ , and  $\beta_2$ ) seem to be stable in the short run as well, as we can infer from the negative sign and significance of the coefficient corresponding to  $\Delta lgr_{3t}$ , (model  $H_3$ , in Tables 3a and 3b, respectively) reported in  $\alpha$  matrix. In other words, the share prices of the bank identified as the adjusting process seems to adjust very well to the long-run relations.

In the second empirical part, our analysis is focused on the two pairs [(i)  $lgr_{3t}$ - $lgr_{4t}$ , and (ii)  $lgr_{3t}$ - $lgr_{5t}$ ], where well established cointegrating relations have been detected. Splitting the examined sample into two sub-periods, we perform cointegration tests and hypotheses testing in each sub-sample. We have employed a model with one lag in the first sub-period, and a model with one or two lags in the second sub-period. In order to secure valid statistical inference, we choose to control for the largest of observations by dummy variables. Equation four (4) describes the model employed in the two sub-periods.

The results, in Table 4, suggest the acceptance of a cointegration rank equal to zero regarding both examined pairs, in the first sub-period. On the other hand, as indicated by the results in Table 5, considering the second sub-period, with 95% significance, the null hypothesis of  $r=0$  is rejected while, a cointegration rank equal to one is accepted, in both cases.

Given the previously mentioned results of cointegration tests, in the third part of our analysis, we focus in the second sub-period in order to perform long-run identification of the two cointegrated pairs. Proceeding in the same line as in the first empirical part, we examine the dynamics of each system, performing hypotheses testing. In Tables 6a-b, we begin our analysis with the unrestricted model  $H_1$ , normalizing the  $\beta$  vector to  $lgr_{4t}$ , in the first case (Table 6a), and to  $lgr_{5t}$ , in the second case (Table 6b). Although, normalization of each cointegrated vector leads to identified cointegrating relations, we choose to impose over-identifying restrictions.

First, given the importance of a zero error correction term, employing models  $H_2$  and  $H_3$ , we test the validity of long-run weak exogeneity hypothesis, on both shares constituting each pair. Reported results, in Table 6a, indicate rejection of the hypothesis of long-run weak exogeneity for each of the shares of Cyprus Bank or EFG Eurobank Ergasias. That is, in the case of the first pair ( $lgr_{3t}$ - $lgr_{4t}$ ), we cannot distinguish between the stochastic trend and the adjusting process of the system. However, in the second pair ( $lgr_{3t}$ - $lgr_{5t}$ ), reported results, in Table 6b, indicate that we cannot reject the hypothesis of long-run weak exogeneity for Piraeus Bank. Overall, only in the cointegrated relation between Cyprus Bank and Piraeus Bank we have evidence of a well established system, where Piraeus Bank is the pushing variable, while Cyprus Bank is purely adjusting.

Regarding the second over-identifying restriction, employing model  $H_4$ , we test the null hypothesis of long-run homogeneity between the share prices in each pair. Reported results, considering model  $H_4$  (in Tables 6a-b), indicate rejection of long-run homogeneity hypothesis in all the examined pairs. Therefore, there is no evidence of a cointegrated vector (1, -1) in any case. Moreover, employing model  $H_5$ , in the last case (Table 6b) and examining models  $H_5$  and  $H_6$  in the first case (Table 6a) we reject the null joint hypothesis of long-run weak exogeneity and long-run homogeneity, in all the examined pairs.

Summing up, considering data from the second sub-sample, we detect just one well established cointegrating relation. The cointegrating relation  $\beta'_2$ , implied by model  $H_3$  (Tables 6b) is described in Equation (7).

$$\beta'_2 : lgr_{3t} = -1.733 + 1.329 \times lgr_{5t} + \text{stat.error.} \quad (7)$$

(-6.367)      (12.493)

The above described cointegrating relation,  $\beta'_2$ , seems to be stable in the short-run as well, as we can infer from the negative sign and significance of the coefficient corresponding to  $\Delta lgr_{3t}$

(model  $H_3$ , in Table 6b), reported in  $\alpha$  matrix. In other words, the share prices of Cyprus Bank, identified as the adjusting processes, seem to adjust very well to the long-run relation between Cyprus Bank and Piraeus Bank.

Moreover, the outcome from the Augmented Dickey-Fuller (Dickey and Fuller, 1981) unit root test (in Table 7) indicates, with 99% significance, acceptance of the null hypothesis, while points to a stationary spread, with 95% significance.

## Summary and Conclusions

Compared with previous research, we extend existing literature by considering pair-wise long-run relations between log-prices of stocks, under different market conditions. Also, we investigate the implications of these relations on the implementation of SA strategies. Our empirical results may be valuable to market participants since the cointegration approach has recently received considerable attention from hedge funds adopting SA or PT strategies.

According to Alexander (2008), the prices (and log prices) of stocks are integrated, and integrated processes have infinite unconditional variance, thus there is little point in attempting to use past prices to forecast future prices in a univariate time series model. However, when the prices of two or more equity shares are cointegrated, there is a multivariate model revealing information about the long-run equilibrium in the system.

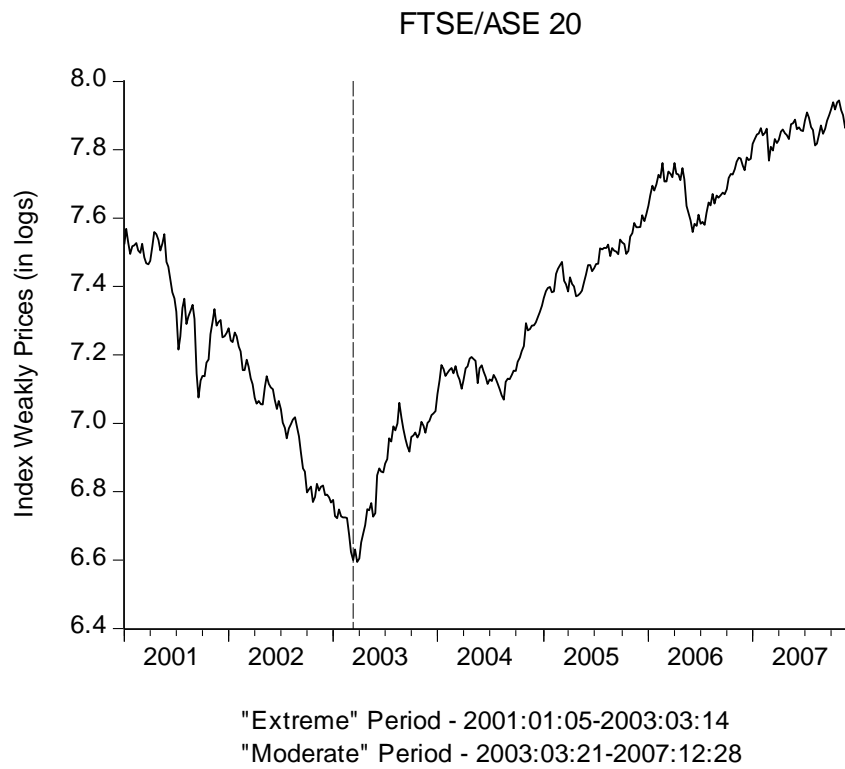
In investigating pair-wise long-run relations between banks' equity shares, quoted in the Greek stock market, we have found two well established cointegrating relations. Based on that finding, one could set up SA strategies in order to exploit the mean reverting properties of these two spreads. However, taking into account a structural change due to alternation in market performance, our results indicate that one should be cautious about applying such strategies. That is, further investigating the long-run relations among the examined stocks, we have divided the sample into two sub-periods in order to re-examine the suggested linear relations under different market conditions. The examined sub-samples contain a bust phase followed by a mild bullish period.

Employing cointegration analysis, reported results initially indicate that changes in market performance affect the stability of long-run relations, suggesting that arbitrageurs should perform rebalancing among the examined equity shares when a change in market trend is evident. Furthermore, "extreme" market performance harms the mean-reverting properties of the three long-run relations while "moderate" market performance points to cointegration between the examined stocks in each pair. However, under "moderate" market performance, we have found that there is one well established cointegrating relation that retains the same characteristics shown in the analysis of the examined full-sample data. In addition, the presence of a stationary spread, with 95% significance, suggests the potential of abnormal returns realization, in the short-run, through exploitation of deviations from its mean value.

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**Figures**

*Figure 1 Plots of data (weekly index prices) in logs*



## Tables

Table 1 Chow's breakpoint test

Pairs of Stocks	F-stats	p-values
$lgr_{3t}, lgr_{4t}$	62.101	(0.000)
$lgr_{3t}, lgr_{5t}$	99.270	(0.000)

Table 2a Bivariate trace tests for cointegration rank and hypotheses testing (full sample)

# lags	r	p-r	i	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{1t}$	$lgr_{2t}$
1	0	2	1	0.042	16.144 <sup>b</sup>	20.164	14.468 <sup>i,a</sup>	13.013 <sup>i,a</sup>
	1	1	2	0.001	0.368 <sup>b</sup>	9.142	2.455 <sup>ii,b</sup>	0.273 <sup>ii,b</sup>
							13.013 <sup>iii,a</sup>	14.468 <sup>iii,a</sup>
# lags	r	p-r	i	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{1t}$	$lgr_{3t}$
1	0	2	1	0.049	18.783 <sup>b</sup>	20.164	9.907 <sup>i,a</sup>	17.319 <sup>i,a</sup>
	1	1	2	0.002	0.603 <sup>b</sup>	9.142	1.638 <sup>ii,b</sup>	3.088 <sup>ii,b</sup>
							17.319 <sup>iii,a</sup>	9.907 <sup>iii,a</sup>
# lags	r	p-r	i	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{1t}$	$lgr_{4t}$
1	0	2	1	0.026	10.963 <sup>b</sup>	20.164	8.123 <sup>i,a</sup>	7.692 <sup>i,a</sup>
	1	1	2	0.003	1.263 <sup>b</sup>	9.142	0.953 <sup>ii,b</sup>	0.342 <sup>ii,b</sup>
							7.692 <sup>iii,a</sup>	8.123 <sup>iii,a</sup>
# lags	r	p-r	i	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{1t}$	$lgr_{5t}$
2	0	2	1	0.014	7.060 <sup>b</sup>	20.164	2.443 <sup>i,b</sup>	2.083 <sup>i,b</sup>
	1	1	2	0.005	1.975 <sup>b</sup>	9.142	1.610 <sup>ii,b</sup>	0.391 <sup>ii,b</sup>
							2.083 <sup>iii,b</sup>	2.443 <sup>iii,b</sup>
# lags	r	p-r	i	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{1t}$	$lgr_{6t}$
2	0	2	1	0.026	12.496 <sup>b</sup>	20.164	2.825 <sup>i,b</sup>	2.469 <sup>i,b</sup>
	1	1	2	0.008	2.902 <sup>b</sup>	9.142	1.791 <sup>ii,b</sup>	1.355 <sup>ii,b</sup>
							2.469 <sup>iii,b</sup>	2.825 <sup>iii,b</sup>

<sup>a</sup> Rejection of the null with 95% significance<sup>b</sup> Acceptance of the null with 95% significance<sup>i</sup> Multivariate Stationarity test is a LR test, distributed as  $\chi^2(1)$ <sup>ii</sup> Doornik and Hansen (2008) univariate normality test, distributed as  $\chi^2(2)$ <sup>iii</sup> Variable Exclusion is a LR test, distributed as  $\chi^2(1)$

**Table 2b** Bivariate trace tests for cointegration rank and hypotheses testing (full sample)

# lags	$r$	$p-r$	$i$	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{2t}$	$lgr_{3t}$
2	0	2	1	0.052	19.285 <sup>b</sup>	20.164	4.996 <sup>i,a</sup>	15.786 <sup>i,a</sup>
	1	1	2	0.000	0.051 <sup>b</sup>	9.142	1.043 <sup>ii,b</sup>	2.334 <sup>ii,b</sup>
							15.786 <sup>iii,a</sup>	4.996 <sup>iii,b</sup>
# lags	$r$	$p-r$	$i$	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{2t}$	$lgr_{4t}$
1	0	2	1	0.022	8.843 <sup>b</sup>	20.164	7.491 <sup>i,a</sup>	7.457 <sup>i,a</sup>
	1	1	2	0.002	0.652 <sup>b</sup>	9.142	0.644 <sup>ii,b</sup>	1.532 <sup>ii,b</sup>
							7.457 <sup>iii,a</sup>	7.491 <sup>iii,a</sup>
# lags	$r$	$p-r$	$i$	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{2t}$	$lgr_{5t}$
1	0	2	1	0.023	9.697 <sup>b</sup>	20.164	4.284 <sup>i,a</sup>	5.600 <sup>i,a</sup>
	1	1	2	0.003	1.185 <sup>b</sup>	9.142	0.470 <sup>ii,b</sup>	3.588 <sup>ii,b</sup>
							5.600 <sup>iii,a</sup>	4.284 <sup>iii,a</sup>
# lags	$r$	$p-r$	$i$	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{2t}$	$lgr_{6t}$
2	0	2	1	0.021	10.772 <sup>b</sup>	20.164	2.149 <sup>i,b</sup>	1.729 <sup>i,b</sup>
	1	1	2	0.008	2.893 <sup>b</sup>	9.142	0.658 <sup>ii,b</sup>	2.274 <sup>ii,b</sup>
							1.729 <sup>iii,b</sup>	2.149 <sup>iii,b</sup>

<sup>a</sup> Rejection of the null with 95% significance<sup>b</sup> Acceptance of the null with 95% significance<sup>i</sup> Multivariate Stationarity test is a LR test, distributed as  $\chi^2(1)$ <sup>ii</sup> Doornik and Hansen (2008) univariate normality test, distributed as  $\chi^2(2)$ <sup>iii</sup> Variable Exclusion is a LR test, distributed as  $\chi^2(1)$

**Table 2c** Bivariate trace tests for cointegration rank and hypotheses testing (full sample)

# lags	$r$	$p-r$	$i$	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{3t}$	$lgr_{4t}$
2	0	2	1	0.057	22.541 <sup>a</sup>	20.164	17.567 <sup>i,a</sup>	7.292 <sup>i,a</sup>
	1	1	2	0.003	1.238 <sup>b</sup>	9.142	1.187 <sup>ii,b</sup>	1.276 <sup>ii,b</sup>
							7.292 <sup>iii,a</sup>	17.567 <sup>iii,a</sup>
# lags	$r$	$p-r$	$i$	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{3t}$	$lgr_{5t}$
1	0	2	1	0.056	22.368 <sup>a</sup>	20.164	19.782 <sup>i,a</sup>	15.310 <sup>i,a</sup>
	1	1	2	0.003	1.219 <sup>b</sup>	9.142	3.488 <sup>ii,b</sup>	2.297 <sup>ii,b</sup>
							15.310 <sup>iii,a</sup>	19.782 <sup>iii,a</sup>
# lags	$r$	$p-r$	$i$	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{3t}$	$lgr_{6t}$
2	0	2	1	0.031	13.136 <sup>b</sup>	20.164	0.760 <sup>i,b</sup>	0.002 <sup>i,a</sup>
	1	1	2	0.005	1.748 <sup>b</sup>	9.142	2.296 <sup>ii,b</sup>	0.636 <sup>ii,b</sup>
							0.002 <sup>iii,a</sup>	0.760 <sup>iii,b</sup>

<sup>a</sup> Rejection of the null with 95% significance<sup>b</sup> Acceptance of the null with 95% significance<sup>i</sup> Multivariate Stationarity test is a LR test, distributed as  $\chi^2(1)$ <sup>ii</sup> Doornik and Hansen (2008) univariate normality test, distributed as  $\chi^2(2)$ <sup>iii</sup> Variable Exclusion is a LR test, distributed as  $\chi^2(1)$ **Table 2d** Bivariate trace tests for cointegration rank and hypotheses testing (full sample)

# lags	$r$	$p-r$	$i$	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{4t}$	$lgr_{5t}$
1	0	2	1	0.025	9.747 <sup>b</sup>	20.164	5.821 <sup>i,a</sup>	7.057 <sup>i,a</sup>
	1	1	2	0.002	0.632 <sup>b</sup>	9.142	1.182 <sup>ii,b</sup>	2.305 <sup>ii,b</sup>
							7.057 <sup>iii,a</sup>	5.821 <sup>iii,a</sup>
# lags	$r$	$p-r$	$i$	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{4t}$	$lgr_{6t}$
2	0	2	1	0.027	12.252 <sup>b</sup>	20.164	2.938 <sup>i,b</sup>	2.804 <sup>i,b</sup>
	1	1	2	0.006	2.316 <sup>b</sup>	9.142	1.309 <sup>ii,b</sup>	0.541 <sup>ii,b</sup>
							2.804 <sup>iii,b</sup>	2.938 <sup>iii,b</sup>

<sup>a</sup> Rejection of the null with 95% significance<sup>b</sup> Acceptance of the null with 95% significance<sup>i</sup> Multivariate Stationarity test is a LR test, distributed as  $\chi^2(1)$ <sup>ii</sup> Doornik and Hansen (2008) univariate normality test, distributed as  $\chi^2(2)$ <sup>iii</sup> Variable Exclusion is a LR test, distributed as  $\chi^2(1)$

**Table 2e** Bivariate trace tests for cointegration rank and hypotheses testing (full sample)

# lags	$r$	$p-r$	$i$	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{5t}$	$lgr_{6t}$
2	0	2	1	0.041	18.369 <sup>b</sup>	20.164	0.532 <sup>i,b</sup>	0.042 <sup>i,b</sup>
	1	1	2	0.009	3.172 <sup>b</sup>	9.142	3.936 <sup>ii,b</sup>	0.216 <sup>ii,b</sup>
							0.042 <sup>iii,a</sup>	0.532 <sup>iii,b</sup>

<sup>a</sup> Rejection of the null with 95% significance<sup>b</sup> Acceptance of the null with 95% significance<sup>i</sup> Multivariate Stationarity test is a LR test, distributed as  $\chi^2(1)$ <sup>ii</sup> Doornik and Hansen (2008) univariate normality test, distributed as  $\chi^2(2)$ <sup>iii</sup> Variable Exclusion is a LR test, distributed as  $\chi^2(1)$

**Table 3a** Long run identification of cointegrated pair:  $lgr_{3t}$ ,  $lgr_{4t}$  (full sample)

	H <sub>1</sub>		H <sub>2</sub>		H <sub>3</sub>		H <sub>4</sub>		H <sub>5</sub>	
	$\hat{\alpha}_3$	$\hat{\beta}_3$	$\hat{\alpha}_3$	$\hat{\beta}_3$	$\hat{\alpha}_3$	$\hat{\beta}_3$	$\hat{\alpha}_3$	$\hat{\beta}_3$	$\hat{\alpha}_3$	$\hat{\beta}_3$
$lgr_{3t}$	0.038 (4.460)	-0.406 (-5.213)	0	-0.025 (-0.071)	-0.015 (-4.437)	1	-0.008 (-1.445)	1	-0.006 (-1.140)	1
$lgr_{4t}$	0.001 (0.068)	1	-0.008 (-1.690)	1	0	-2.471 (-8.149)	-0.005 (-1.062)	-1	0	-1
Constant		-2.057 (-17.750)		-2.650 (-5.034)		5.088 (6.383)		1.218 (5.438)		1.292 (4.346)
Log-Likelihood	2471.244		2462.123		2471.242		2461.842		2461.310	
LR statistic			18.244		0.004		18.806		19.870	
p-value			0.000		0.948		0.000		0.000	
			$\chi^2(1)$		$\chi^2(1)$		$\chi^2(1)$		$\chi^2(2)$	

Numbers in brackets are t-ratios

**Table 3b** Long run identification of cointegrated pair:  $lgr_{3t}$ ,  $lgr_{5t}$  (full sample)

	H <sub>1</sub>		H <sub>2</sub>		H <sub>3</sub>		H <sub>4</sub>		H <sub>5</sub>	
	$\hat{\alpha}_4$	$\hat{\beta}_4$	$\hat{\alpha}_4$	$\hat{\beta}_4$	$\hat{\alpha}_4$	$\hat{\beta}_4$	$\hat{\alpha}_4$	$\hat{\beta}_4$	$\hat{\alpha}_4$	$\hat{\beta}_4$
$lgr_{3t}$	0.043 (4.659)	-0.801 (-10.877)	0	-0.793 (-0.752)	-0.029 (-3.947)	1	-0.034 (-3.896)	1	-0.029 (-3.296)	1
$lgr_{5t}$	0.014 (1.687)	1	-0.003 (-1.028)	1	0	-1.249 (-11.803)	-0.012 (-1.449)	-1	0	-1
Constant		-1.195 (-10.810)		-1.929 (-1.217)		1.518 (6.039)		0.919 (15.827)		0.944 (15.233)
Log-Likelihood	2475.173		2465.237		2473.835		2472.050		2471.087	
LR statistic			19.871		2.675		6.246		8.170	
p-value			0.000		0.102		0.012		0.017	
			$\chi^2(1)$		$\chi^2(1)$		$\chi^2(1)$		$\chi^2(2)$	

Numbers in brackets are t-ratios

**Table 4** Bivariate trace tests for cointegration rank and hypotheses testing (1<sup>st</sup> sub-sample)

# lags	$r$	$p-r$	$i$	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{3t}$	$lgr_{4t}$
1	0	2	1	0.106	18.040 <sup>b</sup>	20.164	0.744 <sup>i,b</sup>	0.289 <sup>i,b</sup>
	1	1	2	0.045	5.256 <sup>b</sup>	9.142	0.474 <sup>ii,b</sup>	1.124 <sup>ii,b</sup>
							0.289 <sup>iii,b</sup>	0.744 <sup>iii,b</sup>
# lags	$r$	$p-r$	$i$	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{3t}$	$lgr_{5t}$
1	0	2	1	0.088	11.184 <sup>b</sup>	20.164	1.159 <sup>i,b</sup>	1.224 <sup>i,b</sup>
	1	1	2	0.006	0.729 <sup>b</sup>	9.142	1.203 <sup>ii,b</sup>	0.095 <sup>ii,b</sup>
							1.224 <sup>iii,b</sup>	1.159 <sup>iii,b</sup>

<sup>a</sup> Rejection of the null with 95% significance<sup>b</sup> Acceptance of the null with 95% significance<sup>i</sup> Multivariate Stationarity test is a LR test, distributed as  $\chi^2(1)$ <sup>ii</sup> Doornik and Hansen (2008) univariate normality test, distributed as  $\chi^2(2)$ <sup>iii</sup> Variable Exclusion is a LR test, distributed as  $\chi^2(1)$ **Table 5** Bivariate trace tests for cointegration rank and hypotheses testing (2<sup>nd</sup> sub-sample)

# lags	$r$	$p-r$	$i$	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{3t}$	$lgr_{4t}$
1	0	2	1	0.055	22.886 <sup>a</sup>	20.164	5.250 <sup>i,a</sup>	4.480 <sup>i,a</sup>
	1	1	2	0.035	8.779 <sup>b</sup>	9.142	2.117 <sup>ii,b</sup>	3.456 <sup>ii,b</sup>
							4.480 <sup>iii,a</sup>	5.250 <sup>iii,a</sup>
# lags	$r$	$p-r$	$i$	$\hat{\lambda}_i$	$\tau_{p-r}$	$C_{95\%(p-r)}$	$lgr_{3t}$	$lgr_{5t}$
2	0	2	1	0.061	24.202 <sup>a</sup>	20.164	5.056 <sup>i,a</sup>	5.082 <sup>i,a</sup>
	1	1	2	0.034	8.656 <sup>b</sup>	9.142	5.689 <sup>ii,b</sup>	2.645 <sup>ii,b</sup>
							5.082 <sup>iii,a</sup>	5.056 <sup>iii,a</sup>

<sup>a</sup> Rejection of the null with 95% significance<sup>b</sup> Acceptance of the null with 95% significance<sup>i</sup> Multivariate Stationarity test is a LR test, distributed as  $\chi^2(1)$ <sup>ii</sup> Doornik and Hansen (2008) univariate normality test, distributed as  $\chi^2(2)$ <sup>iii</sup> Variable Exclusion is a LR test, distributed as  $\chi^2(1)$

**Table 6a** Long run identification of cointegrated pair:  $lgr_{3t}$ ,  $lgr_{4t}$  (2<sup>nd</sup> sub-sample)

	H <sub>1</sub>		H <sub>2</sub>		H <sub>3</sub>		H <sub>4</sub>		H <sub>5</sub>		H <sub>6</sub>	
	$\hat{\alpha}_3$	$\hat{\beta}_3$	$\hat{\alpha}_3$	$\hat{\beta}_3$	$\hat{\alpha}_3$	$\hat{\beta}_3$	$\hat{\alpha}_3$	$\hat{\beta}_3$	$\hat{\alpha}_3$	$\hat{\beta}_3$	$\hat{\alpha}_3$	$\hat{\beta}_3$
$lgr_{3t}$	0.035 (2.827)	-0.367 (-5.009)	0	-0.256 (-2.549)	-0.016 (-3.520)	1	-0.007 (-2.762)	1	0	-1	-0.005 (-2.195)	1
$lgr_{4t}$	-0.018 (-1.549)	1	-0.030 (-3.227)	1	0	-2.388 (-6.189)	-0.005 (-2.060)	-1	0.004 (1.318)	1	0	-1
Constant		-2.159 (-18.052)		-2.459 (-15.024)		4.826 (4.492)		0.440 (1.446)		-0.673 (-1.259)		0.287 (0.612)
Log-Likelihood	1677.398		1675.900		1676.940		1674.999		1671.260		1672.904	
LR statistic			2.995		0.915		4.798		12.276		8.987	
p-value			0.084		0.339		0.028		0.002		0.011	
			$\chi^2(1)$		$\chi^2(1)$		$\chi^2(1)$		$\chi^2(2)$		$\chi^2(2)$	

Numbers in brackets are t-ratios



**Table 6b** Long run identification of cointegrated pair:  $lgr_{3t}$ ,  $lgr_{5t}$  (2<sup>nd</sup> sub-sample)

	H <sub>1</sub>		H <sub>2</sub>		H <sub>3</sub>		H <sub>4</sub>		H <sub>5</sub>	
	$\hat{\alpha}_4$	$\hat{\beta}_4$	$\hat{\alpha}_4$	$\hat{\beta}_4$	$\hat{\alpha}_4$	$\hat{\beta}_4$	$\hat{\alpha}_4$	$\hat{\beta}_4$	$\hat{\alpha}_4$	$\hat{\beta}_4$
$lgr_{3t}$	0.048 (3.967)	-0.757 (-10.891)	0	-0.719 (-5.989)	-0.036 (-3.667)	1	-0.013 (-3.063)	1	-0.023 (-2.605)	1
$lgr_{5t}$	0.010 (0.923)	1	-0.023 (-2.777)	1	0	-1.329 (-12.493)	-0.010 (-2.562)	-1	0	-1
Constant		-1.260 (-10.968)		-1.605 (-8.093)		1.733 (6.367)		0.485 (2.977)		0.859 (8.911)
Log-Likelihood	1697.594		1694.212		1697.402		1695.656		1693.667	
LR statistic			6.765		0.383		3.877		7.854	
p-value			0.009		0.536		0.049		0.020	
			$\chi^2(1)$		$\chi^2(1)$		$\chi^2(1)$		$\chi^2(2)$	

Numbers in brackets are t-ratios

**Table 7** Augmented Dickey-Fuller unit root test on spread (2<sup>nd</sup> sub-sample)

Spread	# lags	Significance Level			T-statistic
		99%	95%	90%	
$\lg r_{3t} - 1.329 \lg r_{5t}$	0	-3.458	-2.873	-2.573	-3.302 <sup>b,a*</sup>

<sup>a</sup> Rejection of the null with 99% significance<sup>b</sup> Acceptance of the null with 99% significance<sup>a\*</sup> Rejection of the null with 95% significance<sup>b\*</sup> Acceptance of the null with 95% significance

## CONQUERING THE POWER OF CHANGE – A PRIVATE UNIVERSITY CASE STUDY

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### Abstract

Leadership has become a global obsession in many ways, but managing change within private universities has put the breaks on organizational learning and learning in general. Our case study attempts to show the manner by which change has been introduced and dealt within the Business School of a private Cypriot University, the European University Cyprus. Then it tries to demonstrate if the success of the change process has its roots in the history of the organization, or its current representative strategies as per the theoretical framework drawn from literature review. Following a qualitative study based on semi structured interviews it emerges that it is the trust placed on the organization by the management, the staff and the student body that can bring high standards of education to the change process. This does not come alone, but together with the acceptance of the change process and embedded innovation. At the other end, there are still strong drawbacks that hinder change management to its full positive results. These reside mostly the inequalities, the social contract issues and keeping promises.

**Keywords:** Change Management, Business Administration, Case Study, Higher Education, Learning

### Introduction

Great leaders are capable, visionary and inspiring, that does not mean they are rational (Kets de Vries, p.183 2004)

Not so recently, organizations worldwide are challenged by continuously turbulent environments, more demanding times and shareholders, less time to act and more astute “customers”. This is why many are restructuring their business to meet at least these tests. The only question mark is on how much time and change dependent are such requirements and which is the sustainable effect foreseen in changing learning systems and in the education industry as a whole.

When usually leaders want to change individual’ or group’s behaviour, they usually tend to implement a simplistic behavioral change program.

Such a program may have a positive effect, to be sure, but that effect will not last long. Making that sort of an intervention is like trying to change the weather by turning up the

heating system inside one's house. It may keep the inhabitants warmer for a time, but it will not change the temperature outside. (Kets de Vries, p.195, 2004)

Within this general context, private universities have to develop and adapt to the new demanding market needs, to the change time schedule, to regulations that govern the operations of a university teaching and research type institution and continue to be self reliant and economically viable. Meanwhile, change is inevitable, while circumstances continue to produce new challenges.

In the our case study, the oldest private Universities in Cyprus, the European University Cyprus (EUC) the human resources seem to have been re-developed, sound personnel policies adopted, proper manpower planning implemented and assessment and a conscious policy revised to improve work and management at all levels. But, it is only the trust placed on the organization by the management, the staff and the student body that can bring high standards of education to the change process? These have been important factors that have contributed to its success story. However, the effects of change are still affecting everyone in their daily activities. Therefore proper change management skills are imperative, if all mismanaged it could have disastrous effects.

The paper is drawn under a case study and event study methodology combined with exploratory research since the moment of the accreditation of EUC in 2008 till 2011. We plan through this study to capture and integrate people's perceptions, behaviour, cognition or knowledge and creative ideas in the way they have faced change in their environment and then propose a pattern for dealing with concrete change management problems and actions to prevent potential activity disruptions.

Altogether, our study also tries to collect and present information related to the way EUC has dealt so far with current change management issues, especially value changes at its strategic level. Additionally, the study wants to raise the need to know how to handle appropriate ways of correct and wrong application of change management in this industry.

Last but not least, the study aims at redesigning a conceptual framework encompassing strategic and practical aspects emerged from the data analysis that can help managers of other European Private Universities deal in a better and sustainable way with such phenomena.

## **Literature review and research theoretical framework**

Whether a large or a small organization of any particular industry, the first thing one must understand about dealing with change is that it is a continuous process rather than a status quo. Change implementation difficulty relates mostly its communicating vessels effect. Blaise Pascal proved in the seventeenth century that the pressure exerted on a molecule of a liquid is transmitted in full and with the same intensity in all directions. Meaning, if you change something in one area, it affects other areas triggering thus changes in those areas too. This is

to say that change is a continuous process, mostly cyclical (Lawrence *et al.*, 2006), that needs adjustment at any of its phases and various types of leadership control, strategies and behaviour.

Also, no matter the organization, change may be applied at different levels, which have different power to force change themselves. These levels are considered in our research to include the most important 4P's:

- The people at work, first, as they are the main trigger for change due to their changing nature, second due to their active role in implementing. Changing people offers the least amount of change leverage, due to its actual "impossible task" character to be achieved in a certain timeframe. Bureaucratic systems are designed to work in the way they do, not considering who does the job. One needs to change the culture of those people, but this is a long, slow process that seldom pulls change back through the system.
- The processes of work determines how work is performed. Changing work processes is important, but it won't force change anywhere else-in fact, it is hard to change work processes without changing the organizational structure and administrative systems of an institution.
- The power of system within which the organization functions, including the support system or the administrative one. If you change the education system, you can force change in every institution within it. Systems control their organizations through their administrative systems-budgeting, personnel, procurement, accounting, auditing and the like. Hence changing these administrative systems also creates remarkable leverage.
- The profile of the organization level. Learning organizations have been described in reverential terms like employees' paradises, good management practices, socialistic models and workplace democracies etc These organizations provide working environments where the employees and management together reflect on all decisions, resolve all differences, if any, through mutual dialogue, and open communication systems resulting in high levels of trust, co-operation and commitment on the part of the employees which enables generation of learning. (Akella, 2008). Universities are close to be this type of organization that is however still constrained by the system's rules and incentives, as well as its administrative systems. One can change much within an organization, mostly if one can put up some flexibility from the administrative systems. But, clearly one has little influence to force change in all Schools within the University, due to the diverse panoply of needs.

Either public or private education institutions, due to their publicly originated system in certain countries, have some basic building blocks of organizational structure. This structure must relocate itself from a bureaucratic to a more entrepreneurial model. Such a model would include five basic strategies that have power over change implementation. We have named them as the "five C's.". These strategies can trigger the "authentizotic" organization, meaning authentic and alive, that Kets de Vries (2004) tries to imply as a success in any leadership.

- The Core Strategy. Creating clarity of purpose for University reform.
- The Culture Strategy. Changing employees' habits, modus operandi, hearts and minds.
- The Customer Strategy. Making Universities accountable to their customers.
- The Control Strategy. Pushing control down from the top and out from the center. Do not fear serendipity though.
- The Compilation Strategy. Creating a set of actions for performance measurement and responsibilities.

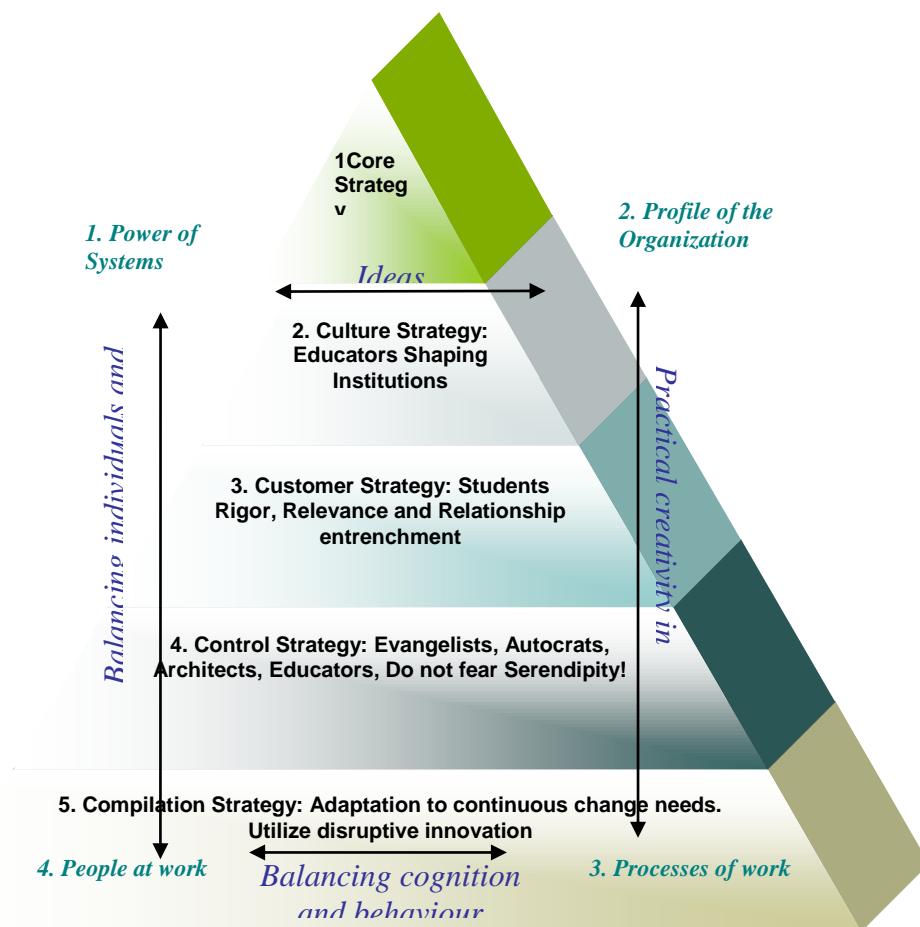


Fig. 1. The Research Theoretical Framework (Source: Authors' research)

The study's theoretical framework creates under a 5Cs format of strategies, a pyramidal 'non-vertical' relationship concept that is supported by the interactions among the 4Ps presented above. In this framework, the bond between the 5Cs and the 4Ps resides in:

- Ideas implementation, (when it comes to implementing the system's requirements into the profile of the organization)
- Practical creativity in collective behaviour is necessary both ways when designing the University profile to match the underlying processes of work, as well as restructuring these processes in order to redefine a new organizational image.
- Balancing cognition and behaviour at both individual and group level is know-how and skills related double way of accommodating people in the new processes of work, as well as tailoring such processes for the people's needs.
- Balancing individuals and systems (when trying to fit systems in for people and when accommodating people's need into the system).

In order to acquire strategic stance in restructuring such institutions one must get leverage as high in the system as possible and one must change as many of the fundamental construction blocks (the 5C's) as possible. By creating a clear purpose and decentralizing power are major changes, for example-but without compilation for performance they are barely sufficient. If the five 5C's represent the central levers for restructuring, then how do they work?

### **The Core Strategy**

The core strategy focuses on steering, not rowing-making policy and setting direction rather than producing services. It involves three basic approaches:

The first is removing what does not add to the purpose of the University-by abandoning it. This move offers to the decision makers the clarity of purpose they need to manage effectively.

A second approach is uncoupling steering from rowing and compliance from service functions. Separating these roles into distinct organizational units with separate missions can enhance the quality and effectiveness of both steering and rowing. The British and New Zealanders, which are relatively far from the Cypriot education system, have done this systematically, at both the national and local levels. It has helped these two countries achieve enormous improvements in the efficiency and effectiveness of their educational systems.

A third core approach is to clarify the aim by creating new steering mechanisms. This is a specific move in the American educational system. In Cyprus, steering functions tend to be concentrated in the hands of a few people rather than in elective bodies. But elected bodies

like the Academic Senate, the Board of Directors, have great difficulty thinking and acting strategically.

There are, however, ways to get around this. When adopting long-term outcome goals of the University, then these are translated into medium- and short-term outcome goals, which then translates into output targets for other Schools and departments. EUC has created a highly visible body representative of stakeholder groups in the community, under the new EUC brand name. It has set long-term goals, which may act as benchmarks, and it measures progress and reports to the all stakeholders including to the community.

While all educators must play key roles in changing mentalities, the burden is even greater for those in leadership positions. Leaders must respond to change appropriately, as they are 'mirrors' for their followers, by creating room for creativity and innovation and releasing any other constraints in their staff's activities.

By nature, researching and teaching is a creative work and a liberal individualistic one. and those trying to impose systems in this industry will not perform well at all. Besides, people like to feel comfortable and do not want to disturb authorities for the sake of being themselves protected. In such case, no development is possible.

### **The Culture Strategy**

This strategy is the weakest of the five C's in terms of implementation and transparency. However, it is a key component of the pyramid that must be fine tuned when implementing change. The other C's will coerce changes in the culture-but they will not always create exactly the culture reformers want. At some point in the change process, all successful implementers discover that they must deliberately work to change their employees' habits, modus operandi, hearts, and minds.

One approach that creates the most leverage is to change what people do. If one creates new experiences and new behaviour, new thinking will come in. Available tools include interactive strategic planning, job and role rotation, internships and externships, cross-walking and cross-talking (e.g., interdepartmental or inter-schools task forces), and contests.

Dealing with people's emotions has leverage because emotions are far more powerful than ideas. You can do this by celebrating successes in outcomes, processes and initiatives and honoring failures; creating new symbols; setting up new rituals; team building; and investing in your employees and their physical and virtual work space.

The final approach to working the culture lever is what the author likes to call "charming minds". Some leaders develop new mental models by involving their staff in the creation of mission statements, in the vision processes, and in articulating their beliefs, values, and assumptions. Others use systems models to create familiar understanding of the way things work and how changes will be successful.

Frequent barriers with these strategic levers are related to:



- elected authorities/managers who play politics when leadership is needed;
- the blockage of having no choice in voting for leaders due to inflexible rules;
- staff rules that eliminate the flexibility employees need to produce changes;
- unions that see their role not as asserting employee's welfare and principles, but as maximizing their connections;
- the intricate array of stakeholders in the existing system.

For sure, there are ways around these various barriers to better serve stakeholders' needs, but they are not easy, they need to be "worked-out."

### **The Customer Strategy**

The first best way to change private higher education institutions is to make it accountable to its customers. In terms of customers we have considered students, academic and administrative staff.

When we talk about "customer needs" and stakeholders in education, we come across a lack of consensus for the student as customer concept (see Eagle and Brennan, 2007 vs. Svensson and Wook, 2007). Trying to advance the study's theoretical framework, the author uses concepts from relational theories, acknowledging that higher education is largely a private good and this essentially "makes the student the customer in the higher education process" (Eagle and Brennan, 2007, p.48).

Related to the internal customers - the academic staff, several countries in the EU including Sweden, Australia and the UK have gone as far as considering compulsory teacher training for lecturers. Some countries, (eg Norway), are currently implementing such a policy. We are not suggesting a similar policy but the acknowledgement that, if you 'train higher education teachers to teach, they will do a better job than untrained ones' (Trowler and Bamber, 2005: 80). Also if you train key leaders in change management and use teaching staff from the field from various organizations that used to be exposed to high pace of change, it proves more effective and less time consuming rather than doing it otherwise.

In most public or highly stratified organizations, accountability flows up the chain of command. The most prevailing way to achieve goals that are important to the customer is by creating customer choice. If customers can choose the service providers they prefer-the flow of money follows their choices-then the institution that serves them must be accountable for satisfying their needs.

The second approach is quality assurance. One can set "customer" service standards and require Universities to meet them or offer their customers some form of redress.

However, in order to use the customer strategy, one has to listen to the both internal and external customers, using surveys, focus groups, interviews, rating systems, complaint

tracking systems, etc. Although necessary, this is not sufficient to enforce change. The University management may find out what the customer wants, but it may not be willing to go through the pain of the changes required to carry it through for the sake of “push” rather than “pull” and avoiding serendipity (Hagel *et al.*, 2010).

In terms of the change application for Universities at their most “visible customer” level (i.e. the student) the Rigor/Relevance Framework further presented in Fig. 2.below (Jones, 2008) may prove an interesting view point knowledge-related. It uses four quadrants that represent levels of learning.

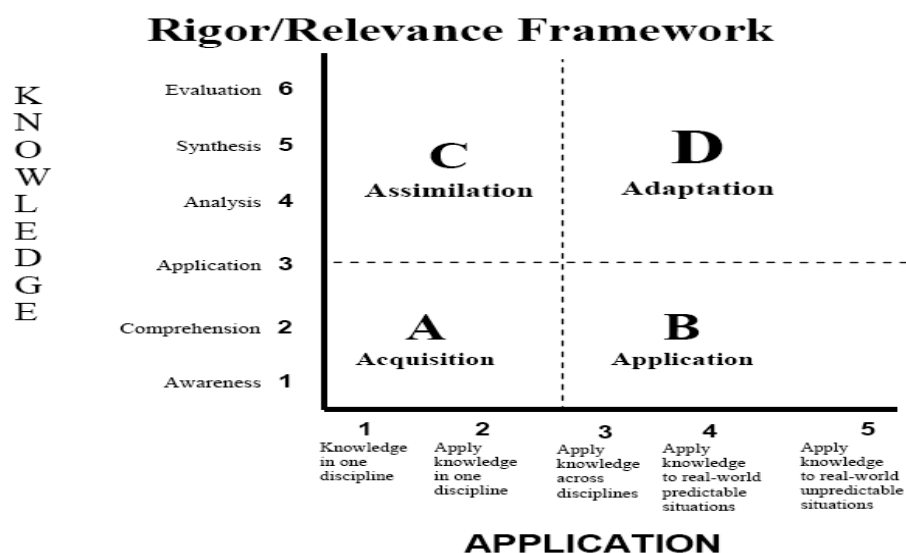
On the Knowledge axis, the framework defines low rigor as Quadrants A and B and high rigor as Quadrants C and D. On the Knowledge axis, Quadrant A represents a basic understanding of knowledge per se. Quadrant A is named “Acquisition” because students gather and store parts of knowledge and information.

Quadrant C, “Assimilation,” represents more difficult thinking, yet still knowledge for its own sake. In Quadrant C, students extend and refine their acquired knowledge to be able to use it automatically and routinely to analyze and solve problems and to create unique solutions.

Quadrants B and D represent actions or high degrees of application. In Quadrant B, “Application,” students use asked to solve problems, find solutions, and finalize work, fulfilling thus some employability criteria (Yorke and Knigh, 2006).

. In Quadrant D, “Adaptation,” students have the competence to think in complex ways as they apply knowledge and skills they have acquired to new and unpredictable situations. Students create solutions and take actions that further develop their skills and knowledge.

Knowing that students need a rigorous and relevant curriculum taught in a climate of positive relationships is an important step in school reform (Jones, 2008, pp 7), while the same way of thinking can be applied to other “customers” of the University.



*Fig. 2. Rigor/ Relevance framework Source (Jones, 2008, pp 5)*

Nevertheless, Jones (2008) matrix misses a control unit and measure and constant rethinking of the necessary double loops and feedback types necessary in learning and managing the process of learning and change, issues that we further discuss.

### **The Control Strategy**

The control strategy pushes considerable decision-making power down through the hierarchy and at times out to the community. It transfers the form of control from detailed rules and hierarchical instructions to shared missions and systems that generate accountability for performance. But what is performance for Universities: knowledge towards students, developing life-long learning skills, creating employability, generating academic knowledge, developing a great name worldwide, increasing shareholder's value no matter what? Maybe all together.

We have suggested four approaches in tackling this strategy:

- Organizational empowerment moves control down to organizations by loosening the grip of the central administrative structures, such as budget, personnel and procurement systems that are run under equalitarian terms.
- Organizations then use employee empowerment to push decision-making authority down to those with front-line knowledge. Finally, some re-inventers use a third approach, called community empowerment.
- They shift control from the University towards the community, empowering community members and other organizations to solve their own problems and take responsibility of their actions.
- Last but not least modifying the assessment methods of learning at all levels (student, instructor, management, community).

In terms of control tools, Private University managers and academia are relatively reluctant in using the Internet, in the sense of not letting it change exclusive knowledge management practices. However, implementation of Internet had been adjusted to acceptance of intranet and fostering communication among personnel for academic, managerial and supporting roles. It wants to exploit the advantages of online communication without letting such communication challenge its expertise model. But one cannot have it both ways. One cannot participate in a medium fundamentally developed around the concept of ingenuousness if one insists on a closed model of know-how and knowledge control, such as the above mentioned frame: the intranet.

In terms of managerial control over the teachers' unions and vice versa, one cannot act towards major changes unless it offers that "little something" gradually. Teachers' Union

negotiations with the management should not be “over the bush”, but transparent and with advancements based on concrete propositions and adjusted upon European benchmarks and accomplishments. In this respect, control pressure from the Union should be made from a third party/ consultant involved both in the negotiations process as well in drafting terms and conditions. The Union is always a tool for auditing and maintaining University regulations and system of work down to people.

### **The Compilation Strategy**

Creating a compilation of strategies and using consequences for performance is probably the most powerful lever in the reformation tool kit.

There are three approaches to working this lever:

- When appropriate, the greatest impact of this strategy can be achieved by using enterprise management: putting the University in a competitive market, making it dependent on its “customers” for its revenue, and letting it sink or swim based on how well it serves its customers. There is nothing like competition to force rapid change. This approach is only appropriate for services that should be paid for directly by their customers, but not for the academic and research work, where competition should come in terms of services and stimuli offered to “internal customers”.
- A second approach is called controlled competition. If you cannot put the University in a market you can often create competition through competitive contracting, by using “market testing” approach. As a paradox though, when a British University introduced a certain innovative programme, another American University won the funds in their own country on the same idea. The same thing can happen internally in Cyprus, when private universities compete in coping each others programmes instead of being innovative, searching for blended learning techniques, become innovative and focused on developing student’s creativity (MihaiYiannaki and Savvides, 2010) and diversity both in curricula development and in course delivery. Eventually, utilize disruptive innovation, a term of art coined by Clayton Christensen (2010), that can be introduced as a process whereby simple application of creativity related programs and change management for the bottom of a market can then relentlessly moves ‘up market’, eventually displacing established competitors.
- The third approach is performance management. If you cannot use competition, you can measure results and create incentives or rewards for those who accomplish them. You can use tools such as performance awards, performance pay, performance-based budgets, and gain-sharing to create incentives for high performance at both students and staff members’ levels.

## Research Methodology

The qualitative approach has been chosen by the research team as it provides an inventory of in-depth data with higher information content that cannot always be anticipated at the outset of the research process.

The significance, in particular, of qualitative methodology is also in the fact that it enables a contextual and social placement of gathered information, includes the process, causal and related nature of phenomena, and does not study and acquire, respectively, the data separately from other accompanying phenomena. Similarly, it allows for the acquisition of the so called “concealed” contents, which can easily escape the classical positivistic approach. Finally quantitative research often restricts experiences that are so crucial to ‘attitudes/opinions’ which is the focus of this research.

As the moderator can challenge and probe for the most truthful responses, supporters claim, qualitative research can yield a more in-depth analysis than that produced by formal quantitative methods.’ (Mariampolski, 1984).

These interviews contain standardized instruments that emerge from the literature review and the research theoretical framework grouped primarily on the categories of 5C’s and 4Ps. Also the purpose of the interviews was to discuss the importance of enhancing change adaptation, change behaviour, response to change and acceptance of change within the University/ Business School. Upon the obtained results, the paper has identified the main barriers and constraints related to change introduction in the Business School as well as has improved the research framework.

The main data collection instrument, the semi-structured interview was initiated with 4 of the members of the University and Business School authorities, managers and chair persons. Analysis has been conducted in the spirit of the Miles and Huberman’s (1994) approach, manually and mechanically. The manual part has included traditional analytical methods such as introducing marginal remarks and memos within the transcripts and then producing a one-page summary with key points for each semi structured-interview. At this stage, analysis was conducted in search of relationships and patterns.

Coding, for both instruments, was a combination of pre-coding and open coding. The pre-assigned codes were derived from the literature and the study’s objectives. Open coding was carried out during analysis, both at the manual and mechanical level.

Following the culmination of the above procedures, the research team was able to describe the current situation and isolate the knowledge, training, coaching and attitude deficiencies which needed to be addressed and included within change management recommendations part. However the results of the project provide an excellent opportunity for the future expansion of the topic idea at European and International level.

### Research Results Interpretation

<i>Organisational Imbalance</i>	<i>Change Pathology</i>	<i>Management responses</i>
<i>Over-reliance on individuals: too many evangelistic and autocrats few architects and educators</i>	<i>Creativity without learning</i>	<i>-No creative culture implemented, nor efforts in this way undergone till the settlement of change.</i>
<i>Over-reliance on systems: too many architects and educators few evangelistic and autocrats</i>	<i>Institutionalisation without creativity</i>	<i>-Overreliance on MIS, without understanding its role in the general strategy, fear of regulators, but positive feedback from them.</i>
<i>Over-reliance on thinking: too many evangelistic and educators few autocrats and architects</i>	<i>Ideas without implementation</i>	<i>-No initiative follow up, despite medium to high level of novelty acceptance, advertising is seen in a heterogeneous way. Bureaucracy gets things stuck.</i>
<i>Over-reliance on doing: too many architects and autocrats few evangelists and educators</i>	<i>Change without strategy</i>	<i>-Strong focus on customer strategy without innovation, but based on diversification, which may lead to control, quality and time management issues.</i>

Table 1. The Pathologies of Changes and EUC management response:

Source: (Lawrence et al., 2006, pp.65, and research results)

<i>Strategy Analysis</i>	<i>Research Results</i>
<i>The Core Strategy. Creating clarity of purpose for University reform.</i>	<i>Clarity recognized at managerial level in both form and content, but the strategy of change is very diversely seen.</i>
<i>The Culture Strategy. Changing employees' habits, modus operandi, hearts and minds.</i>	<i>Culture is not identifiable yet at managerial level. Initial stage of shaping organizational culture due to lack of specialized continuous training and human resources allocation. All is based on trust and on existing people's capabilities.</i>
<i>The Customer Strategy. Making Universities accountable to their customers.</i>	<i>Very diverse opinions on customer strategy, approach and education, as well as regarding supporting issues and processes.</i>
<i>The Control Strategy. Pushing control down from the top and out from the center. Do not fear serendipity though.</i>	<i>Very tall organization, with limited power of action at bottom level, lacking serendipity support and liberty of action regarding investments in people, systems and processes, and non-rigid but framed assessment systems.</i>
<i>The Compilation Strategy. Creating a set of actions for performance measurement and responsibilities.</i>	<i>Balanced compilation strategy, yet with missing parts affecting the overall change results, especially linked to management of resource allocation and lack of HRM transparent policies.</i>

Table 2. The Research Framework synthetic results

Source: Respondent's results based on author's semi structured interview as in Appendix 2.

### Emerging Recommendations for How to Change in Business Schools

The following eight components have been identify the more specific actions that schools must take to achieve rigor, relevance, and relationships. These eight are not sequential, but all must be addressed if schools are to prepare students adequately for their future. The aspects of the living system model should be reflected through each of these components.

- Be guided by a Common Vision and Goals through the Rigor, Relevance, and Relationships framework. Everyone must be committed to shared goals to measure success, and personnel must have the same viewpoint as to what is the main goal of the University.
- Be ready to avoid the pathologies of change in the University, by knowing well its imbalance, where is the vision and mission and the next following steps.
- Give power to Leadership Teams to Take Action and Innovate. Leadership does not reside in a single position, but reflects the aptitudes and attitudes of all personnel, as role models, who take action and improve through effective learning communities.
- Notify decisions virtually and through CIO (Cognizant, 2010) and allow budgetary liberty. The entire University reform is a continuous process guided by a well-developed data structure based on several measures of student learning. There is a need for quality data to make fast decisions about curriculum, instruction materials and methods as well as assessment. But, there is a need for separation of budgetary issues for better providing incentives to staff development, trust, commitment and bonding.
- Adopt effective Instructional Practices for lifelong learning. More than excellent marks, successful instructional practices include having a broad range of strategies and tools to meet the needs of diverse learners in all disciplines and grade levels.
- Make Clear Student Learning Expectations, letting though in innovation and creativity. When clarity takes place in explaining students what they are expected to learn, they meet with success in improving student realization, but also if creative incentives and modus operandi are enforced.
- Address Managerial Structures and Processes. Managerial structure should be determined by instructional needs. Only after a comprehensive review of instructional practices should schools begin to address managerial issues such as school schedules, use of time, unique learning opportunities, school calendars etc.
- Monitor Progress/Improve Support Systems. Highly successful programs recognize the need to monitor student progress on a regular basis. Successful higher education institutions use formative assessments in an organized, deliberate, and ongoing way to monitor student advancement. More, they use this data immediately to adjust instructional methods and adapt to meet student needs.
- Redefine and reinvent process on an ongoing basis and assure quality without copying models, but basing them on ethical standards and organizational culture. High-performing schools realize that success is a continuing and ever-changing course of action. This step in the process, in fact, should refresh the process and

cause University/ Business School leaders to consider new challenges and search potential solutions and successful practices internationally, find benchmarks and assure quality.

### **Deliverables from managing change in our research and case study**

The following three form the core still pending deliverables of our managing change framework at Universities/ Business School level:

- (1). Aim for rigor, relevance, and relationships, inspiring trust,
- (2) Begin with the end in mind, and look at the open non-vertical pyramidal cluster of strategies, allowing open innovation and creativity in process, content and form.
- (3) Consider Universities an organism that links the above strategies with the 4Ps through its 4 borders.

### **Conclusions**

This research has produced a theoretical framework backed by a case study where change management was interpreted in terms of semi-structured interviews and event methodology results for the European University Cyprus for the period of 2008-2011. We can conclude that this framework proves to be valid in the conditions and that a series of 10 principles result as conclusions to our research study.

These principles give improved detail to the practices that one needs to focus on when implementing quality changes and learning in higher education institutions:

1. Decide with data, not intuitions. True data-driven achievement involves much more than simply reacting to “low-test” scores. The choice of what and how much to change must be based on data that shows what the world beyond the Business School expects graduates to know and be able to do, but also what is ethical to know and do.
2. Enlist passionate people who glimpse opportunities. Leadership is one of the keys to success. That leadership is started and designed by a main leader, but is not restricted to a single individual. Successful Universities thrive with models of team and shared leadership.
3. Develop staff through professional and personal learning, training in managing change, and conflict. A staff team that functions as a professional learning community comes together for learning within a supportive community. At the same time conflict, which in times of change is inherent, should not be a threat to cooperation, nor needed to be resolved rapidly and permanently (Huczynski and Buchanan, 2001), but rather in a correct and just manner.
4. Inspire innovative instruction and engagement. Just as standards and tests do not constitute a curriculum, high-performing Business Schools recognize that curriculum is not instruction. The idea is to play the game on the uniqueness of each student and become a student centered organization. Prioritize the curriculum, as less is more. Teachers need to



engage in a clear way to help differentiate among curriculum topics that are essential for all students and those that are only nice to know.

5. Make good use with the community to form true partnerships based on keeping the promise and thus enhancing trust. Community and business partners bring many benefits to a University and especially to Business Schools in terms of learning, teaching, sharing, financial support and not least employability ( Yorke and Knight, 2006)

6. Hold teams accountable for learning results. Good leaders not only set powerful visions and high expectations, but also follow up to make sure staff implement approved practices.

7. Know your “customers”, know your strengths. Business Schools need to find ways to customize instruction by fully understanding the culture, prior experiences, learning styles, backgrounds, and interests of its all “customers”. At the same time they have to offer various success paths without distorting the most performing ones who are already implemented and have proven unbeaten. Rather than holding instructional approaches constant and putting up with different results in student accomplishment, multiple pathways create different alternatives for students’ assessment and ways to acquire the same learning.

8. Measure learning by know-how. Many Business Schools need to reexamine grading policies both at the school and classroom levels to ensure that student achievement measurement results in students being graded on proficiency rather than seat time.

9. Compel to high expectations. Business Schools that establish high expectations for all students and provide the support necessary to achieve these expectations have high rates of academic success. High expectations have to be a way of life and drive daily behaviors and actions.

10. Foster positive relationships to close the loop rigor/ relevance/ relationship. Strong relationships based on trust and commitments are decisive in students carrying out thorough work. Students are more likely to make a personal vow to engage in rigorous learning when they know teachers, parents, and other students actually care about how well they do.

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## Appendix 1. Research Semi structured Interview Base

The Interview questions are valid for the period 2008 to 2010. The questions “how much” have been scaled from 1 to 5. (Where: 1. is very little, 2. little, 3. some, 4. significant and 5. very much.)

- What is your opinion about change at University level in general?
- How much has the education environment changed for the past two years?
- Which are the areas of change needed in the University? (Name at least 3 areas).
- Where do you see your University coping best with change?
- What are the most difficult tasks in this respect?
- What are the three things you would change first now?
- Have you benefit of training in change management?
- How can the University improve service to its stakeholders?
- Students; B. academic staff; C. administrative staff; D. the community
- How much does money help you in managing change?
- What financial aids you consider in implementing change?
- Would a specific strategy that is known to everyone help you in implementing changes? Which is this one?
- How much uncertainty you think is acceptable when implementing change, if any from a scale of 1 to 5?
- How much planning do you use when implementing change in general and how much you use for this case?
- Do you involve your team in implementing change?
- Yes, why? To what level/ which areas? And how many of all your team members? Do you allocate extra members for this?
- No, why?
- How much of change do you consider in your core strategy?
- How much change you allow in controlling the business?
- How much have you changed in your department/ area?
- How much budgeting do you do when implementing change?
- What are three budget items you consider necessary but had not really thought about prior to this year's change and where would you cut this budget for this year?
- How much you want to change the believes of your personnel? If so how much you think you have changed their believes?
- How much you want to change the believes of your students? If so how much you think you have changed their believes?
- How much creativity from your staff do you allow when implementing change?
- Do you consider change at advertising level and publicity of your University and by which means?
- Do you consider change in the pricing, what prices would you use for students fees (promotional, skimming, etc)?
- Do you consider change in the type of customer niche and which would be this one?
- Do you consider change in the offerings of products? And to what degree of diversification?
- Do you consider change in the relationship with your partners (business ones) and other organization? How do you think this would this affect your future business?(How do you keep them happy?
- How much importance you give for free interchange of ideas?
- How much leadership you think is required in times of change for your University?
- How much novelty do you think is acceptable for your University?
- Do you think is good to follow the market or follow your own strategy?
- Have you reconsidered changing the goals set up two years ago?
- What are you most important performance indicator for your Institution?
- The human resources have had to be re-developed, sound personnel policies adopted, proper manpower planning implemented and assessment and a conscious policy adopted to improve management at all levels. How did you achieve this in your area?

- Regarding research / (your department) area what was the biggest change you (want to be) implemented?
- Are you satisfied with the achieved change strategies implemented at your University?

## Appendix 2. Research Semi structured Interview Responses

Question	No. 1	No. 2	No. 3	No. 4
1	change is inevitable, represents a continuous process, we have to learn from it, available to all academics and the society	very important, especially in the light of changes in the EU in higher education of the Bologna process framework.	under the factor of change as a positive promotor regarding the transformation from college to university status there was a need for rapid change.	it is a fulfillment of the strategy of the Ministry of Education of Cyprus, one of the axis of the strategy of Cyprus for education and health for the next 5 years
2	very significant in the private university area, less in public ones, in order to conform to legislation, internal procedures	in the private higher education yes a lot, but much in education in general	It has changed subsequently for more than 2 years. It has been expressed in process and procedures to be a university relevant and pertinent to the University status.	The university environment has changed a lot. Level 4 to accommodate students at each stage of the strategy.
3	teaching, research, administration, strategic development, change of bureaucratic procedures	quality assurance, development and implementation of international qualifications frameworks with 3 cycles, lifelong learning	overall university culture, autonomy, the research factor	culture of the people and instructors, systems and procedures, infrastructure (MIS)
4	teaching, because research is at its early stage and so is administration	quality assurance and ECTS	in research and cooperation with other universities or established academic networks	procedures we start coping with problems at MIS, infrastructure
5	assessment, find out new changes in the teaching methods, quality is very difficult to assess, how you assess only students' evaluation, faculty assessment is difficult and is done subjectively by students, peer review being done only during the first year and not later on.	got everyone involved	the adaptation of university culture in both administration and academic personnel	culture is very difficult to change due to resistance to change and systems
6	Schedule, too many things to do at the same time for the requirements of others, the system that we have, reducing the teaching load, changing mentalities, which is a long term process	more development of quality assurance, lifelong-learning, social inclusion, social responsibility in the community, capturing older graduate in catching up with their studying	comply with the University Charter, as the operations of schools and departments, mentalities	It is very difficult to change things, try to change the attitude of instructors to see themselves as faculty members for 24 hours in this job, to do continuous research oriented institution and in teaching in class
7	Only during my studies it was part of my subjects	Continuously, due to the evolution in various areas in the Higher Education.	yes, when this training is not instrumental oriented services	very difficult to convince and get accepted
8	a). reorganising the advising service, that people just for that, b). by not overloading them, c). should reorganise their MIS, d). increasing contacts with them	a. further enhancement of students Centre approach, b. more opportunities for development, c. more opportunities for development, d. give also programmes that serve university employees, private and public, municipalities.	a. by establishing a constant and perpetual feedback process and procedures. B. establish proven respect of academic outcomes, c. by providing regularly training and management and university oriented culture issues, d. Be again in constant and perpetual communication with community, an open locus for discussion and activities, collaborative type of activities and synergies in new projects that are of paramount importance for the community	a. see students as clients, adapt all services to be student oriented, to care, continuous monitoring and academic feedback of students, b. developing academic staff, give them opportunities to undertake research and more time for doing that, c. training and developing career paths, proper procedures, d. create research centres to solve problems of communities, respond to community needs through expertise and faculty members
9		4	4	2
10	they are rare for private universities, just funds from private enterprises	grants from outside society, state budget, in research and infrastructure	by allocating special budget for managing change oriented culture	money in terms of training and required research, not so important, but needed in bringing MIS, infrastructure supports
11	Change has to be small and continuous, because it can upset people, it should be planned and agreed, no change without asking them and complete buy in.	the SMART objectives we develop every year	interactive communication based on reciprocity	should be communicated to everybody. But people have resistance to change and it is set by law anyway and the University Charter
12		3	3	3
13	5,5	5,5	5,5	4,4
14	a. Yes, allow, programmes, courses, ECTS. It depends on the time, only all or only coordinators, administrative staff also. Yes in some cases.	a. Yes, all areas, No allocation of extra staff.	a. research. It depends on the project. The whole university	a. 4,5, all, yes people from outside the school
15		4	3	3
16		2	4	2
17		4	3	4
18		4	3	3
19	exceptional items, conferences, research, publications. I cut publications off	add more development advantages and introducing new motivation.	very centralised, it cannot work this way	nothing
20	4, 2	3,3	4,4	5,2
21	4, 2	3,3	4,4	2,2
22		3	4	5
23	essentially it has to increase, improve, consider more possibilities, mainly media and organisation events, conferences organised by the university and abroad.	toward academic nature	yes, this is done through needs and oriented culture advertising	I do not believe in advertising here, only in word of mouth and given results of students and to community
24	In new courses, promotional price for new courses makes sense	they are ok	no idea.	no, just promotional pricing for new programmes.
25	It is not feasible, the target market is given	give them more attention to some countries that were not before in	no idea.	yes, professional experience, executives
26	3/ new programs, adult learning seminars and professional studies	are significant changes in the programmes made.	accommodate balance	yes, high diversification
27	relationships are evolving, intensity networking, studying their needs, satisfy their needs for graduate training and senior staff training.	satisfy their needs as well	I consider the community perceptions towards our university is higher, and we got to serve it, this affects positively and forms of our synergism.	they are the final customers eventually, respond to their needs and to the community's needs
28		5	4	5
29		5	5	5
30		4	3	4
31	follow their strategies that follows market strategy	follow the market	what is to follow the market. No. we serve community needs not the market	follow the market is the boss
32	yes	no, but further enhance them	yes, definitely in order to adjust processes and regulations	yes
33	students retention, no of new students	service to the students in their activity and the overall image of the University	service to the community, students and state of art research	number of students, research of faculty members
34	to praise the employees achievements, no material items though	involvement of the people and encouraging initiatives	not applicable	2, did not achieve, just a little
35	1. encourage colleagues to carry out research and meeting. 2. provide the time to do that. moderately, not fully, it has to be recognised the need for investment, yet the university is not yet ready to invest in research.	get more faculty members involved in the research and teaching. Attracting more grants and financial support for the university	A new research policy that will affect the whole operation of the university and codification of all research performances.	involve faculty members more
36	teaching and MIS	yes, so far so good. Significant level 4.	to an extended part yes	not really, level 2

## CURRENCY RISK HEDGING DURING THE FINANCIAL CRISIS: A CASE STUDY

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### **Abstract**

This study tries to identify if the financial risk of foreign exchange exposure is neutralized or not for any given importer hedging an average of euro 100,000 per month with forward contracts. The exploration is based on the case study methodology triangulated with primary data collection and secondary data analysis of the exchange rates for forward contracts rates versus actual spot rates given by a Cypriot Bank for EURO versus USD, GBP and JPY.

The hypothetical question is tested by the Sharpe ratio and regards only the hedge or not hedge situation, out of the possible combinations, disregarding intermediary choices or transaction and translation costs. We have looked at the overall, but also annual results of the total hedging versus the total non-hedging strategies for the period of the financial crisis (March 2007-February 2010) and analysed the forward rates under the 'unbiased predictor' preconception. Our results show that always hedging is preferable to remaining un-hedged for the Cypriot importer for JPY exposures, remaining un-hedged is a better solution to GBP currency exposures, while the decision to hedge or not to hedge against the USD depends on the firm's perspective of data analysis and especially cash flow changes. Subsequently, we found dependency on non-hedging more to the currency depreciation, the reduction of the risk free rates, the volatility of the FWD and actual future Spot prices in the market, as well as longer time periods.

**Keywords:** currency risk, derivatives, FX exposure, financial crisis, hedging

### **Introduction**

Cypriot importers have a significant FX risk exposure due to their regional positioning as well as to the tight competition within the international market. However, Cyprus banking and corporate sector have few corporate hedging techniques available as derivative banking product solutions to mitigate such exposures. In practice, the only product available in the currency market is the forward exchange contract (FEC). Among the panoply of reasons for which this study is intended, one can mention the risk aversion of banks towards innovative financial derivatives, the lack of consensus in the local and international legislation in this field, as well as the mixed results in the empirical studies of theory of efficient foreign exchange market hypothesis.

The subject of this study is the analysis of a hypothetical Cypriot importing firm exposed to payments in GBP, USD and JPY against its receivables in EURO.

Specifically, the research is carried out for observing the performance of two opposing strategies in terms of their ability to optimize the domestic currency value (EURO) of the exposure versus the other three currencies. Hence, the first strategy is always hedge by using 1 month FEC at locked forward rate (FWD). The second strategy is not to hedge at all for all period of time; both strategies taking the possible risk of FX loss, but also the possible gains.

The study is based on secondary data analysis, collected on forward currency exchange rate, on actual rate as also on spot rate (each collected on the first trading day of each month) quoted for 36 months. Our research time span supports a 3-year data analysis, a special time due to the experienced financial crisis of 2007-2010. All the raw data are collected from the Treasury Department of the Bank of Cyprus (BoC) Public Company Ltd upon the authorization of the Department's Manager, as well as from the organised Money Market.

The study's questioning is if there any benefits to hedge FX exposure through the purchase of Forward Exchange Contracts (FECs) during the financial crisis, and challenges the literature (Eun and Resnick, 1997), who tested the hedging usefulness of FECs and their impact on lowering the possibilities of a financial distress.

Since Morey and Simpson (2001) considered FEC and measured their performance with *ex post* efficient frontiers and a simple return per unit of risk measure, like Jong *et. al.* (1997) who compared futures to remaining unhedged and used the Sharpe-ratio and minimum-variance as measures, the study is based also on *ex-post* data. Thus, our study uses primarily the Sharpe-ratio method for measuring the relative levels of risk for both strategies, but also their returns.

## Literature Review

### Market Efficiency and Foreign Exchange Risk Exposure

All currency fluctuations experienced during the last few decades has drawn attention to the potential vulnerability of multinational firms to FX risk. This topic has also produced a considerable amount of research (e.g. Giddy and Dufey, 1992; Jorion, 1990; Amihud, 1994; Bartov and Bodnar, 1994; Berkman and Bradbury, 1996; He and Ng, 1998; Allayannis and Ofek, 2000; Griffin and Stultz, 2001; among others).

Shapiro (1975), Hodder (1982), Levi (1994) and Marston (2001) argued that, exchange rate fluctuations are an important source of macroeconomic uncertainty; since having a significant impact on firm's value, regardless of whether the firm is domestically or internationally oriented.

However, due to the rapid pace of globalization few firms today could be considered as purely domestic and unaffected by exchange rate fluctuations (Bartov and Bodnar, 1994).

Consequently, the procedure of identifying and mitigating such mentioned risks through financial or operational hedging is defined as FX risk management which is absolutely essential, due to the increasing number of firms operating in multiple currencies.

The level of rate fluctuations is not certain or predictable, as it depends on the price, volume, volatility, interest rates, time to maturity etc of the FX exchanged at the transaction's date, but also as also on the efficiency of the FX markets. Research in the area of efficiency of FX markets has established only a weak form of the Efficient Market Hypothesis (EMH) (Fama, 1965) which implies that successive changes in exchange rates cannot be predicted by analysing the historical sequence of exchange rates (Soenen, 1979).

However, when the efficient markets theory is reasonably applied to the FX market under floating exchange rates there is some evidence to suggest that the present prices properly reflect all available information (Giddy and Dufey, 1992). This suggests that exchange rates react to new information in an immediate and unbiased way, so that no contestant can make a profit from this information. And certainly so, information on direction of the rates arrives randomly as exchange rates also fluctuate randomly.

Unbiased prediction means that the FWD on average will overestimate or underestimate the actual future spot rate in equal frequency and degree as presented in Eitman *et al* (2007, p.121). Differently said, the expected mean value of deviations in predicting FWDs is zero. Yet, in reality the FWD may never equal the future spot rate. In fact, the market efficiency assumes that: all relevant information is reflected immediately in the spot and forward exchange rates, transaction costs are low and instruments denominated in different currencies are perfect substitutes for one another (Eitman et al., 2007)

However, tests of FX market efficiency have come to a consensus that rejects this hypothesis; it appears that the FWD is not an unbiased predictor of the future spot rate and that it does pay to use all intelligence to try forecasting such rates. Moreover, Bodnar and Gentry (1993) among others argued that exchange rate movements affect some industries in a different way than others because some are more export or import dependent than others. They reported important negative exchange exposure for industries such as metal mining, heavy construction other than building, petroleum refining etc.

In our case, our hypothetical importing firm is exposed to such risks automatically, due to its exposure to foreign trade activities. And, since risk management plays a significant role for our Cypriot importer, the necessity of developing appropriate strategies to manage foreign exposure becomes crucial.

### **Missing empirical support**

The most surprising fact is the lack of empirical support for a statistically significant relation between firm's value and exchange rates; the possible reasons will be explained below. More precisely, Jorion (1990) investigated the currency exposure for a sample of U.S multinationals but found weak evidence of such a relation. Afterwards, Bodnar and Gentry (1993) examined the industry-level exposures and found that from industries in Canada, Japan and the U.S only 20% to 35% of them have significant exchange rate exposure.



In an attempt to explain the limited success of finding significant correlations from earlier studies, Bartov and Bodnar (1994) argued that one drawback possibly was the sample selection. Respectively, only firms that are heavily exposed to currency rate changes, as well as those with the same 'sign' of exposure – meaning that all firms benefit from either an appreciation or a depreciation of the exchange rate. Another potential drawback could be due to the existence of mispricing. Investors might incorrectly estimate the relation between firm's value and exchange rate movements introducing with this way, systematic errors. For the above mentioned reasons, they suggested the inclusion of lagged changes of the exchange rate and the simultaneous effect. Therefore taking a sample of firms they investigated the correlation between abnormal returns, derived from the market model and both contemporaneous and lagged changes in dollar. They did not find correlation with the dollar movements in the same time period but one period lagged-change had significant impact on the abnormal return. They performed also other tests but they came to the result that, it is difficult to establish a clear link between stock returns and changes in the exchange rates; these results are in line with Amihud (1994).

In a more recent study by He and Ng (1998) 171 Japanese multinational firms were analysed and significant exposure to exchange rate fluctuations for about 25% of the firms was found. He and Ng also looked at the determinants of exposure and found the estimated exposure are positively related to the level of a firm's export ratio as also it is related to variables that are proxies for firm's hedging incentives.

Based on the above mentioned surveys, we will examine whether or not as also at what level fluctuations on FX rates on GBP, USD and JPY currencies affects our firm's value and its overall portfolio returns.

### **Why stay un-hedged?**

Nance, Smith, and Smithson (1993) surveyed large U.S firms and reported that 38% did not use hedging instruments in 1986. Berkman and Bradbury (1996) found that 52% of publicly traded New Zealand firms did not hold derivative instruments for hedging purposes in 1994. Mian (1996) reviewed 1992 financial statements and found that 74% of the companies did not use derivatives. Geczy et al. (1997) also reported that, 59% of large non-financial U.S firms, did not use currency derivatives in 1991.

From a survey of Bodnar *et al.* (1998) for non-financial firms it was found that, the percentage of firms that uses derivatives has remained relatively constant over the past few years. He also reported that partial hedging is not uncommon for FX derivative users. In this respect, one possible reason could be the managers' belief that individual investors can hedge on their own if they desire to adjust their exposure, getting in line with several aspects of the EMH. Smith, Smithson and Wilford (1990) also argued that hedging can increase firm's value due to market imperfections and economies of scale.

In theory, shareholders may be able to diversify their exchange rate risk with portfolio strategies (e.g. Allayannis and Weston, 2001). On the other hand, Modigliani and Miller (1988) supported that the fact

that shareholders can hedge from their own, is not valid due to the highly transaction costs and their lack of knowledge about financial manipulations, however unavailable in this study.

Additionally, taking the fact of fully awareness of their exposure, as also reducing the possibility that shareholders can effectively hedge from their own, another reason could be that firms' managers may decide that cost outweigh the benefits. For example, Business Week (October 26, 1998, pp74-77) reported that an aggressive hedging strategy at Eastman Kodak was terminated because the costs outweighed the benefits; briefly speaking the company incurred losses when using such strategy.

Taking the above mentioned into consideration, we consider that the second strategy of our analysis takes place due to the importer's belief that derivative tools are neither appropriate nor sufficient to mitigate firm's exposures. It is also important to mention relevant studies that showed the consequences for the firms that stayed un-hedged.

Referring again to the survey of Eun and Resnick (1997), who firstly used the traditional passive hedge of FECs, but also introduced a passive strategy using put options; they also considered a number of variants of the random walk as the basis of the selective strategies. Using Sharpe measure of portfolio performances their results showed that the selective strategies based on random walk offer superior outcomes for an internationally diversified stock portfolio rather than of the passive strategies or remaining un-hedged.

On the other hand, Morey and Simpson (2001) considered different data and expanding the set of selective hedging strategies. They considered hedging only when the forward premium or the pricing of the deal is historically large and when relative purchasing power parity (PPP) model (Gustav Cassel, 1918) indicates an incorrectly priced bilateral exchange rate. Using ex post efficiency frontiers and return per unit of risk to compare the strategies they found that for 12 month time period the 'large premia' strategy (selective strategy that will not be used in this study due to lack of derivative price dissociation from the actual exchange rate) gives the best result and in all cases they noted that the un-hedged strategy performs better than the always hedge strategy.

### **The Use of Forward Contracts**

When hedging, companies are mainly using forward or future contracts, options and swaps. This study has focused only on the forward contract as it is the only one used by Cypriot companies in their local currency market. Moreover, the most reliable derivative providers, the banks use only the forward as a hedging method. Jesswein *et al.* (1995) examined the use of foreign exchange risk management products by 500 U.S firms. The results showed that, 93% of the respondents used forward contracts followed by swaps and options. Yet, perhaps the reason may be the simplicity in understanding the pricing and the transaction in itself. A study made by Joseph (2000) showed that British firms employed a narrow set of techniques to hedge exposure, as also they put emphasis on currency derivatives than on internal

hedging techniques. Possibly this issue has to do to the relative stability or the not so frequent 'setbacks' of the GBP compared to other hard currencies.

Moreover, Marshall (2000) studied the FX risk practices of 179 large British, American and Asia-Pacific multinational firms and found that the most popular external method for managing translation and transaction exposure is the forward contract, although swaps are most popular in British firms. Later on, Chan *et al.* (2003) examined the hedging practices of New Zealand, and he found out that the most frequently used as derivative tools to against FX risks, are the forward contracts. Some other surveys examined the use of derivatives to manage particular types of exposures (e.g. Eun and Resnick, 1994, Brealey and Kaplanis, 1995; Allayannis and Ofek, 2000; among others).

Glen and Jorion (1993) included in investors' strategy not only forward contracts but also primitive assets. They compared between the risk-return performance of globally diversified portfolios with the use and non-use of forward contracts. They showed that the use of forward contracts resulted in statistically significant improvements in the performance of the internationally diversified portfolios. Their particular study alters the equation though without specifying the integratory effects and compatibilities of the primitive assets.

On one hand, Eun and Resnick (1994) considered the impact on the investment results when exchange rate risk is hedged with FECs. The study showed improvement of the risk-return outcome when the international investments were hedged, which is an aspect we evaluate in the data analysis, when applying the Sharpe ratio interpretation.

On the other hand, Brealey and Kaplanis (1995) showed that commonly used strategies to hedge against currency risk, such as one-period cash flow hedges and long-term fixed hedges, may leave the firm exposed to FX risk. A continuously rebalanced hedge is needed in order to enhance the hedging effectiveness of a forward contract. But, this method is rather time and resources consuming, while it may need dedicated software or an automatic system for calculations, besides analysts for data interpretation. However, through this study we may see what happens on a medium period of time.

Allayannis and Ofek (2000), and Graham and Rogers (2000) observed the use of currency derivatives as the only particular type of exposure, since the adoption of such 'method' increases the ability to control the variation in intrinsic values, a much debated topic for finance people. It is important to mention that despite the fact that the purchase of FECs can be modified to the needs of each party, the firm losses the opportunity to benefit from a better spot rate prevailing in the date of transaction compared to the FWD given. A hedged position will hence not produce the benefit of favourable exchange movements, but on the other hand 'insure' the firm against undesirable exchange rate fluctuations.

To sum up the literature review findings, we have considered the hedging and non hedging results for different geographic areas, for different periods of high fluctuations or non-crisis related ones. Moreover,

a correlation with other derivatives has been presented, the competitive influence or the way they are interrelated.

Ultimately, considering all the above mentioned conflicting research results and theories, doubt still remains over the issue of whether a firm should hedge or not hedge its position. Also evaluating the consequences obtained from the decision to not hedge at all, we test out the level of consistency with previous researchers.

Therefore our research questions levitate around two important issues:

1. Are there any benefits to hedge FX exposure through the purchase of FECs and how this change during financial crisis? Which returns portfolio outperforms? (Use or not-Use FEC)
2. Does the research exercise reflect the EMH so that the FWD is an unbiased predictor of the future spot rate?

## Methodology

### The study methodological tools

Secondary data include both quantitative and qualitative data, and they can be used in both descriptive and explanatory research (Saunders et al, 2003), as well as permanent and available (Denscombe, 1988). The first set of secondary data we use in this research is both raw data, such as the LIBOR one month (1M) rates collected from the Internet specialised websites ([www.global-rates.com](http://www.global-rates.com)) for the three currencies' interests used (GBP, USD, JPY), and compiled data that have received some form of selection and summarising (Kervin, 1999) from multiple sources. The second set of secondary data refers to the selection for the period of March 2007-February 2010 (i.e. 36 consecutive months) for the today's spot rate (SP1) which is the closing day rate of the bank, then for the actual or future rate (SP2) which is the next month rate and for the one month forward rate (FWD 1M) all being bank indirect quotation for (GBP/Euro, USD/Euro, and JPY/Euro). Such category of data is obtained from the Cypriot Bank's treasury department system.

The forward quotations obtained are expressed as a percent-per-annum deviation from the spot rate, method of quotation facilitating comparison of premiums or discounts in the forward market with interest rate differentials. However, our research is not focused on the analysis of the forward price based on the interest rate differentials, due to lack of direct transaction pricing, and the lack of the actual deposit rate offered in the interbank market.

All returns are calculated according to the direct quotation system available in the importer's country (i.e. Cyprus).

$$\% \Delta = \frac{(\text{Ending rate} - \text{Beginning Rate}) \times 100}{\text{Beginning rate}}$$

The advantage of the secondary data in our case allows a larger historical selection of data to fit our analysis of the FX rates during the financial crisis; as also it is unobtrusive, quickly obtainable and provides room for longitudinal studies.

Our main interpretation tools are eventually the standard deviation of returns, the average of returns and risk free rates which are analysed for each compiled portfolio, while the Sharpe ratio will emphasise the reward for risk in both chosen trading strategies (actual vs. forward).

What we try to observe over the entire 36 month period, is the total net proceeds that come from transacting Euro 100,000 at the rate differentials (FWD-SP2) for hedging compared to the total net proceeds that come from the rate differentials (SP2-SP1), for non-hedging. Then we compile all these in the same way to find our targeted Sharpe ratio and interpret it as a measure of risk-return appetite and volatility.

### Methodology

Saunders et al. (2003) mentioned, there is no clear solution to problems facing measurement invalidity. While organizations may argue their records are reliable, there are often inaccuracies and inconsistencies, however the fact that the screen-prints of the rates are directly extracted from the Bank's live-database and by an official of the bank, these strengthens the reliability and validity of the data, besides the fact that they do not refer to the current business of the bank but to historic ones.

### Sharpe Ratio (S) in depth

Since Sharpe ratio is a risk-adjusted measure of return that is often used to evaluate the performance of a portfolio; making the performance of one portfolio comparable to that of another by making an adjustment for risk. The study employs the Sharpe ratio for calculating the average return and above the risk free rate ( $R_f$ ) of return per unit of portfolio risk. The ratio uses the standard deviation of a portfolio's total return as the measure of risk (Eitman et al., 2007). We have used this measure accordingly, by dividing the difference between the average returns and the average of the  $R_f$  (LIBOR 1M of each currency) to the standard deviation of such portfolio returns.

The formula of Sharpe ratio used is:

$$S = (E[R] - R_f) / \sigma$$

Where:

For our research calculations these estimators are based on the actual returns when analyzing the monthly Sharpe ratios, but also on returns averages, when analyzing both the annual and the three year period.

$R_f$ : is the benchmark rate called risk free rate of return different for each month, as Libor interest rates are not constant through the year, fluctuating daily. We use  $R_f$  as such when calculating Sharpe measure per month, while when calculating the same ratio for the year and for the 36 month period we utilize its average value.

$E[R]$ : is the expected value of the rate of return derived from each strategy.

$R$ : is the rate of return (i.e.  $R_1$  (FEC),  $R_2$  (non-FEC)).

$\sigma$ : is the standard deviation of the amounts obtained either when hedging at FWD or not hedging at SP2;  $\sigma$  is computed for the portfolio of monthly, annual or the 36-month period returns.

The reason for choosing the LIBOR rate is that such  $R_f$  is closer to the actual price of each currency, rather than treasury bills interest rates, which are more appropriate in equity markets where it offers investors an opportunity to participate in a company's success through an increase in its stock price. To ensure a smooth timeliness support for the reward risk analysis through Sharpe measure, we have looked also at the monthly estimated return for each strategy and the  $R_f$  of each month against the incurred risk (Stdev) of the two strategies.

Drawing on the thread of literature in order to evaluate the portfolios that are created, the Sharpe-ratio model of Howard and D' Antonio (1984,1987) is used as it mentioned previously. Due to the fact that we use historical data, the version of ex-post Sharpe ratio (ex post calculations) is used to where the differential returns is the average over several months.

Additionally, Sharpe ratio has as its principal advantage that it is directly computable from any observed series of returns without need for additional information regarding the source of profitability. Other ratios such as the bias ratio indicator have recently been introduced into the literature to handle cases where the observed volatility may be an especially poor proxy for the risk inherent in a time-series of observed returns and hence it is not appropriate for our approach.

Also, our selection based on the Sharpe ratio's independence on time over which it is measured. It will change with time period depending on the actual historic data, but there is no correlation between it and the length of time period. This is because the return and the standard deviation both increase with time. The Sharpe ratios which are calculated over different months are directly comparable. Moreover, our selection of Sharpe ratio based on the fact that a differential return represents the result of a zero-investment strategy.

Concluding this part, it is essential to mention the reasons for selecting Sharpe ratio rather than other available methods. We did not use the Sortino ratio (Brian M. Rom, 1986) as it uses downside deviation for the denominator instead of standard deviation, the use of which doesn't discriminate between up and down volatility. Therefore, the reason for not employing such method is due to the high probability of its non-consecutive occurrence in our sample and the importance of taking into account not only the returns

that have downside price volatility but also the effects of upward price movements; thus to evaluate which strategy is better to choose, for hedging purposes. In addition, we do not use the Treynor ratio (Jack L. Treynor, 1966) is that it focuses only on systematic risk of a portfolio as it assumes a portfolio manager has diversified away all the unsystematic risks in contrast with the Sharpe ratio that works with both systematic and idiosyncratic risks. Another reason of rejecting this method as a measure in our samples is that, it is not straightforward and intuitive as the Sharpe ratio and requires an understanding of the Capital Asset Pricing Model -CAPM (Jack Treynor; 1962). Recently, the (original) Sharpe ratio has often been challenged with regard to its appropriateness as a fund performance measure during evaluation periods of declining markets, such as the assumed period for our analysis.

### Unbiased predictor test formula

Eventually for the unbiased predictor test, we check the formulaic representation of the forward rate for GBP/Euro for example:

$$\text{Fwd (GBP/Euro)}_{30\text{days}} = \text{SP (GBP/Euro)} \times \frac{[1 + (i\%\text{GBP} \times 30\text{days}/360 \text{ days})]}{[1 + (i\%\text{Euro} \times 30\text{days}/360\text{days})]}$$

Where Fwd (GBP/Euro)<sub>30days</sub> is the forward rate for the next month that we try to predict based on the spot rate of today (e.g. SGBP/Euro) , the i%GBP and i%Euro are the risk free rates represented by LIBOR 1M for GBP/ USD/ JPY respectively and Euro.

For this reason we calculate the difference between the predictor and SP2 and then the difference between the Predictor and the FWD (FEC) applied to the amount of Euro 100,000 in order to see if the changes in the FWDs and the predictor follow or not the market changes, meaning the SP2 (as presented in Appendix 4).

### Data Analysis

Data analysis is presented based on five appendices presented at the end of the study and hence in 5 subsections: Appendix 1 (GBP/Euro), Appendix 2 (USD/Euro), Appendix 3 (JPY/Euro), Appendix 4 The unbiased predictor analysis and Appendix 5 Research Data Analysis Results against the findings of previous researchers and against our research questions.

### The GBP/ Euro results

Regarding the returns comparison presented in the charts and the tables of Appendix 1, it appears that the rate of returns for every period R2 (non-FEC) > R1 (FEC). For brevity reasons, it becomes apparent that for each period separately the result follows the same pattern; as R2>R1.

Combining briefly these results, the returns volatility is the highest in period 2, incurring contradictory positive large returns for non-FEC and negative large returns for FEC; the same pattern being applicable for period 1 and 3 even if for these periods the risk taken for R2 is slightly higher.

Moreover, compared to the huge discrepancies registered with the associated returns outcome as shown at Box 4.1.1.2, there is no traditional correlation between risk and return of the two portfolios. What we can notice is that the high risks associated with the portfolio returns are providing either good gains or large amounts of losses. Thus, even if the risk level from both approaches on this date is at highest level, one can conclude that the importer is better off not to use FEC as it generates high returns otherwise.

### **Sharpe Ratios values**

The Sharpe ratios values ( $S_1$ ,  $S_2$ ) for each period and overall in Appendix 1 shows the most of them bearing negative values for both strategies during the entire period of analysis; meaning that the lesser the negative outcome the more effective strategy for the importer. All these negative relative results are generated by the fact that in most cases the LIBOR 1M rate for each currency, exceeds both rates of returns  $R_1$ ,  $R_2$  ( $R_f > R_1$  (FEC),  $R_f > R_2$  (non-FEC)). A uncommon situation occurred in the period 1 (chart 4.1.2.1), in August 2007 and June 2007, where both  $S_1$  and  $S_2$  reached their lowest value (-0.01685%, -0.00763%) respectively. due to the fact that both rates of return are importantly smaller than the  $R_f$ .

Observing the Sharpe ratio values during period 2, the most impressive difference ( $S_1 - S_2$ ) takes place only on June 2008 where both  $S_1$  and  $S_2$  reached their lowest values on the whole financial crisis period; while this result is presumably based on previous results where both  $StdevR_1$ ,  $R_2$  reached their highest value. Thus the difference between the  $R_f$  and the rates of returns has a determinant role while for both approaches  $R_f$  is superior.

Evaluating the illustrations presented in Appendix 1, the results show that during all periods separately the rewards of  $S_2$  are better than of  $S_1$  ( $S_2 > S_1$ ); while the  $R_f$  had sharply diminished period by period, while the discrepancies between both  $S_1, S_2$  had reduced, too.

Closing the analysis of the Sharpe ratio values as it is shown on the above Box illustration of the total value of them, one can clearly notice that  $S_2 > S_1$ ; which means that choosing an un-hedged approach provides a relative profit, as also superior returns on average while taking similar risk. Selecting to hedge against GBP through the purchase FEC, is proved that the importer, registers a loss under similar risk conditions.

From the aforementioned results it has been demonstrated how the difference between rate of returns and risk free rates in both  $S_1$  and  $S_2$ , has a determinant role. The essential difference between  $S_1$ ,  $S_2$  and  $R_f$  is due to the depreciation of the British pound and the BoE's intend to help UK exports become more attractive internationally and keep the economy of Britain in good shape after the Northern Rock event in 2007. The BoE needed to enhance liquidity after the 'credit crunch' especially in the banking industry, the economy propeller.



**The Euro/USD results**

Combining the results shown in Appendix 2, following the same methodology, it is obvious that for periods 1 and 3 the  $R2$  (non-FEC) >  $R1$  (FEC) and for period 2,  $R1$  (FEC) >  $R2$  (non-FEC). Also, during period 2 both of the rates of returns reached their maximum and their minimum values for the entire time horizon.

Specifically, one can notice that during all the periods and overall the FEC returns are riskier than non-FEC, i.e.  $StdevR1 > StdevR2$ .

**Sharpe Ratios values**

It is obvious that during period 1 the  $S1 < S2$ , hence the rewards for staying in un-hedged position with the same risk taken were favourable than to hedging through the purchase of FECs.

During period 2  $S1 > S2$ ; while the superiority of  $S1$  occurred with the highest difference up to 0.00046% denoting that the rewards gained from hedging were much better than those from non-hedging regardless of the higher risk taken.

Analyzing period 3, one can clearly notice that the rewards of  $S2$  are higher of  $S1$  with smaller risk taken ( $StdevR2$ ), meaning that the decision for the importer not to hedge his risk generates higher rewards.

Chart 4.2.2.5 is a summarized chart, illustrating clearly the level and pace of shrinking the difference between  $S1$  and  $S2$  while coming in line with the previous results;  $S2$  prevails in periods 1 and 3 so having higher rewards for the same level of risk taken and  $S1$  prevails in period 2. It is important to mention that as the USD Libor Interest rate was diminishing during the each period (Box 4.2.2.1 in Appendix 2) the discrepancies between  $S1$  and  $S2$  are substantially reduced too.

Surprisingly, one can notice that for the entire financial period,  $S1$  yields even with slightly difference higher rewards than  $S2$  does; meaning that the rewards gained from the hedge position generates higher returns. However, it is important to analyze at what level risk free rates decline affected both  $S1$ ,  $S2$ . These reductions affected the rewards taken from both strategies rising the question of which strategy is better in such situation as the differences between  $S1$  and  $S2$  in total are very small and the amounts of the latter during the whole period is gradually increasing.

**The Euro/JPY results**

Evaluating the results shown in Appendix 3, it is obvious that for period 2 and 3,  $R1$  (FEC) >  $R2$  (non-FEC); while in period 1  $R2$  (non-FEC) exceeds  $R1$  (FEC).

Evaluating the periods separately, it is shown that for period 2 and 3, the decision to hedge against JPY proved to generate positive returns while hedging in period 1, the returns were negative.

In terms of acceptable risk, when combining the illustrations in Appendix 3, one can notice that the Stdev's of all the returns follow one another, having close values, with the risk of hedging being lower than non-hedging overall. In detail, StdevR1 compared to StdevR2 proved to show less risk during periods 1 and 2, but riskier during period 3, despite the high volatility incurred during period 2 for both portfolios.

Considering now the previous return results (Box 4.3.1.2), the best period to hedge proved to be the period 2, where the R1 supports smallest risk, as at the same time generating higher rewards, compared to R2 which is backed by high risk and incurs large amount of losses.

In contrast with period 3, where  $\text{StdevR1} > \text{StdevR2}$ , the rewards gained from choosing FEC (R1) are positive JPY 114,660 compared to R2 which generates a loss of - JPY 177,000, which is exactly the opposite case we have in period 1.

### **Sharpe Ratios values**

Analyzing the results shown in Chart 4.3.2.1 and Box 4.3.2.1, we notice that during period 1, S1 and S2 have similar values. Considering the factors that influenced such results, one can exclude the factor of the  $R_f$  which remains approximately in the same level from the previous month (just 0.01% difference, as it shown in Appendix 3), the result shows that this situation is due to the continuous appreciation trend of the JPY against most currencies and most importantly for our case, JPY depreciation against the Euro.

Analysing period 2, the results shown that  $S1 > S2$  making the decision to hedge to be favourable for the importer. Chart 4.3.2.3 shows S1 mirroring S2, but bearing values in opposite direction. In correlation with Box 4.3.2.1, one can notice that for the whole period 3,  $S1 > S2$  despite small differences; meaning that the rewards gained through the purchase of FEC are higher at the same level of risk.

Chart 4.3.2.4 summarizes the Sharpe ratio values for each period separately, in consistency with the results shown so far, with the  $S1 > S2$  for the periods 2 and 3 while  $S2 > S1$  in period 1.

Combining these results with the results given in Box 4.3.1.2 and 4.3.1.3, we noticed that in period 1, the decision to stay in un-hedged position, provides higher rewards, higher volatility of returns at a slightly higher level of risk, while the hedged position provides substantial losses.

During periods 2 and 3, it proves that the hedged position is profitable compared to the losses registered while un-hedged, despite contrasting discrepancies between the risk values (Stdev).

An analysis of Sharpe ratios totals it essential now in order to evaluate which strategy generates favourable rewards for the full period of financial crisis.

### **The unbiased predictor role of the forward rate**

Considering the charts presented on Appendix 4 as the base of discussion for each currency evolution regarding the unbiased predictor theory, we have compared actual/future spot rates SP2 to the predictor

rate, as well as the predictor with the quoted FWD given by the bank. The results show in all cases very similar results for FWD and the predictor, meaning the bank is utilising a certain predictor formula close to ours. However, concomitantly, the actual market (SP2) does not follow the predictor, registering large fluctuations, although the patterns of the SP2 are sequencing the predictor.

Our results prove a relatively weak efficiency form of the market, which is consistent with part of the literature review presented and to the possible assumptions of asset market determination in the literature review.

When applying the estimation formula example mentioned in the methodology at 3.2.4, one can notice that it provides results that show 'traits' of unbiased predictor, yet the fluctuations of the predictor versus the actual spot rate are too large to sustain the estimator efficiency, especially in two important market changes (January- March 2008 and January-March 2009). Another reason could be that once following a certain trend, the bank will also adjust its pricing accordingly and provide FWD rates that are more effective in the market, which if followed by all banks and players in the market will push the price at within its estimations bands, but not necessarily in an opposite direction.

### **Research Data Analysis Results**

Based on data analysis it appears that FEC is proved to be ineffective as a derivative tool for offsetting GBP exposures during this period or when the risky currency depreciates continuously and FWD rates look more volatile than the actual rates. Hence, in this particular case all Sharpe ratios show positive returns for the level of risk taken for the non-FEC (SP2).

In the analysis of Euro against USD portfolio challenges results. Although non-hedging proved to be the better solution of offsetting exposures in USD currency, the difference between S1 and S2 is very small in favour of S1, but difficult to interpret. Yet, the non-hedge strategy's risks (Stdev) all through each year and overall proved to be lower, while both strategies' returns showed alternative conflicting results. In brief, the USD hedging proved inefficient due to the incurred losses, yet under conditions of high volatility of SP2 rates compared to the FWD ones.

All through our analysis it is proved that the  $R_f$  plays also a very important role in sustaining or demising the actual average in the long run, but also the currency depreciating and appreciating movements.

Finally, the results of our survey from the portfolio analysis of Euro against JPY showed that FECs are definitely effective derivative tool for mitigating exposures in JPY currency as the rewards gained through them are much higher than from not hedging at all. Again, this may be correlated to the fact that the JPY, the currency aimed for hedging, had continuously appreciated against the Euro, while overall the FWD price for JPY was less volatile than the SP2. At the same time, although annual Sharpe ratios

have also mixed results, overall the Sharpe ratio for FEC for the 36-month period is superior despite registering a higher risk (Stdev) for SP2 compared to FWD and SP1.

Synthetically, the results of our research can be condensed as in the table of Appendix 5.

Following the line of investigation done by Eun and Resnick (1997), we came to the same result that is improvements in the risk-returns outcomes when hedging against the USD and JPY currency. This result is also consistent with the study of Gien and Jorion (1993) that proved improvements in the performance of diversified portfolios when FECs are used.

In terms of proving if the FWD rate is an unbiased predictor, our analysis shows a weak form of this theory, followed by a weak form of market efficiency, especially because in the market it proves that all relevant information is not reflected immediately in the spot and forward exchange rates, but it takes time until the rates are adapting, meanwhile the importer being exposed to high risk and eventual losses.

Again, to sustain further the unbiased hypothesis a longer period of time may be suggested and information gaps and market imperfections may be needed to be further improved.

Also due to inexistent transaction costs, other issues related to this topic become irrelevant.

However, contrary to Shapiro (1975), Hobber (1982), Levi (1994) and Marston (2001) who argued that, exchange rate fluctuations are an important source of macroeconomic uncertainty, this study shows that if persisting on a certain type of strategy may prove to be profitable or not depending on the currency trend, strength, and not necessary on the industry.

Also, from our study the results showed consistency with the argument of Howard and D'Antonio (1984,1987), as the Sharpe ratio model proved to be an effective tool providing sensitive interpretations of our study.

Eventually, the results in absolute values could have been completely different if the amounts exchanged would have fluctuated also, which is consistent to the literature review.

## Conclusions

Pursuing an extensive critical analysis of well-established literature review regarding currency price volatility, hedging through derivatives, EMH, this study considered two financial success strategies for foreign trade companies going concern.

The two strategies are opposing, but not self-exclusive: always hedge and not hedge at all the FX payables exposure in GBP/USD/JPY against receivables in Euro of an importer operating from Cyprus, during the financial crisis of 2007-2010.

More explicitly, our literature review provided mixed and conflicting support to EMH theory, hedging prices predictability, their link to asset type dependency, despite the increasingly high usage of derivatives as hedging tools.

For not forcing out our results and for locking our study to the FEC tool, we have not compared the efficiency of various existing derivative tools also due to the lack of such products available with the Cypriot banks, but we would recommend it for other research types. Also we have not used combined strategies due to potential arguments regarding the weight of each hedging technique, although such approach is worth testing, as many importers partially hedge their FX risk also on various maturities and amounts, this impacting directly on their discounted cash flows.

Other motives such as regulation and trust were also not approached for the same reason of testing FEC efficiency versus non-FEC, although if recognised such interventions, result in consistent results changes.

We have analysed the limitations of several results on forward as a hedging technique, as well as those of not hedging and in relation to research time horizon. Literature review shows those longer periods of time are more relevant than short term ones, while various regions react differently depending on the dynamics of their currency strength; therefore it will be advisable to correlate for future research the impact of optimum currency areas.

Finally the data analysis, supported by secondary data obtained from official sources of a Cypriot Bank as well as publicly accessible professional websites, was able to give responses to the three main set of research questions set during the literature review process, which consider the impact on firm's annual profitability, the effectiveness of FECs and results' reflections on EMH and spot price predictability.

In detail, our empirical results showed total loss registered in GBP portfolio returns when using FECs compared to significant profits while un-hedged all through the analysed periods. Subsequently the Cypriot importer should not hedge its GBP currency exposures at all with FECs, especially when the currency registered continuous depreciation against the Euro, despite any immediate reduction of the representative risk free. These findings came into contrast with the Eun and Resnick (1997) surveys that showed improvements of the risk-return outcomes, when the international investments were hedged through FECs. This study results also conflict with those of Edwards (1982), who argued that unanticipated changes of some exchange rate determinant might not always be important as in some nations it may take people more time to find out the news. Hence, this study shows a sign that during financial crisis information asymmetry issue escalates rather than prompting for enhanced decision making, which is contrary to Giggy and Dufey (1992) suggestion that prices reflect all available information.

Contradictorily, the results of Bartov and Bodnar (1994) found that one period lagged-change had significant impact on the abnormal returns; as it is shown in our GBP portfolio negative returns outcomes lead to catastrophic money deficits and increased probabilities for a firm's financial distress or damage.

Ultimately, we can argue that current GBP spot rates provide weak support for the unbiased predictor as the FWD rate, although closely quoted to the estimator deviates substantially from the future actual spot rate, although in time it readjusts to the market. This is only because the forward quotations are rather based on the present spot rate, but not necessarily estimators of future spot rates.

Moreover, from the USD portfolio analysis the results lead to differing outcomes and to simultaneous divergent answers to our main research questions. This is due to the differences between the rewards obtained under hedge and not hedge strategy, with the later being overall superior, despite its relative lower risk. One can argue that despite the small difference in the Sharpe ratios, hedging proved inefficient, although in the second year of the financial crisis, the high SP2 volatility brought profits. Additionally, one can sustain that while results show higher total returns generated through non-FEC, Stdev measures are good enough evaluators of an investment portfolio as the modern portfolio theory assumes.

Lastly, for JPY we obtained overall better Sharpe ratios under FEC, while non-FEC at all incurred large losses and registered a higher volatility on SP2 as well as during the 36-month period. Therefore, the JPY/Euro hedging, FEC proved to be effective, not because of continuous reduction of  $R_f$ , but rather due to a continuous appreciation of the JPY against the Euro.

We can conclude that the methodological tools employed the Sharpe ratio and standard deviation of returns proved to be useful and easy to apply, especially for the GBP and the JPY, despite using the averages of portfolio returns and risk free rates over the standard deviations of the portfolio returns. It also proved useful a breakdown of the entire period in three main annual periods, which managed to identify the periods with the highest price volatility.

However, for the USD, the close results of the Sharpe could not provide a clear decision, thus the absolute returns, the average returns and standard deviations made a better delimitation, as presented in the last synthetic Box 4.5.1.

The risk free rate utilised showed to have a relative impact in the study, by being a catalyst in the movements of the SP prices in the market in one direction or another, but also in supporting currency depreciation or appreciation

The general conclusion emerging from our results is that over the periods considered, always hedging is preferable to remaining un-hedged for the Cypriot importer for JPY exposures, remaining un-hedged is a better solution to GBP currency exposures, while the decision to hedge or not to hedge against the USD depends on the firm's perspective of data analysis and especially cash flow changes. Last, but not least, we proved that the spot rates are a weak form of an unbiased predictor for the actual future spot rate (as it can be shown in the Appendices 1-4) where the predictor follows the FWD, but not the SP2 and where over or under estimations of future spot rates occurred in equal frequencies, but did not approach zero. This means that our exercise's results reflect also a weak form EMH as the current rates already reflect

past rates and volume information; while FWD rates are the most publicly and easily accessible 'prices' of information.

One can support that there is a need for analysis for longer time periods, as the financial crisis affected importantly our results, not only with the sharp depreciations/appreciations of foreign currencies but also to the reduction of risk-free rates and sudden shifts in portfolio returns.

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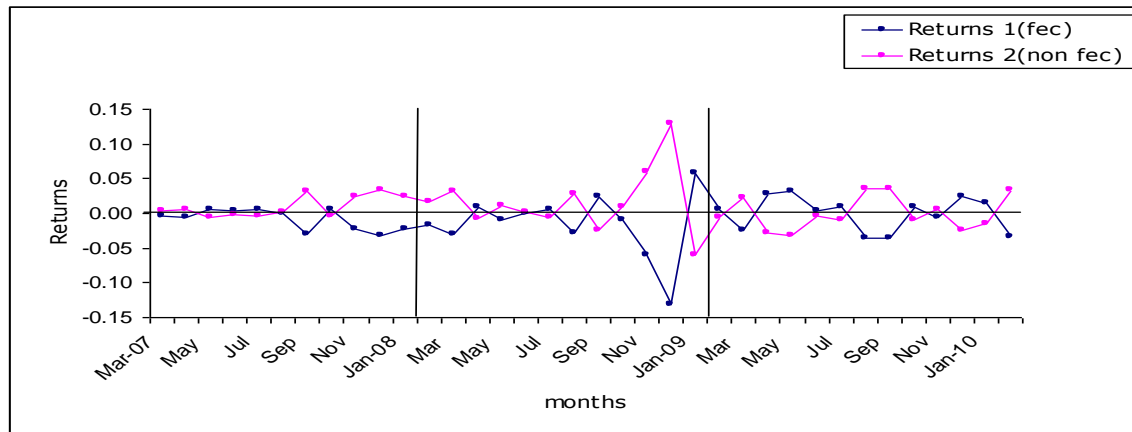
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## Appendix 1

Chart 4.1.1.1: Rate of Returns for FEC and non-FEC (GBP)



Box 4.1.1.1: % Average of the rate of Returns at each period (GBP)

<i>Average</i>	<i>R1(FEC)</i>	<i>R2(non-FEC)</i>
<i>period 1</i>	-0.943%	1.087%
<i>period 2</i>	-1.355%	1.404%
<i>period 3</i>	-0.096%	0.098%

Box 4.1.1.2 Sum of R1, R2 (GBP)

	<i>R1 (amounts)</i>	<i>R2(amounts)</i>
<i>entire period</i>	-21235.20	22876.00
<i>period 1</i>	-8055.10	9236.00
<i>period 2</i>	-12464.80	12905.00
<i>period 3</i>	-715.30	735.00

Box 4.1.1.3: Stdev for R1 and R2 (GBP)

	<i>Stdev R1</i>	<i>Stdev R2</i>
<i>entire period</i>	2686.45	2686.86
<i>period 1</i>	1027.7	1033.1
<i>period 2</i>	4039.9	4031.1
<i>period 3</i>	2247.7	2249.9

Chart 4.1.2.1: Sharpe Values (GBP)

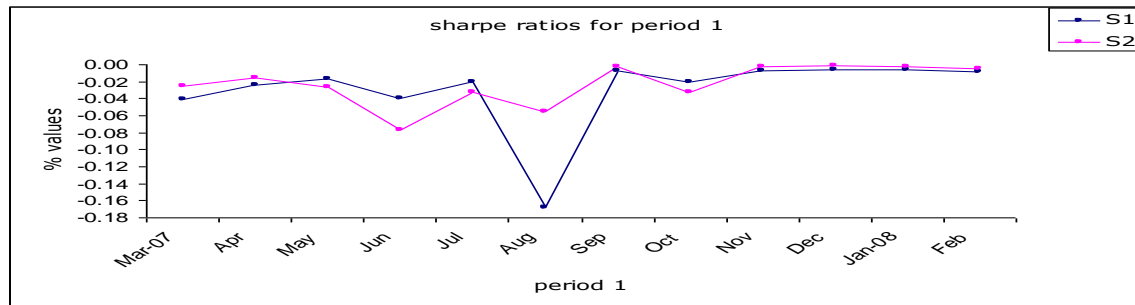


Chart 4.1.2.2: Sharpe Values (GBP)

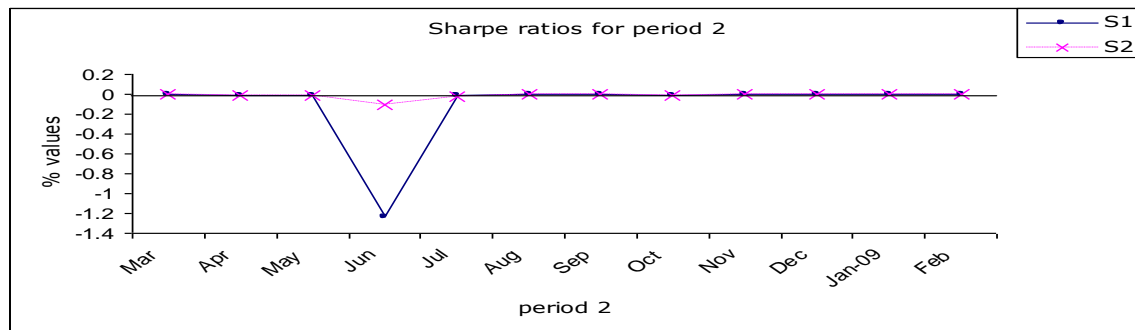
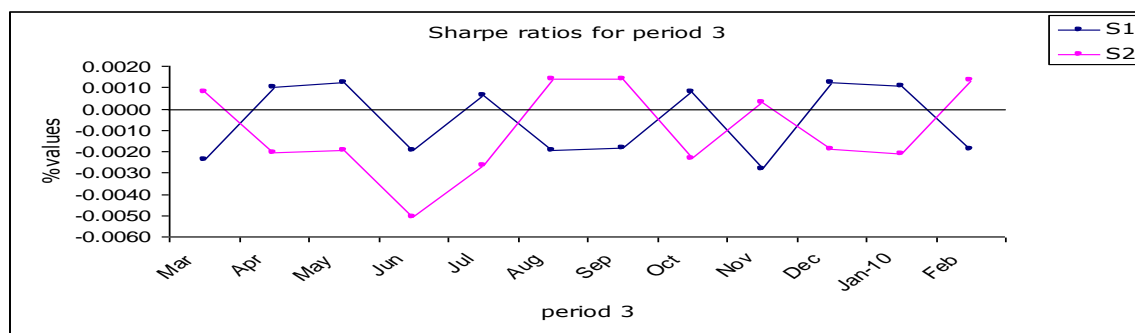


Chart 4.1.2.3: Sharpe Values (GBP)

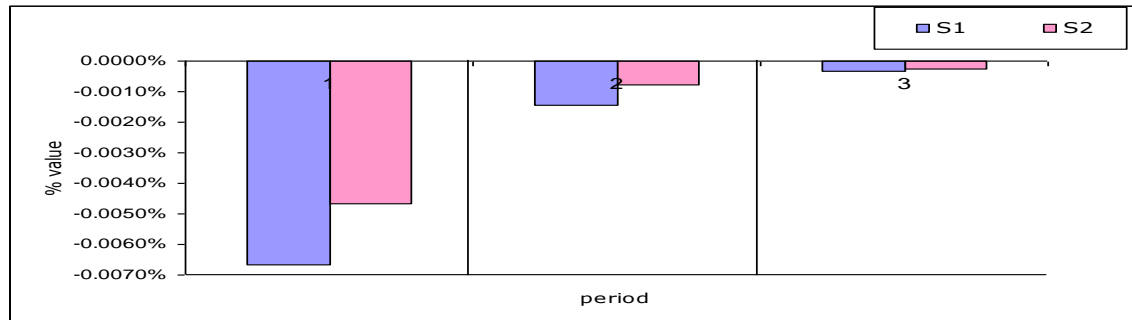


Box 4.1.2.1: Sharpe's ratio values (GBP)

	S1	S2	Avg Rf rate
Period 1	-0.0066%	-0.0046%	5.890%

<i>Period 2</i>	-0.0015%	-0.0008%	4.523%
<i>Period 3</i>	-0.0003%	-0.0002%	0.649%

Chart 4.1.2.4: Sharpe ratios S1 and S2 (GBP)



Box 4.1.2.2: Sharpe's ratio total for 3 periods (GBP)

	<i>S1</i>	<i>S2</i>
<i>Stdev R(amounts)</i>	2686.453	2686.849
<i>Avg R(FEC &amp; non-FEC)</i>	-0.798%	0.863%
<i>Avg Rf</i>	3.687%	3.687%
<i>Sharpe total</i>	-0.00167%	-0.00105%

#### 4.1.3 Risk-Free rate illustration

Chart 4.1.3.1: Risk-free rates (Libor 1 M GBP Interest Rates)

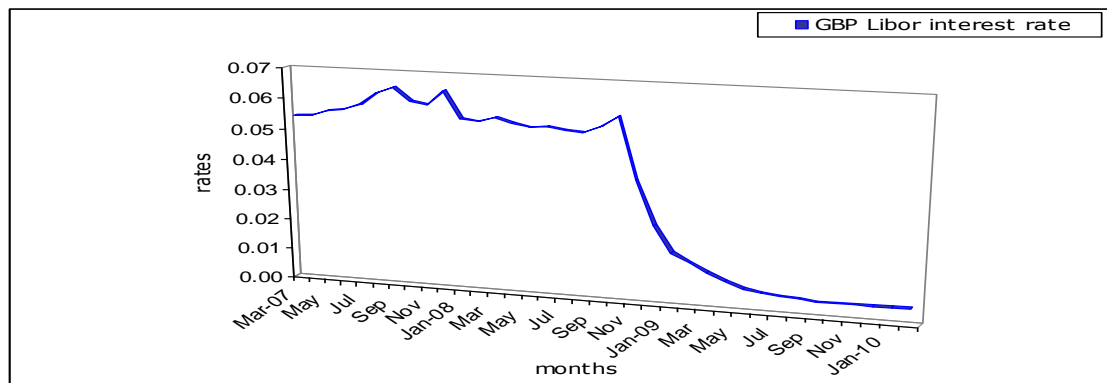
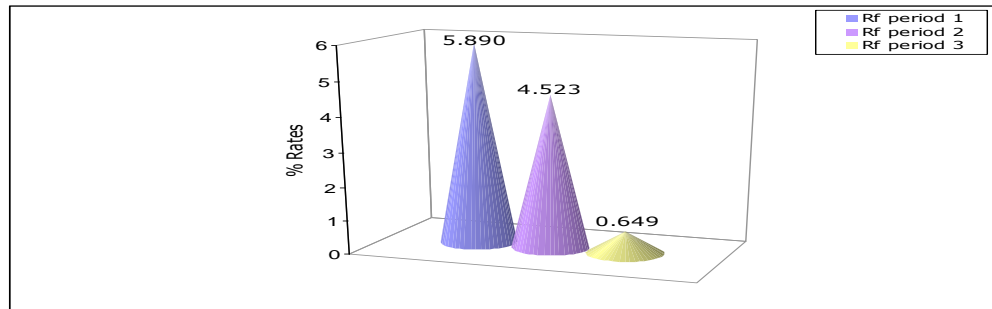


Chart 4.1.3.2: Risk-free average per period (GBP)

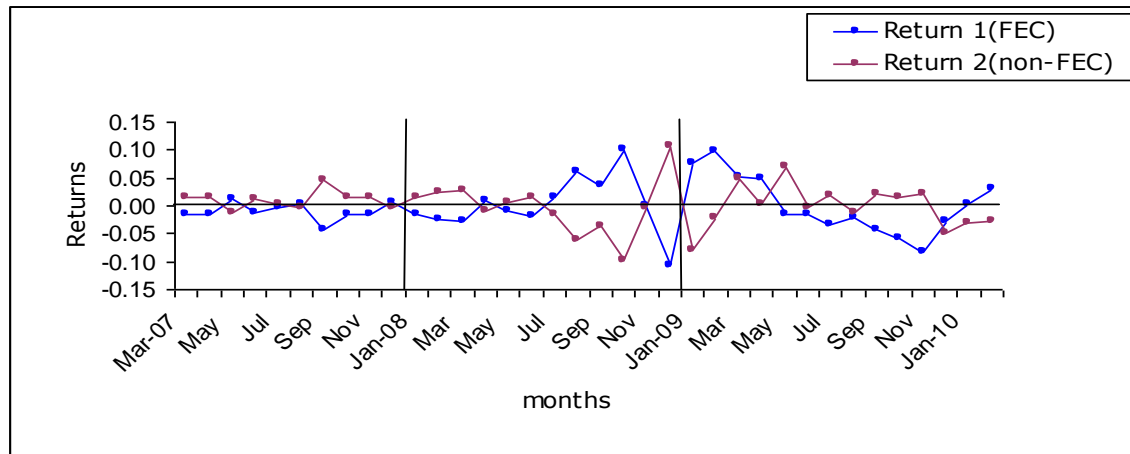


**Data Table 1. GBP/EUR**

<i>DATE</i>	<i>Risk-free rate</i>	<i>Return1</i>	<i>Return2</i>	<i>Return 1 (FEC)</i>	<i>Return 2 (nonFEC)</i>	<i>SDEV1</i>	<i>SDEV2</i>	<i>Sharpe 1 (S1)</i>	<i>Sharpe 2 (S2)</i>
03/01/07	0.05434	-195.70	286.00	-0.00290	0.00425	138.38	202.23	-0.000414	-0.000248
04/02/07	0.05470	-353.30	440.00	-0.00522	0.00651	249.82	311.13	-0.000240	-0.000155
05/01/07	0.05647	432.00	-335.00	0.00634	-0.00492	305.47	236.88	-0.000164	-0.000259
06/04/07	0.05717	196.30	-109.00	0.00290	-0.00161	138.81	77.07	-0.000391	-0.000763
07/02/07	0.05910	373.20	-274.00	0.00551	-0.00405	263.89	193.75	-0.000203	-0.000326
08/01/07	0.06294	-53.50	154.00	-0.00079	0.00229	37.83	108.89	-0.001685	-0.000557
09/03/07	0.06507	-2038.10	2162.00	-0.03015	0.03204	1441.15	1528.76	-0.000066	-0.000022
10/01/07	0.06073	390.10	-283.00	0.00559	-0.00406	275.84	200.11	-0.000200	-0.000324
11/01/07	0.05994	-1592.30	1688.00	-0.02293	0.02434	1125.93	1193.60	-0.000074	-0.000030
12/03/07	0.06465	-2300.30	2417.00	-0.03232	0.03402	1626.56	1709.08	-0.000060	-0.000018
01/01/08	0.05617	-1699.20	1801.00	-0.02310	0.02452	1201.52	1273.50	-0.000066	-0.000025
02/01/08	0.05548	-1214.30	1289.00	-0.01612	0.01713	858.64	911.46	-0.000083	-0.000042
03/03/08	0.05701	-2312.30	2404.00	-0.03017	0.03140	1635.04	1699.88	-0.000053	-0.000015
04/01/08	0.05565	730.30	-636.00	0.00924	-0.00806	516.40	449.72	-0.000090	-0.000142
05/01/08	0.05451	-770.60	834.00	-0.00983	0.01065	544.90	589.73	-0.000118	-0.000074
06/02/08	0.05503	-6.30	75.00	-0.00008	0.00095	4.45	53.03	-0.012371	-0.001020
07/01/08	0.05427	445.60	-383.00	0.00562	-0.00483	315.09	270.82	-0.000154	-0.000218
08/01/08	0.05372	-2218.50	2272.00	-0.02812	0.02882	1568.72	1606.55	-0.000052	-0.000016
09/01/08	0.05600	2033.80	-1987.00	0.02506	-0.02449	1438.11	1405.02	-0.000022	-0.000057
10/01/08	0.05940	-686.60	728.00	-0.00867	0.00920	485.50	514.77	-0.000140	-0.000098
11/03/08	0.03958	-4770.60	4818.00	-0.05970	0.06033	3373.32	3406.84	-0.000029	0.000006
12/01/08	0.02558	-11041.80	10976.00	-0.13050	0.12962	7807.73	7761.20	-0.000020	0.000013
01/01/09	0.01737	5595.50	-5655.00	0.05853	-0.05912	3956.62	3998.69	0.000010	-0.000019
02/02/09	0.01466	536.70	-541.00	0.00596	-0.00601	379.50	382.54	-0.000023	-0.000054
03/02/09	0.01180	-2105.00	2090.00	-0.02353	0.02336	1488.46	1477.85	-0.000024	0.000008
04/01/09	0.00948	2630.40	-2644.00	0.02874	-0.02888	1859.97	1869.59	0.000010	-0.000021
05/01/09	0.00743	2816.90	-2827.00	0.03169	-0.03180	1991.85	1998.99	0.000012	-0.000020
06/01/09	0.00665	261.20	-274.00	0.00303	-0.00318	184.70	193.75	-0.000020	-0.000051
07/01/09	0.00602	838.90	-834.00	0.00978	-0.00972	593.19	589.73	0.000006	-0.000027
08/03/09	0.00557	-3053.10	3062.00	-0.03593	0.03604	2158.87	2165.16	-0.000019	0.000014
09/01/09	0.00509	-3102.90	3108.00	-0.03525	0.03531	2194.08	2197.69	-0.000018	0.000014
10/01/09	0.00510	931.20	-923.00	0.01022	-0.01013	658.46	652.66	0.000008	-0.000023
11/02/09	0.00514	-578.00	580.00	-0.00641	0.00643	408.71	410.12	-0.000028	0.000003
12/01/09	0.00514	2203.70	-2196.00	0.02427	-0.02419	1558.25	1552.81	0.000012	-0.000019
01/01/10	0.00517	1381.60	-1359.00	0.01559	-0.01534	976.94	960.96	0.000011	-0.000021
02/01/10	0.00532	-2940.20	2952.00	-0.03370	0.03384	2079.04	2087.38	-0.000019	0.000014

## Appendix 2

Chart 4.2.1.1: Rates of returns for FEC and non-FEC (USD)



Box 4.2.1.1: % Average of the Rate of Returns at each period (USD)

Average	R1(FEC)	R2(non-FEC)
Period 1	-1.114%	1.201%
Period 2	1.961%	-1.422%
Period 3	-1.315%	0.665%

Box 4.2.1.2: Sum of R1, R2 (USD)

	R1(amounts)	R2(amounts)
entire period	-5538.70	3630.00
period 1	-18706.00	20110.00
period 2	35189.70	-26050.00
period 3	-22022.40	9570.00

Box 4.2.1.3: Stdev for R1 and R2 (USD)

	Stdev R1	Stdev R2
Entire period	6142.72	5328.46
period 1	2073.92	2055.12
period 2	8186.28	7429.45
period 3	5754.51	4696.19

Chart 4.2.2.1: Sharpe ratios (S1, S2) for the whole period (USD)

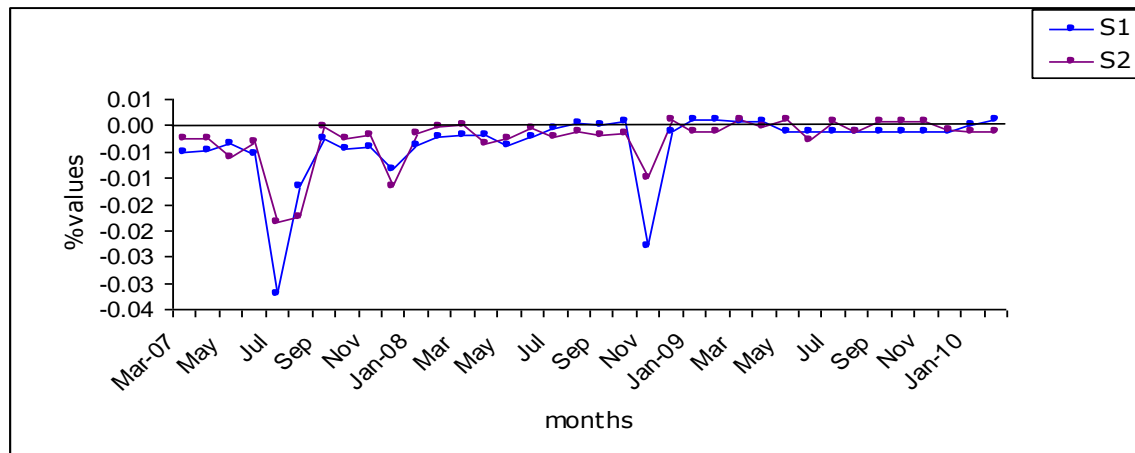


Chart 4.2.2.2: Sharpe Values (USD)

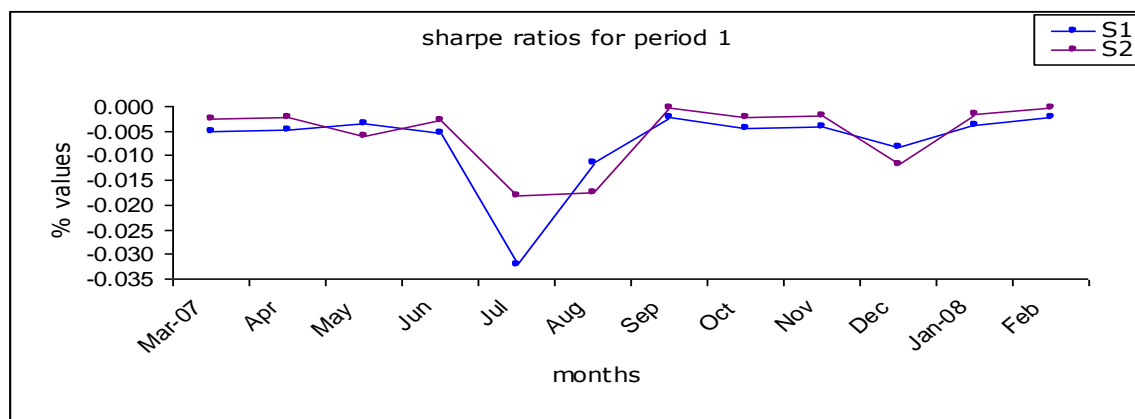


Chart 4.2.2.3: Sharpe Values (USD)

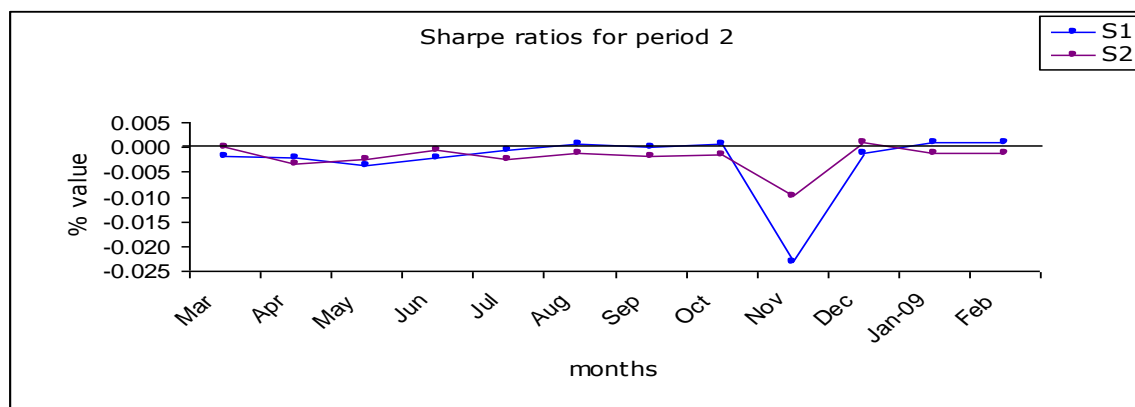
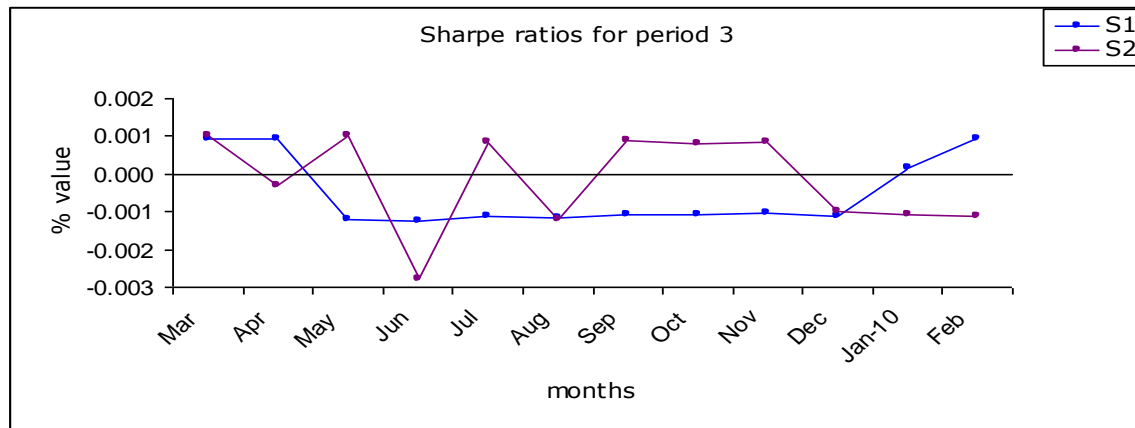


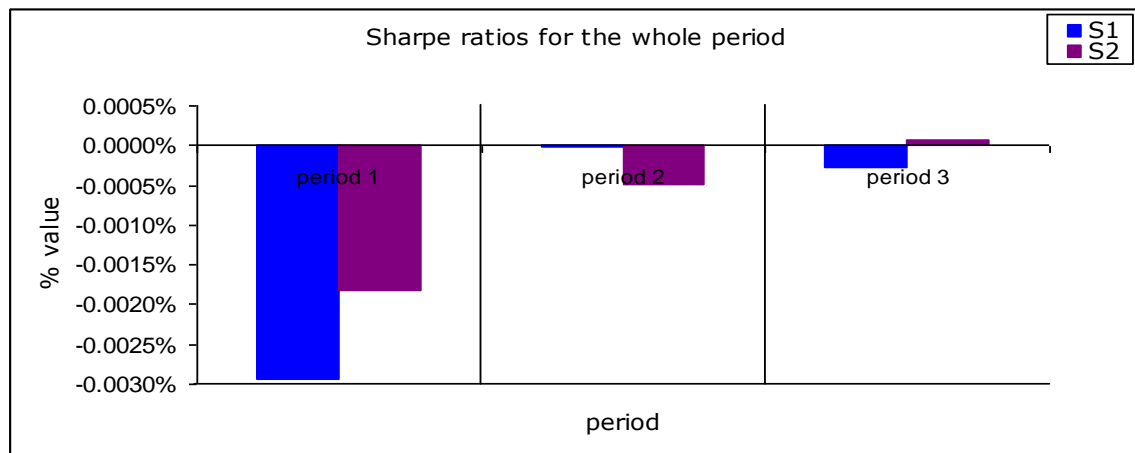
Chart 4.2.2.4: Sharpe Values (USD)



Box 4.2.2.1.: Sharpe's ratio values (USD)

	S1	S2	Avg Rf
Period 1	-0.00292%	-0.00183%	4.952%
Period 2	-0.00002%	-0.00048%	2.149%
Period 3	-0.00028%	0.00008%	0.303%

Chart 4.2.2.5: Sharpe ratios S1 and S2 (USD)





Box 4.2.2.1: Sharpe's ratio total for 3 periods (USD)

	<i>S1</i>	<i>S2</i>
<i>Stdev R(amounts)</i>	6142.716	5328.456
<i>Avg R (FEC &amp; non-FEC)</i>	-0.156%	0.148%
<i>Avg R<sub>f</sub></i>	2.468%	2.468%
<i>Sharpe total</i>	-0.00043%	-0.00044%

## 4.2.3 Risk-Free rate illustration

Chart 4.2.3.1: Risk-free rates (1 M Libor USD Interest Rates)

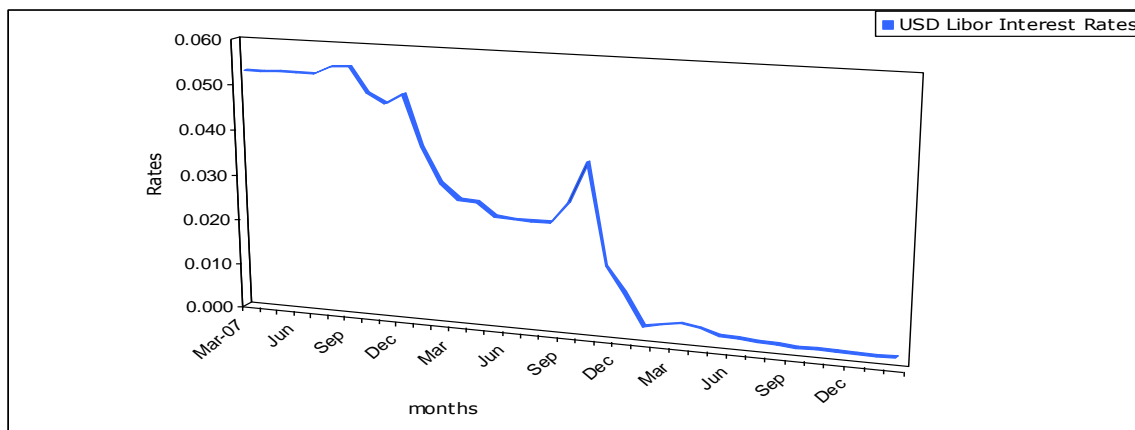
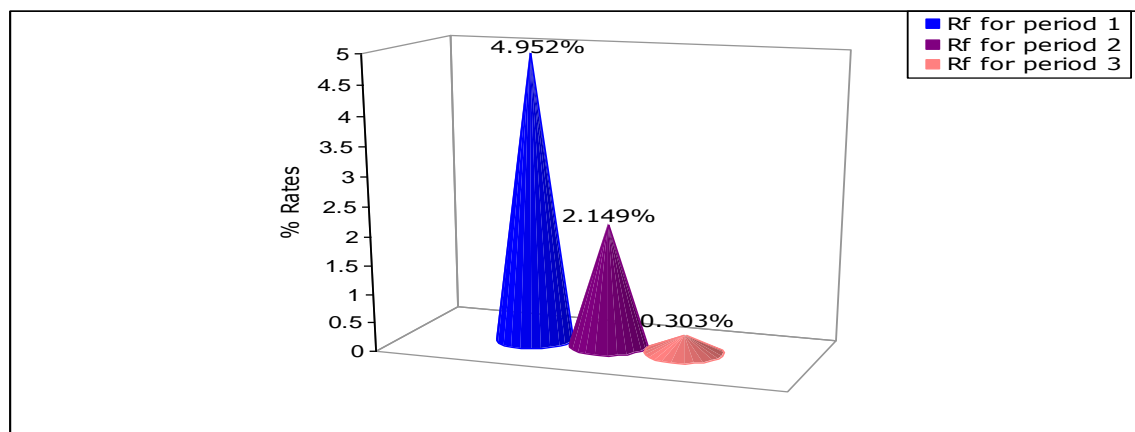


Chart 4.2.3.2: Risk-free average per period (USD)

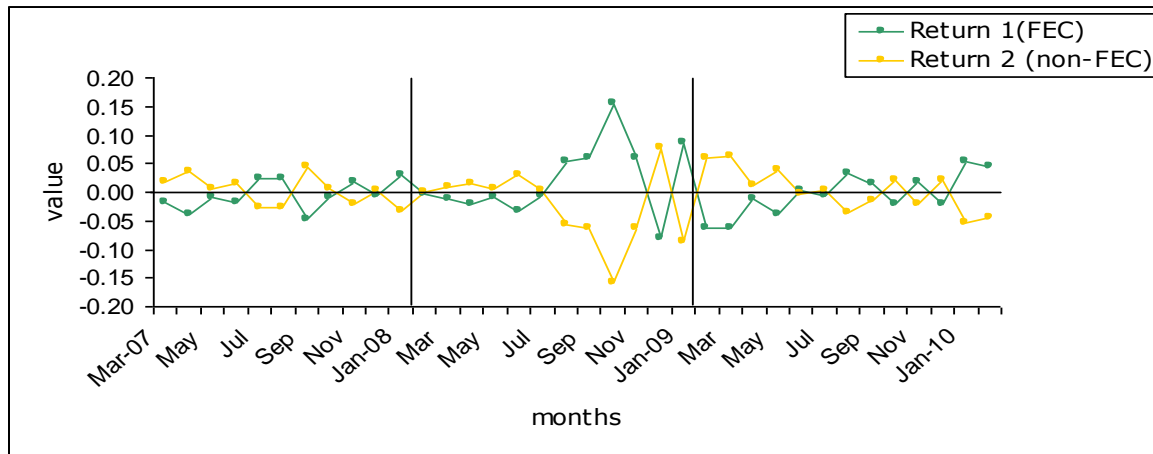


Data Table 2. USD/EURO

DATE	Risk-free rate	Return 1	Return 2	Return1 (FEC)	Return2 (nonFEC)	SDEV1	SDEV2	Sharpe 1 (S1)	Sharpe 2 (S2)
03/01/07	0.05320	-1866.90	2040.00	-0.0142	0.0155	1320.10	1442.50	-0.000051	-0.000026
04/02/07	0.05320	-2049.70	2210.00	-0.0153	0.0165	1449.36	1562.71	-0.000047	-0.000023
05/01/07	0.05320	1695.60	-1520.00	0.0125	-0.0112	1198.97	1074.80	-0.000034	-0.000060
06/01/07	0.05320	-1704.90	1850.00	-0.0127	0.0138	1205.55	1308.15	-0.000055	-0.000030
07/02/07	0.05320	-242.00	390.00	-0.0018	0.0029	171.12	275.77	-0.000321	-0.000183
08/01/07	0.05497	618.00	-470.00	0.0045	-0.0034	436.99	332.34	-0.000115	-0.000176
09/03/07	0.05512	-5860.00	6050.00	-0.0430	0.0444	4143.65	4278.00	-0.000024	-0.000003
10/01/07	0.04981	-1977.60	2100.00	-0.0139	0.0148	1398.37	1484.92	-0.000046	-0.000024
11/01/07	0.04767	-2203.50	2270.00	-0.0153	0.0157	1558.11	1605.13	-0.000040	-0.000020
12/03/07	0.05017	761.00	-660.00	0.0052	-0.0045	538.11	466.69	-0.000084	-0.000117
01/01/08	0.03909	-2039.50	2120.00	-0.0140	0.0145	1442.14	1499.07	-0.000037	-0.000016
02/01/08	0.03137	-3836.50	3730.00	-0.0259	0.0252	2712.82	2637.51	-0.000021	-0.000002
03/03/08	0.02807	-4391.40	4240.00	-0.0289	0.0279	3105.19	2998.13	-0.000018	0.000000
04/01/08	0.02785	1366.60	-1540.00	0.0088	-0.0099	966.33	1088.94	-0.000020	-0.000035
05/01/08	0.02506	-1264.00	1060.00	-0.0082	0.0069	893.78	749.53	-0.000037	-0.000024
06/02/08	0.02470	-2714.00	2470.00	-0.0175	0.0159	1919.09	1746.55	-0.000022	-0.000005
07/01/08	0.02460	2214.20	-2460.00	0.0140	-0.0156	1565.68	1739.48	-0.000007	-0.000023
08/01/08	0.02468	9436.50	-9690.00	0.0607	-0.0623	6672.61	6851.86	0.000005	-0.000013
09/01/08	0.02927	5271.20	-5500.00	0.0362	-0.0377	3727.30	3889.09	0.000002	-0.000017
10/01/08	0.03810	14102.90	-13920.00	0.1003	-0.0991	9972.26	9842.93	0.000006	-0.000014
11/03/08	0.01621	95.00	-260.00	0.0008	-0.0021	67.18	183.85	-0.000230	-0.000099
12/01/08	0.01083	-13526.90	13470.00	-0.1072	0.1067	9564.96	9524.73	-0.000012	0.000010
01/01/09	0.00383	10874.80	-11070.00	0.0779	-0.0792	7689.64	7827.67	0.000010	-0.000011
02/02/09	0.00463	13724.80	-2850.00	0.0984	-0.0222	9704.90	2015.25	0.000010	-0.000013
03/02/09	0.00532	7434.80	6290.00	0.0533	0.0500	5257.20	4447.70	0.000009	0.000010
04/01/09	0.00461	6964.80	470.00	0.0499	0.0036	4924.86	332.34	0.000009	-0.000003
05/01/09	0.00342	-2325.20	9290.00	-0.0167	0.0701	1644.16	6569.02	-0.000012	0.000010
06/01/09	0.00316	-2075.20	-250.00	-0.0149	-0.0018	1467.39	176.78	-0.000012	-0.000028
07/01/09	0.00291	-4515.20	2440.00	-0.0324	0.0172	3192.73	1725.34	-0.000011	0.000008
08/03/09	0.00270	-2795.20	-1720.00	-0.0200	-0.0119	1976.50	1216.22	-0.000012	-0.000012
09/01/09	0.00247	-5955.20	3160.00	-0.0427	0.0222	4210.96	2234.46	-0.000011	0.000009
10/01/09	0.00244	-8105.20	2150.00	-0.0581	0.0148	5731.24	1520.28	-0.000011	0.000008
11/02/09	0.00238	-11405.20	3300.00	-0.0817	0.0224	8064.69	2333.45	-0.000010	0.000009
12/01/09	0.00233	-3785.20	-7620.00	-0.0271	-0.0505	2676.54	5388.15	-0.000011	-0.000010
01/01/10	0.00232	384.80	-4170.00	0.0028	-0.0291	272.09	2948.64	0.000002	-0.000011
02/01/10	0.00229	4154.80	-3770.00	0.0298	-0.0271	2937.89	2665.79	0.000009	-0.000011

## Appendix 3

Chart 4.3.1.1: Rates of Returns for FEC and non-FEC (JPY)



Box 4.3.1.1: % Average of the Rates of Returns at each period (JPY)

<i>Average</i>	<i>R1(FEC)</i>	<i>R2(non-FEC)</i>
<i>Period 1</i>	-0.450%	0.151%
<i>Period 2</i>	1.600%	-1.879%
<i>Period 3</i>	0.027%	-0.067%

Box 4.3.1.2: Sum of R1, R2 (JPY)

	<i>R1(amounts)</i>	<i>R2(amounts)</i>
<i>entire period</i>	2336410	-3490000
<i>period 1</i>	-806500	230000
<i>period 2</i>	3028250	-3543000
<i>period 3</i>	114660	-177000

Box 4.3.1.3: Stdev for R1 and R2 (amounts) (JPY)

	<i>Stdev R1</i>	<i>Stdev R2</i>
<i>Entire period</i>	640966.37	642494.56
<i>period 1</i>	398181.12	400032.69
<i>period 2</i>	943181.13	944218.78
<i>period 3</i>	445374.37	443733.36

Chart 4.3.2.1: (JPY)

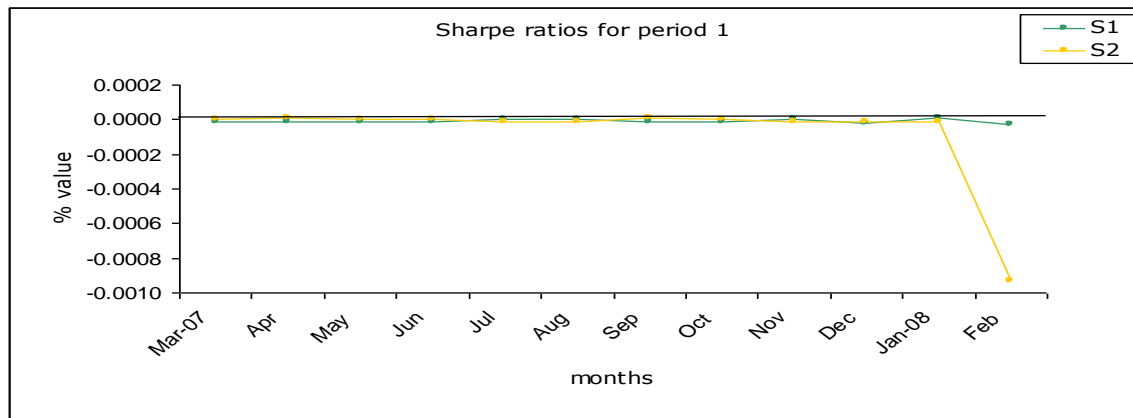


Chart 4.3.2.2: (JPY)

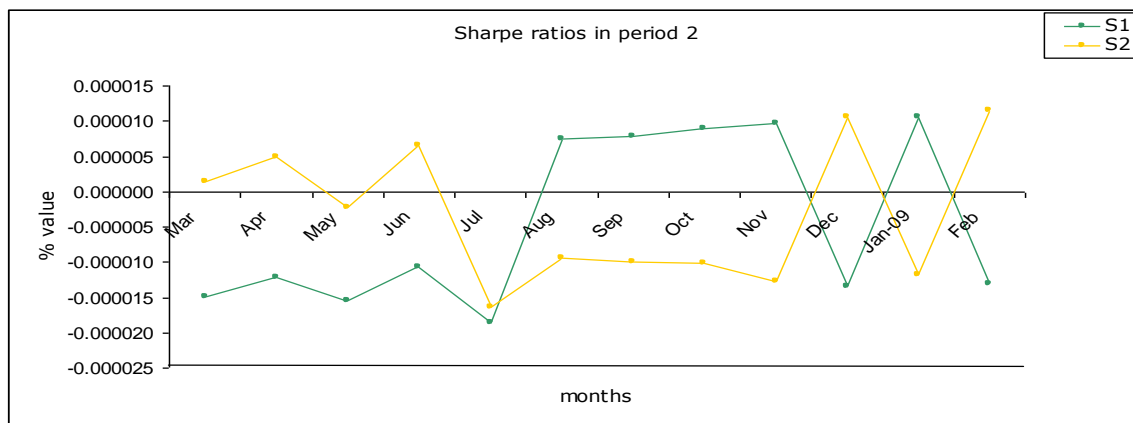
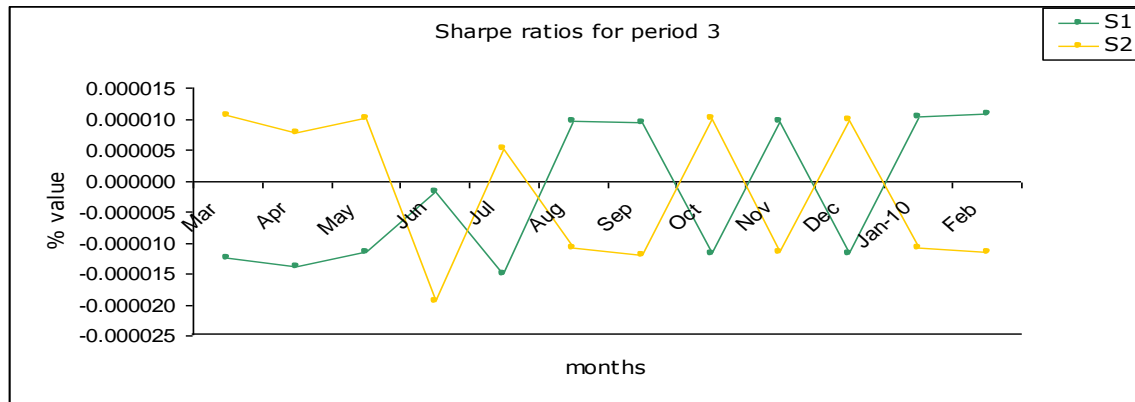


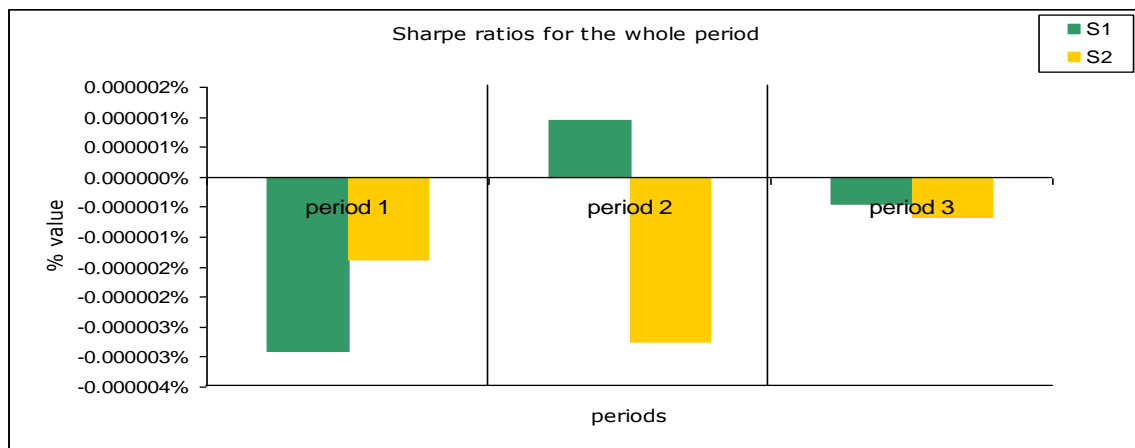
Chart 4.3.2.3: (JPY)



Box 4.3.2.1: Sharpe's ratio values (JPY)

	<i>S1</i>	<i>S2</i>	<i>Avg Rf</i>
<i>Period 1</i>	-0.000003%	-0.000001%	0.703%
<i>Period 2</i>	0.000001%	-0.000003%	0.712%
<i>Period 3</i>	-0.0000005%	-0.0000007%	0.228%

Chart 4.3.2.4: Sharpe ratios S1 and S2 (JPY)



Box 4.3.2.2: Sharpe's ratio total for 3 periods (JPY)

	S1	S2
<i>Stdev R(amounts)</i>	640966.37	642494.56
<i>Avg R(FEC &amp; non-FEC)</i>	0.393%	-0.598%
<i>Avg Rf</i>	0.548%	0.548%
<i>Sharpe total</i>	-0.0000002%	-0.0000018%

## 4.3.3 Risk-Free rate illustration

Chart 4.3.3.1: Risk-free rates (Libor1 M JPY Interest Rates)

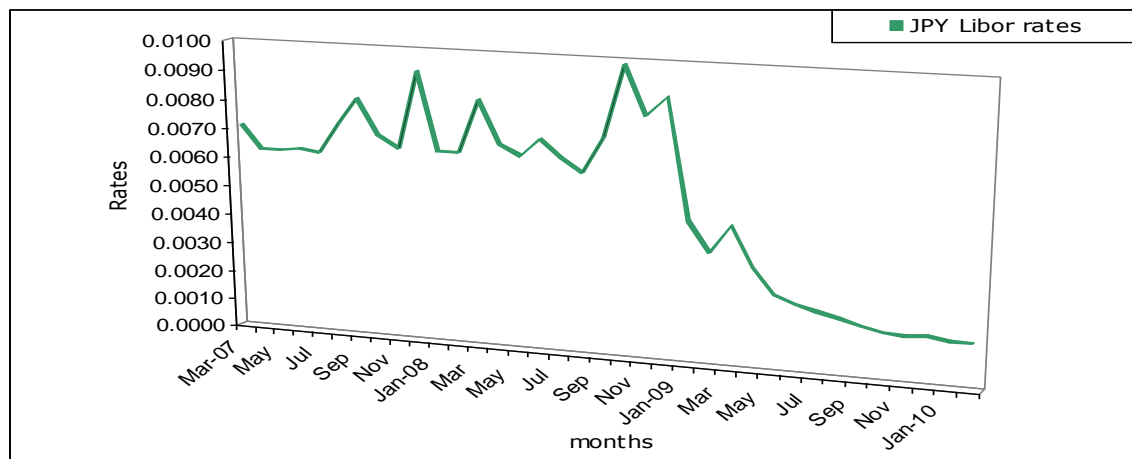
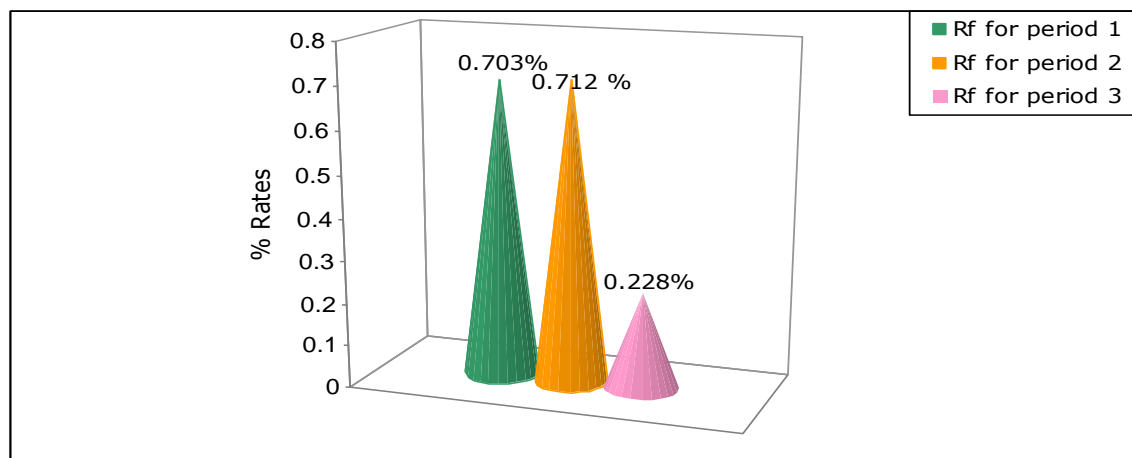


Chart 4.3.3.2: Risk-free average per period (JPY)



**Data Table 3. JPY/EUR**

<i>DATE</i>	<i>Risk-free rate</i>	<i>Return 1</i>	<i>Return 2</i>	<i>Return1 (FEC)</i>	<i>Return2 (nonFEC)</i>	<i>SDEV1</i>	<i>SDEV2</i>	<i>Sharpe 1 (S1)</i>	<i>Sharpe 2 (S2)</i>
03/01/07	0.0071	-299520	259000	-0.01939	0.01672	211792.62	183140.66	-0.00000013	0.00000005
04/02/07	0.0063	-590530	544000	-0.03761	0.03454	417567.77	384666.09	-0.00000011	0.00000007
05/01/07	0.0063	-163060	118000	-0.01004	0.00724	115300.83	83438.60	-0.00000014	0.00000001
06/01/07	0.0064	-291220	245000	-0.01779	0.01493	205923.64	173241.16	-0.00000012	0.00000005
07/02/07	0.0063	395540	-447000	0.02382	-0.02684	279689.02	316076.73	0.00000006	-0.00000010
08/01/07	0.0074	384630	-435000	0.02380	-0.02684	271974.48	307591.45	0.00000006	-0.00000011
09/03/07	0.0082	-744220	699000	-0.04731	0.04431	526243.01	494267.64	-0.00000011	0.00000007
10/01/07	0.0070	-154130	102000	-0.00939	0.00619	108986.37	72124.89	-0.00000015	-0.00000001
11/01/07	0.0066	317620	-367000	0.01922	-0.02214	224591.26	259508.19	0.00000006	-0.00000011
12/03/07	0.0093	-115220	60000	-0.00713	0.00370	81472.84	42426.41	-0.00000020	-0.00000013
01/01/08	0.0066	500070	-549000	0.03083	-0.03375	353602.89	388201.62	0.00000007	-0.00000010
02/01/08	0.0067	-46460	1000	-0.00296	0.00006	32852.18	707.11	-0.00000029	-0.00000931
03/03/08	0.0085	-206330	158000	-0.01316	0.01005	145897.34	111722.87	-0.00000015	0.00000001
04/01/08	0.0070	-307070	253000	-0.01940	0.01593	217131.28	178898.02	-0.00000012	0.00000005
05/01/08	0.0067	-142000	86000	-0.00883	0.00533	100409.16	60811.18	-0.00000015	-0.00000002
06/02/08	0.0073	-543900	489000	-0.03365	0.03015	384595.38	345775.22	-0.00000011	0.00000007
07/01/08	0.0067	-94250	38000	-0.00566	0.00227	66644.81	26870.06	-0.00000019	-0.00000016
08/01/08	0.0062	905710	-963000	0.05427	-0.05751	640433.68	680943.83	0.00000008	-0.00000009
09/01/08	0.0074	921660	-972000	0.05859	-0.06159	651712.04	687307.79	0.00000008	-0.00000010
10/01/08	0.0099	2303330	-2346000	0.15523	-0.15765	1628700.26	1658872.51	0.00000009	-0.00000010
11/03/08	0.0083	745320	-772000	0.05959	-0.06159	527020.83	545886.44	0.00000010	-0.00000013
12/01/08	0.0089	-933360	908000	-0.07952	0.07719	659985.19	642052.96	-0.00000013	0.00000011
01/01/09	0.0049	1087990	-1114000	0.08604	-0.08792	769325.11	787716.95	0.00000011	-0.00000012
02/02/09	0.0039	-708850	692000	-0.06142	0.05988	501232.64	489317.89	-0.00000013	0.00000011
03/02/09	0.0048	-775150	766000	-0.06333	0.06254	548113.82	541643.79	-0.00000012	0.00000011
04/01/09	0.0035	-169960	163000	-0.01307	0.01252	120179.87	115258.41	-0.00000014	0.00000008
05/01/09	0.0026	-525980	518000	-0.03994	0.03931	371924.02	366281.31	-0.00000011	0.00000010
06/01/09	0.0024	27770	-37000	0.00203	-0.00270	19636.36	26162.95	-0.00000002	-0.00000019
07/01/09	0.0022	-66020	61000	-0.00484	0.00447	46683.19	43133.51	-0.00000015	0.00000005
08/03/09	0.0020	469180	-473000	0.03421	-0.03448	331760.36	334461.51	0.00000010	-0.00000011
09/01/09	0.0018	193990	-197000	0.01465	-0.01487	137171.64	139300.04	0.00000009	-0.00000012
10/01/09	0.0017	-288380	285000	-0.02210	0.02184	203915.45	201525.43	-0.00000012	0.00000010
11/02/09	0.0016	255780	-260000	0.01919	-0.01950	180863.77	183847.76	0.00000010	-0.00000011
12/01/09	0.0017	-259890	256000	-0.01988	0.01958	183769.98	181019.34	-0.00000012	0.00000010
01/01/10	0.0016	704800	-708000	0.05288	-0.05311	498368.86	500631.60	0.00000010	-0.00000011
02/01/10	0.0016	548520	-551000	0.04346	-0.04365	387862.21	389615.84	0.00000011	-0.00000012

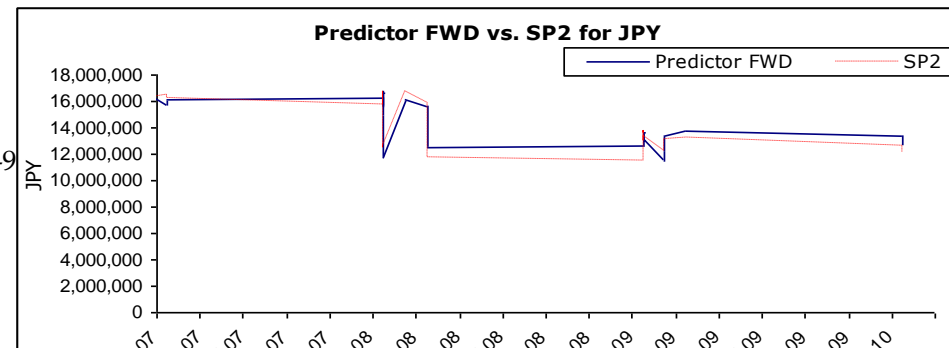
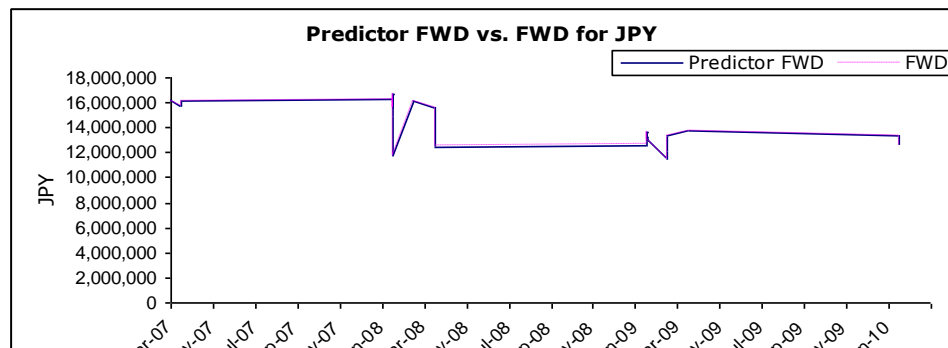
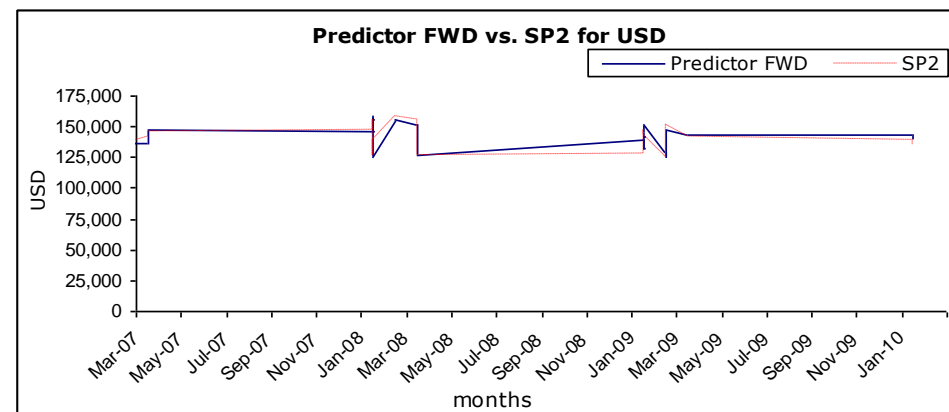
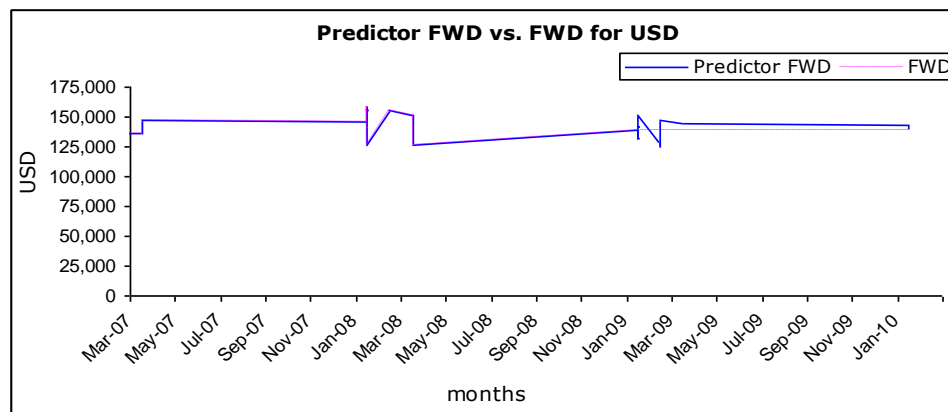
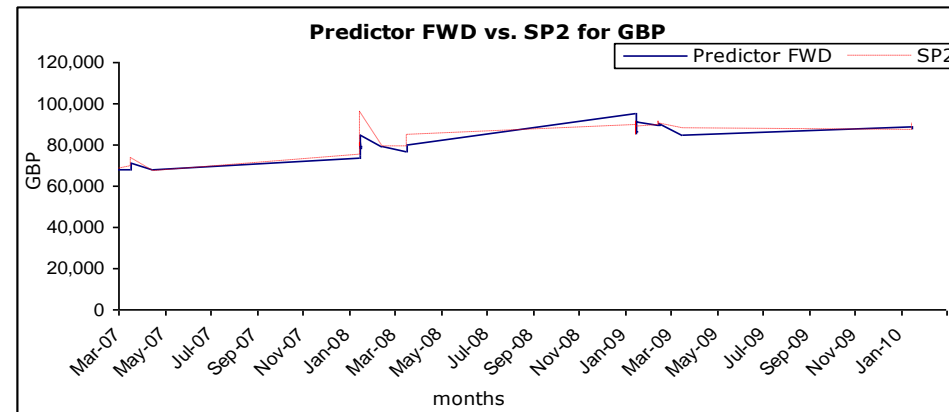
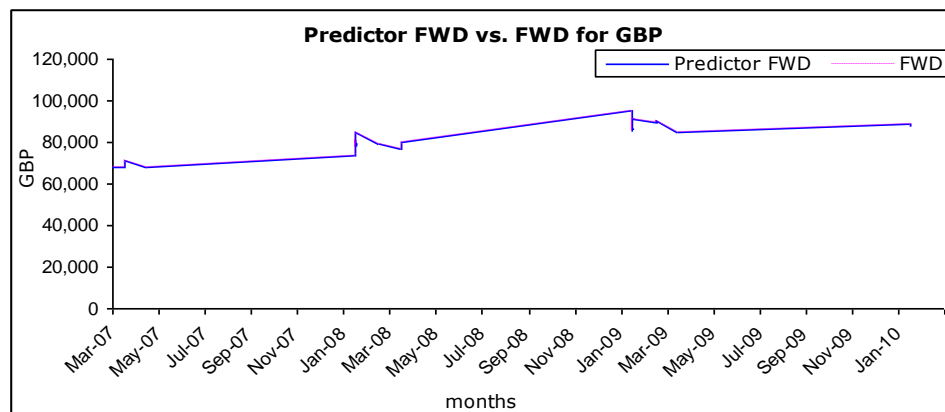
## Appendix 4 (Predictor Test)

Predictor FWD vs. FWD and Predictor FWD vs. SP2 for the GBP, USD and JPY

Time

frame:

03/2007-02/2010





**Appendix 5. Research Data Analysis Results**

<i>GBP/Euro</i>				<i>USD/Euro</i>			<i>JPY/Euro</i>		
	<i>FEC</i>	<i>Non-FEC</i>	<i>Non-FEC</i>	<i>FEC</i>	<i>Non-FEC</i>	<i>Non-FEC</i>	<i>FEC</i>	<i>Non-FEC</i>	<i>Non-FEC</i>
	<i>Returns</i>		<i>Risk</i>	<i>Returns</i>		<i>Risk</i>	<i>Returns</i>		<i>Risk</i>
<i>P 1</i>	-	+	<i>Riskier</i>	-	+	<i>Less risk</i>	-	+	<i>Riskier</i>
<i>P 2</i>	-	+	<i>Less risk</i>	+	-	<i>Less risk</i>	+	-	<i>Riskier</i>
<i>P3</i>	-	+	<i>Riskier</i>	-	+	<i>Less risk</i>	+	-	<i>Less risk</i>
<i>M36</i>	-	+	<i>Similar risk</i>	-	+	<i>Less risk</i>	+	-	<i>Riskier</i>
<i>Sharpe</i>	<i>S1&lt;S2</i>			<i>S1=S2</i>			<i>S1&gt;S2</i>		

Where P 1, 2, 3 are the three periods and period M36 represents the entire 36-month, and '+' means profit, while '-' means loss.

## RECONTEXTUALISING AND RECONCEPTUALISING PERSPECTIVES AND TYPOLOGIES OF ELITE INTERVIEWING: CASES FROM THE FOOTBALL INDUSTRY

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### Abstract

Elite individuals and groups constitute a distinctive, upper echelon social grouping and in various shapes and forms, elites have been an enduring feature of many societies. In the contemporary era, the concept of elites and the related notion of celebrity have seen fresh developments. The paper considers the literature on elite interviewing both generally and, more specifically, in an organization and management disciplinary context. Furthermore, in relation to the processes involved in elite interviewing, the paper focuses on the notion of role of context in relation to elite interviewing. For the purposes of illustration, the paper engages with the organizational and management context of the English football industry. The intention is that this will offer fresh insights into the function of context in elite interviewing.

The paper's examination of the literature feeds into the fieldwork stage which employs an inductive and interpretivistic methodology. The key method employed within the methodology is semi-structured interviews that are tailored for elites conjoined with participant observation. The approach is applied to an elite interviewing process mindful of its overall organization and management context and its specific focus on the football industry.

The paper concludes that there is some scope for recontextualising elites and elite interviewing through the development of novel conceptual and theoretical underpinnings and models. By engaging with social constructionism, lived experience and narrative informed frameworks the paper draws heightened attention to the potent role of sector and context in elite interviewing. In relation to the task of interviewing elites in the English football industry context the paper identifies that there is scope to recontextualise this specific context with, for example, issues of arrogance, amateurism, power, and the phenomenon of insider/outsider.

Elites and celebrity constitute phenomena that have risen unabated in the 21st Century and therefore they merit on-going close attention. Equally replete in contemporary life are organizational and managerial domains and the elites that reside within them. For many

people, football is one particular domain that plays a central role in their lives and therefore constitutes a significant field worthy of research.

The work is an original study of the issues surrounding interviewing elites in the organizational and management context of the English football industry. In a more general sense, elite interviewing is generally an under-commented subject in the business and management arena and this study seeks to contribute to redressing this.

**Keywords:** Celebrity, Context, Elite, Interview, Football

## Introduction

Elite interviewing is a field of research methods and methodology that has come to increasing prominence in recent years. When the term 'elite' is applied to a person or group they are generally considered to be people who are well-known, famous, distinctive or important. Elite also implies use of qualitative judgements regarding some people being seen as perhaps better than others. Moreover, elite involves the formation of identities in relation to ideas of professionals and professionalism and implies notions of power bound up and associated with them. And, the idea of elites broaches and intertwines with the phenomenon of celebrity. While elite groups may have common themes, they are also likely to have differing identities that emerge in distinctive contexts and environments.

Access to, and interviews with, elites can be challenging and the extant literature is right to dedicate energies to considering the issues involved in planning and conducting approaches. A good degree of progress has been made in relation to elite interviewing by the existing literature however this has been generated primarily in the fields of applied social sciences, sociology and politics (see by way of illustration: Rivera, Kozyreva and Sarovskii, 2002; Leech, 2002; Lilleker, 2003; McEvoy, 2006; Tansey, 2007; Neal and McLaughlin, 2009; Slote Morris, 2009).

This paper argues that there is further potential to explore the phenomenon of elite interviewing with a view to reconceptualising certain marginalised and underexplored aspects of academic disciplines and research settings or sectors. In order to progress this, the paper examines the current state of the literature on elite interviewing within research methods for business management and organization and identifies a number of issues in relation to the writing. It contextualises this by conducting interviews in the context of the 'business' of football in the United Kingdom. The overall effect of this discussion allows the paper to offer a degree of recontextualisation on elite interviewing and to generate lessons for interviewing individuals in business and management contexts.

## **A Consideration of the Literature on Elites and the Processes of Interviewing Elites**

This paper focuses on elite interviewing in the management and organizational context of English football. Therefore, in order to progress an analysis and argument in relation to this phenomenon it will be necessary to elaborate a number of pertinent key terms and dimensions. The review commences by examining some initial and general ideas on the notion and nature of elites. The discussion then turns towards making some preliminary comments on the kindred experience of celebrity. Integrally, the paper considers interviewing as a research method and this is gradually focused on to the area of elite interviewing. This cumulative analysis is then considered in relation to the specific business context of English football.

### **A Consideration of 'Elite'**

The Concise Oxford English Dictionary defines elites as 'a group of people considered to be superior in a particular society or organisation' (Concise Oxford English Dictionary, 2011). An elite is constituted of individuals and collectives that form a separate and distinct echelon or grouping in a given society or section of society. Although, by their very nature, elites are often in a minority, typically they can be seen to have knowledge, influence, control and power in a setting or situation. Human history has shown that there is a longstanding propensity for elites to emerge and develop. Indeed, in demonstrating this longevity, it is worthy of note that the very term 'elite' is derived from the Latin term 'eligere' meaning 'to elect'.

Drawing upon these initial definitions, it is possible to identify a number of elite groups, such as, for example, scientific, political, educational and bureaucratic elites, (see: Zuckerman, 1972; Rivera et al, 2002; McEvoy, 2006, Rice, 2010). By way of illustration of elitism in action within a specific domain it is possible to consider, for example, linguistic elites. In a UK context this might, for instance, point at speaking with a received-pronunciation accent associated with 'the Queen's English' and signal (aspirant) membership of a posh or middle-upper social class. Equally, there may also be educational elites. These could include people who have attended educational establishments with world famous reputations, for example, Eton, Oxford, Cambridge, Harvard or the Sorbonne. Given the connection with power and control it is of little surprise that the examination of elites has taken place to a large extent in relation to the discipline of politics, political thought and its linkage to cultural and organizational life (Parenti, 2010; Richardson, Kakabadse and Kakabadse, 2011; Seidl, 2010). It is also worthy of note that many of the characteristics of different forms of elite groupings, for example, educational and linguistic, converge in the world of politics where a large number of politicians come from well-educated, 'well-spoken' middle class origins.

In corporate terms definitions of elites range from simply those who occupy the higher echelons of an organisation through to more specifically the ‘...owners, directors and senior executives of the largest and most important of a nation’s business corporations. They can be variously defined according to criteria of corporate size and type of enterprise’ (The Online Dictionary of the Social Sciences, 2011). Welch et al (2011: 6) also acknowledge the importance of an organisation’s size and type when determining its status but develop this further by suggesting that ‘Elite status is also affected by the company’s standing in relation to other firms in the industry and more broadly by its public image.’ From this perspective elite status is regarded as being fragile, unstable and dependent upon time and place (Harvey, 2010: 195; Aberbach and Rockman, 2002: 675). These observations highlight that the elite status of an organisation, group or individual is not fixed; rather it is fluid and highly dependent upon the context in which it is situated. Burt (1992) also emphasised the importance of contextualisation and went on to note that social factors were also important. He observed that although some individuals within organisations have relatively little role or job-title power they are regarded as being elites because they are strategically positioned within social structures.

The argument hitherto has underlined that the term ‘elite’ does not refer to a homogenous group and rather there is a great diversity of what constitutes elite. For this reason it is inappropriate to treat elites uniformly. This is congruent with the observations of Delaney (2007: 210) who emphasises that not all elite interviewing is alike (he cites, for example, philanthropic elites, political elites, organisational elites and ultra-elites). In the present paper, it therefore follows that although interviewing ‘football elites’ has similarities to interviewing other types of elite it also has significant differences. One of these key dimensions is that many of these elites are, to some greater or lesser extent, also celebrities which is an issue considered in greater depth below.

In this paper we acknowledge the need to be aware of contextual issues and we also recognise the need to move beyond merely defining elites in terms of traditional role criteria. Consequently we use the term elite to describe, not only the highly placed, but also those who are afforded elite status because of their accumulated experience, knowledge, respect and/or notoriety. In addition, given this transient nature of elite status, we were also careful to identify ‘former’ elites as part of the study. This correlates with work by Davies (2001) who mentions interviewing people who were elites but have now retired and he makes the point that the interviews were best described as ‘guided reminiscences’ rather than semi-structured interviews. In short, within the context of this paper, the term elite describes a broad range of individuals some of whom derive their elite status from their current positions within a hierarchy and others who are, or have been, regarded as being elite at some other point in time. For example, elite interviewees involved in the study included media personalities, acting and former football club Chairmen, managers and

administrators of football clubs, governing bodies and football related organisations (e.g. the Professional Footballers' Association) and high profile coaches/managers.

Justification for gathering interview data from elites is provided by a number of scholars. For instance, Tansey (2007) explains that because elites are often key informants their first-hand accounts are valuable when corroboration of facts and additional information are required. In addition he explains that contributions from elites may be helpful in developing inferences about larger populations and reconstructing accounts of past events. Likewise Delaney (2007: 208) emphasises the value of interviewing elites and comments 'You gain a unique opportunity to understand the worldview of those with significant influence.' Lilleker (2003: 208) elaborates further by highlighting that elites '...provide insight into events about which we know little: the activities that take place out of the public or media gaze, behind closed doors.' This observation is of particular relevance to the UK football industry where intense media scrutiny has resulted in clubs becoming closed institutions that are wary of 'outsiders'. Gaining access to football industry elites provides a rare and valuable opportunity to explore unique accounts and insights which have been previously considered in only limited contexts.

### **A Consideration of Celebrity**

The current paper proposes that, in certain domains and situations, notions of elite and celebrity are often closely aligned or overlap. The social dimension of elite status is particularly pertinent when exploring the conjoined area of celebrity. The term celebrity derives from the Latin word 'celeber' which means 'much frequented' or 'thronged'. However, although we can accurately trace the origin of the term, according to Cashmore and Parker (2003: 215) celebrity remains a 'slippery concept' with 'seemingly amorphous boundaries'. Despite this a number of scholars have attempted to provide definitions. According to Alberoni (1972: 76) celebrities are '...a powerless elite - a group that occupy a privileged social position but derive status not from institutionally based social power, but from the fact of public attention.' Similarly, Meyer (1995: 184) argues that 'Other elites command attention because of their power to influence; celebrities derive any influence they may have from attention.' In essence celebrity status is derived from notoriety and 'well knownness' and as a consequence is inherently ambiguous and insecure (Boorstin, 1961; Dyer, 1991; Gamson, 1994).

Although the phenomenon of celebrity is in no way unique to the twentieth and twenty-first centuries (Crawford, 2004; Whannel, 2002), the accelerating ascendancy of it during contemporary *époques* potentially adds a further dimension to ideas of elites (Rojek, 2001; Turner, 2004, Inglis, 2010). Indeed, according to Bainbridge and Bestwick (2010: 215) celebrity is a pervasive phenomenon which can be observed in many settings they suggest: 'Many person-types are somehow associated with celebrity-hood: heroes, leaders, legends, idols, stars,

superstars and icon.’ Goodman (2010:510) reminds us of Warhol’s famous saying that ‘One day everyone will be world famous for fifteen minutes’. In drawing on Warhol, the consequence of Goodman is to underline the fleeting and fickle nature of celebrity and to mark a contrast with certain more solid and permanent aspects of ‘elite’.

Following in the vein of Goodman’s analysis, Lawler (2010:419) suggests that celebrity is in fact a poor aspect of the genre of fame. He indicates that it is ephemeral and prone to disappearing as quickly as it has been conferred by a changeable and capricious public opinion. Likewise Crawford (2004: 133) discusses the shallowness of contemporary celebrity and comments ‘...[it] often lacks depth of character, as figures are frequently painted in one dimensional terms.’ Therefore, unlike elite status it would seem that celebrity is more difficult to control. Nevertheless, while considering power and control, Lawler (2010) continues by making the point that celebrity, in a similar manner to belonging to an elite, is an opportunity to both gain and lose a range of other things. These could simultaneously include, for example: wealth and privacy.

As was noted above, elites can be identified in a range of societal arenas. Politics, and political life, were identified as one of these and Lawler (2010: 422), with reference to politics, draws an important distinction between elites and celebrity. He suggests that ‘political greatness’ is different from a notion of ‘celebrity greatness:

‘Celebrity greatness, being self-absorbed or irresponsible, is still easily distinguished from political greatness. Politicians (or, better, political leaders) either aren’t or are more than celebrities. President Obama is quite the celebrity, but he’s more than that. (Before he ran for president, it wasn’t so clear he was more than that.) Bill Clinton, Al Gore, and Mike Huckabee are now merely celebrities. Sarah Palin, because the shameless media imposed the burdens of celebrity on her, was stuck with (and really enjoyed) skilfully making the transition from politician to celebrity. Being governor of Alaska was boring and paid poorly; becoming president was and will continue to be a most improbable long shot, but now she’s rich and famous and commands the media’s attention in all its dimensions. Palin, like Lady Di, is amazingly adept at linking her celebrity status to causes beyond herself, but increasingly the content of the cause seems secondary.’

Lawler’s comments have powerful resonance for this paper’s focus on the football industry and those who operate within it. Many of these individuals are, it would seem, very much involved in ‘celebrity greatness’ rather than any alternative form of greatness that exudes a more powerful form of gravitas perhaps. This could have implications for the processes of interviewing and the structures and principles that play out in their course. This is a point that has been long identified as indicated by Meyer (1995:184):

'There is much to this insight that celebrity is deliberately manufactured and that the famous are therefore not necessarily the "deserving." Additionally, and importantly, the celebrity's social influence is not based on formal, institutional power (Alberoni 1972). We turn our attention to those public figures whose *lives* are watched with great interest, but whose claims to attention are not tied to the *consequences* their actions have for those watching. Celebrities are, in Alberoni's (1972) play on Mills, a "powerless 'elite/ "a group that occupy a privileged social position but derive status not from institutionally based social power, but from the fact of public attention. Their notoriety has less to do with what they *do*, or with how they can directly affect lives, than with what and who they *are*. Other elites command attention because of their power to influence; celebrities derive any influence they may have from attention.' (Emphasis added].

Meyer's comments provoke an interesting reflection when applied to football. Football elites/celebrities are arguably somewhat different to the notion expressed by Meyer above. A football player's notoriety can partly stem from who they are but their notoriety will also have something to do with *what they do* i.e. whether or not they are a skilful player, a good or bad player, a successful (or not so successful) coach. From this perspective football elites/celebrities are different to the celebrities emerging from popular television programmes such as, for example, 'Big Brother' who, it might be said, have nothing to offer other than *who* they are. Rather football elites/celebrities are known for what they do and also their institutional/organisational affiliation –which club they've played for /which organisation they've worked for, for example the Football association etc. and their role within a club/organisation etc.

### **Elite Interviewing: Acts, Processes and Atmospheres – A Consideration of the Literature**

The paper has now considered the realms of elites, celebrity and undertaken an initial consideration of these phenomena in relation to the United Kingdom football context. This stage of the argument considers the processes and issues involved in interviewing elites and involves the need to provide an appreciation of interviews as a genre of research method.

There is a considerable body of literature on the various forms and processes of interviews within the research methodology arena. The paper undertook a scan of the terms 'elite' both as a standalone index entry and also within sub-categories of the index entry for interviews and, furthermore, identified some thirty key texts on research methodology for business management and organization students. It was highly significant that this search of seminal textbooks provided only one reference to elites and this was an incidental reference to the term in the context of a particular case rather than seeking to focus on the sphere of elite interviewing. In a more general sense, a decade earlier, Welch et al (2001:1) pointed up the weakness in the overall research methodology literature noting that, for example, sociology and geography had gone



some way to addressing this lacunae (see Useem 1995; Yeager & Kram 1995). In some regards, this has been addressed in some disciplinary spheres however this is not the case in organization and management.

Neal & McLaughlin (2009: 689-690) in citing the work of Liazos make the very valid point that a good deal of social science work has tended to concentrate on marginalised populations, what Liazos controversially termed 'nuts, sluts and perverts' (1972: 103). Neal & McLaughlin go on to align themselves with Punch who noted that 'it is still painfully obvious . . . that researchers have rarely penetrated to the territory of the powerful and many field studies still focus on lowly, marginal groups' (1986: 25). They duly observe that across a span of subject areas it is possible to find studies on powerful, autonomous elites:

'...not only does a multi-disciplinary body of work concerned with the study of elite populations exist (Palmer, 2000; Cook et al., 2002; Pimlott, 2002; Simon, 2002; Welch et al., 2002; Davies, 2004; Ball, 2005; Glees et al., 2006, for example), but alongside this is an expanding set of methodological accounts of the experiences of researching 'upwards' and engaging the seemingly powerful in the research process.'

Neal and McLaughlin's comments provide a useful insight and overview to the research on the elite, nevertheless, importantly, the paucity of commentary in business and management research methods textbooks in relation to elite interviewing is contrasted with the engagement with elite interviewing by wider social science and humanities journals (Rice, 2010: 70). In this regard the sphere of politics and political literature has been important in the writing on elite interviewing. An analysis of the more extended literature (book, journal and web-based) suggests that a number of recurrent themes can be identified. These incorporate, process, power and positionality:

- Process Issues – This includes discussions and commentaries making points regarding preparation, question design (open v closed), semi-structured approach, and the need to:
  - adopt a conversational style and be flexible,
  - need to highlight credentials and affiliation in order to gain access;
  - overcome pre-prepared monologues\talk tracks by 'probing' (i.e. elites are often 'professional' communicators);
  - recognise the tendency of elites to claim undue credit and exaggerate their contributions;
  - provide elites with feedback;

- use snowballing techniques to gain referrals
- Power – A recognition of the frequent imbalance between interviewer and interviewee; the reversal of the ‘usual’ non-elite interviewing situation where the interviewer is deemed to have the power; and degree of openness
- Positionality – The question of whether the interviewer is an insider/outsider and the impact on the data? Does an outsider gradually become an insider as more and more interviews are conducted? Issues related to being an insider or an outsider?

In certain disciplinary realms, the research on elite interviewing has a relatively longstanding history. With regard to the process aspects of elite interviewing, Zuckerman (1972:163) in her work *Interviewing an Ultra-Elite* considered Nobel laureates in science. She makes a range of comments on the preparation for accessing the elite and conducting the interview. She notes the need to have brief but clear and polite initial written communication as elites are ‘time poor’ and will not dedicate a large amount of time to considering a request. In keeping with the approach advocated by Ostrander (1993), Welch et al. 2002, and Rice (2010) Zuckerman also notes the need to establish legitimate credentials with the interviewee. Goldstein (2002) supports much of this stating that being clear about intentions from the outset is centrally important. In addition Delaney (2007: 212) emphasises the need for a succinct introductory letter which emphasises ‘the value of the elite’s particular experience.’

Zuckermann (1972:163) also states that with well-known and famous elite interviewees it is imperative to have thoroughly researched their biography. Moreover, when dealing with elites she proposes that ‘standard’ questions will not suffice and the conversation must be tailored. She also goes on to make a range of normative comments pertaining to tape recorders, interviewing techniques and an ability to be fluent in jargon and technical language (167–170). A number of scholars emphasise that elite audiences tend to prefer open-ended questions because they do not like to be strait-jacketed and cornered; rather they often wish to be diplomatic or measured in their responses (Schoenberger, 1991; Clark, 1998; Aberbach and Rockman, 2002; Rice, 2010). McEvoy (2006:185) provides insights and lessons from interviewing politicians in Northern Ireland. She shows how she used semi-structured interviews to allow and show parity and equity in the way she approached politicians of the different factions. This nevertheless, allowed space for them to expand.

In relation to gaining access, Hunter (1995) explains that elites have the ability to protect themselves from intrusion and criticism and Laurila (1997) observes that although elites are often visible they are not necessarily accessible. Elites often erect barriers which separate them from the wider community and as a result researchers may have to invest significant financial and time resources to gain access (Shenton and Hayter; 2004 and Welch et al. 2002). In order to increase

their chances of gaining access Peabody et al. (1990) advocate that researchers should draft an interview schedule that can be shown, and verified, in advance to respondents. This 'advance warning' dimension is also subscribed to by Goldstein (2002) and Lilleker (2003). In line with the usual interview technique of 'starting with the easy questions' then moving on to more difficult ones Leech (2002) suggests the interview schedule should move from 'non-threatening' to 'threatening' questions and Pridham (1987) indicates that a 'funnel' method with general questions at the beginning before the more significant aspects of the interview.

The ability to restrict or grant interviews is a source of power for elites and this contributes to the divide that exists between interviewer and interviewee. Indeed Delaney (2007: 215) suggests that restricted access to elites is yet another marker which indicates that the interviewer is a 'status subordinate'. Welch et al (2001:1) goes to the crux of the issue of power in elite interviewing:

'The power of an elite interviewee stems from organizational hierarchy, corporate values and history, personal assets and degree of international exposure. However, handbooks on qualitative methodology do not address the 'double trouble' that most of us face: namely, the task of conducting an in-depth interview, while simultaneously balancing the power of an influential elite.'

Welch et al go on to make the point that the nature and structure of an elite is far more complex than an organizational chart would *prima facie* suggest. This clearly has major implications for addressing and dealing with the power inherent therein. Despite Welch et al's early observation that very little work has explored power issues in elite interviewing more recently a small number of scholars have begun to consider this area. For instance, Delaney (2007: 215), suggests that interviewers can use power and status differences to their advantage by making it clear to the elite interviewee that they are being interviewed because they are able to provide a valuable contribution. In this way the encounter is not regarded as being a battle for control, rather it is seen as a contest more akin to jiu-jitsu in which the interviewee's 'momentum' provides the interviewer with an advantage. For instance, using this approach the interviewer may be able to incorporate non-threatening questions such as 'I am unsure about this area, would you mind explaining further?' This strategy is an illustration of how the 'gap' between the interviewer and the elite interviewee can be manipulated (Moss, 1995 and Rice 2010). Slote Morris (2009: 213) also discusses power issues but shifts the focus away from the interview and argues that although an interviewer may feel powerless they are not entirely so because they have control over how the interview data is contextualised and interpreted. This observation is supported by Neal and McLaughlin (2009: 695) who go on to suggest that power relationships in elite interviewing can be ambiguous, multi-directional, transient, untidy and messy. Smith (2006: 645) elaborates on this when he explains that

‘...the idea that elites can be neatly defined and treated as consistently powerful is a view which relies on a rather simplistic idea that there is a dichotomy between powerful elites and powerless others. . .such an outlook ignores the preposition that power exists in a variety of modalities . . .that these modalities of power can be negotiated and are not inscribed and consequently that elites may change over time (even during the course of one research project).’

In the present study this observation that status as a given elite status/power can be transient was pointedly remarked. By the time the study had been concluded many of the people interviewed during the study had vacated their positions. The football industry is dynamic - people move around and status and power can shift quickly. Aberbach & Rockman (2002) make the valid point that where elite interviewing is part of a longitudinal study this may experience specific issues in relation to elites. They note that elites have a tendency to be dynamic and experience high turnover of role which can mean that it is challenging to keep some stability and consistency in the sample.

McEvoy (2006: 185) makes a number of interesting comments in relation to the management of identity issues. She notes the evident power ‘differential’ between interviewer and interviewee. This might be derived from not just position but also age, gender, ethnicity and other status dimensions. She notes in the context of Northern Irish political milieu:

‘The respondents are all experienced politicians, former ministers in the power-sharing government and/or senior members of their respective parties while I am a young researcher at the point of embarking on an academic career. As a young female I was aware of the ‘male space’ of politics (Mackay, 2004, p. 112) and that my gender would probably have an effect on the attitude of the respondent, given that the majority of respondents are male and middle-aged’.

Equally, McEvoy (2006:186) raises the interesting notion of ‘affiliation’ in relation to interviewing elites. She ponders whether the perception of her kindred (or not) ethnic identity had led her data to be distorted. In a related vein, she notes Arthur (1987) success with interviewing Dublin politicians because they had trust in him linked to his background and notes that Nationalist politicians tended to accord her the same trust-based access. In the football focus and context of the current paper, this raises an interesting point in relation to the interviews conducted. The researcher has often gained access through ‘snowballing’ telephone calls from interviewee in a given quarter of the footballing community to another. Nevertheless, it is interesting to reflect on what drives this trust and warmth dimension of the elite interview positioning and access.

Rivera et al (2002: 683) indicate that there are gaps in the literature of various varieties in relation to differing national context and the social structures therein. It is suggested that much of the literature hitherto generated is aimed at accessing and interviewing elites in advanced

industrial democracies (see, for example, Aberbach, Chesney, and Rockman 1975; Dexter 1970; Peabody et al. 1990). However, the pointers under which the issues are addressed would seem to be similar to those faced in many diverse contexts, namely: have an institutional affiliation; reassure the respondent that there are no right answers; establish an appropriate identity for the interviewer; request interviews in person when possible; develop an appropriate questionnaire.

Language and communication is an evident medium of positioning and positionality. The manner in which an elite talks, the lingua franca employed, is an integral aspect of any community and an elite is no different. Goffman (1959) describes the elite interviewing interaction as a performance which is manufactured to generate particular impressions and is shaped by audience and environment. From this perspective elites are regarded as having a 'front stage' and a 'back stage' persona. Research by Puwar (1997: 11) identifies that when they are interviewed politicians tend to adopt monologues which are akin to pre-scripted official speeches and they also tend to engage in highly, defensive off-hand behaviour. Equally Ball (1994: 97-98) highlights the challenge of overcoming attempts of elites who try to present themselves in the best light, convey a particular interpretation of events and dismiss the interpretations of others. Delaney (2007: 211) highlights an issue that is particularly pertinent to the realm of football whereby senior figures become a spokesperson for their organisations when they are interviewed and Thomas (1993: 85) develops this further to suggest that such elites '...even to speak as if they were the organization.' As a consequence the researcher may feel that they are being treated in a formulaic manner with the 'same old line' being 'trotted out' and offering little more than might be available in the general press and media. However, the opposite may sometimes be the case with elite figures feeling that they have the right or the capacity or protection to be able to speak their minds.

Within all of this is the interesting role of the interviewer progressively conducting their interviews. They must reconcile the gradual transforming role of insider/ outsider and the complexity of being 'friend' and 'critic' simultaneously (Becker, 1995; Herod, 1999; Sabot, 1999, Desmond, 2004). Herod (1999:314-324) explores the insider/outsider issue within elite interviewing at some length by focusing on trade unions. He makes the point that assuming the role of a 'cultural insider' will not necessarily deliver better quality data than a relative 'outsider' (ibid, p321). Moreover, he is wary of the over-simplistic dualism that 'insider/outsider' infers:

'I have come to realize that what I had initially taken to be a simple and unproblematic dichotomy "insider" or "outsider" with regard to positionality was not quite so analytically simple, but that the issue of positionality was, in fact, quite messy on the ground. Specifically, it is apparent that the positionality of the researcher can shift depending upon a number of considerations, in the process disrupting the supposedly stable dualism of "insider"/"outsider" and the privileged positionality of the "insider" that much literature on interview methodologies

has assumed exists....As a consequence of this ....the researcher can adjust shift her/his positionality in a self-conscious way 'on some occasions playing up social distances between researcher and interviewee, on others playing down such distances i.e. they can manipulate what Moss (1995) has called "the gap". This is to say, the researcher's positionality is not necessarily fixed in some absolute sense, 100% "outsider" or 100% "insider", but it may translocate through categories and identities, such that at some times and places the researcher may emphasize certain positionalities and identities and not others' (ibid, p.321).

As the 'insider/outsider' a researcher conducting interviews is also conducting participant observation of some form or another. This may be deliberate or inadvertently consequential. Therefore, interviewing of any form can be implicitly argued to involve participant observation and it is a methodological choice by the researcher how this is addressed and employed (Waddington, 2004). Desmond (2004) continues his analysis of insider/outsider by introducing the idea of transition or 'grey zones':

I have increasingly come to think, however, that it might be more appropriate to consider instead the notion of "degrees of outsidersness" in which there is a continuum of "outsidersness" along which researchers operate. Such a perspective would enable us to recognize that even an erstwhile "insider" becomes, in a sense, at least a partial "outsider" the moment they put on their researcher's hat in that they no longer hold the same positionality they did before, having created a space of critical distance between themselves and the elite to which they may belong objectively but with which they now have a different relationship ± whereas an "outsider" may change her/his positionality to become closer or more distant from their sources depending upon the situation.' (ibid, p.321).

Allied to the issues of positionality, and the extent to which an interviewer is an insider or an outsider in relation to elites, is the 'dilemma of seduction' (n.b. this is also germane to the issue of celebrity also). According to Delaney (2007: 217) a common problem for those interviewing elites is that:

'There is something seductive about interviewing those with great wealth, power and success. It is tempting by the end of an interview to 'envision' yourself in the particular career path or life circumstance of your interview subject. You enter someone's life for an hour or two, you may speak as 'relative equals'...and it is easy to come out of an interview thinking either 'that was amazing to interview someone like that' or 'that could be me' – both of which reflect the process of seduction..... I have watched inexperienced interviewers go through this process, returning starry eyed from an interview, identifying with, or defending, the elite person well beyond what would typically be seen after an interview.'

Delaney further describes this phenomenon as being akin to Stockholm Syndrome whereby captives begin empathise with their captors and are even prepared join them in their cause.

Having defined elite and examined this through the predominant politically and sociologically orientated literature it is clear that it shows and characterises elites in a specific manner. This is a valuable contribution to the debate on elite interviewing, however, equally there is scope to identify, develop and explore additional facets. Firstly, the degree to which these can be examined in a more in-depth and rich manner with regard to theoretical possibilities. Secondly, there is scope to consider these issues in different contexts in recognition of the possibility and need to contextualise and problematise the concept of elites in a more complex manner than may currently the case. The study engages this task by examining the English Professional Football industry as a case study. This provides a fresh and novel context in which to some of the questions and issues raised by the literature discussion.

### **Football – Background Context, Elites and Celebrity**

Within the football focal of interest of the paper, it can be readily recognised that elites and celebrity play a major role in this particular organizational and managerial sphere. This is inextricably linked to the presence of a range of different elites across the sector. Here, the research is not necessarily addressing the likes of the English Premiership footballers, such as, by way simply of example, the stellar footballers, Rooney, Suarez or Lampard. Rather, it is keen to show and explore the world of ‘elites within elites and elites alongside elites’. The rise of the phenomenon of celebrity has coincided with radical transformations in the structure of what can be termed the English ‘football industry’ especially in the latter part of that epoch and it is useful to examine a number of background contextual issues in relation to this.

As part of the process of considering elite interviewing in the organizational context of the English football industry it will be useful to provide a brief background. The scale of the transformation is staggering; in their Annual Review of Football Finance: Lost in Translation The Football Money League Deloitte (2009: 30) observed that

‘In 1991/92, the last season before the formation of the Premier League, the former Division One clubs had a collective turnover of £170m. By contrast the revenue of the top 20 Premier League clubs in 2007/08 is projected at over ten times this amount at £1.9billion.’

Indeed, even clubs in the lower divisions became ‘multifaceted leisure businesses with a range of income streams’ (Matusiewicz, 2000: 166). Consequently, for many success ‘on the pitch’ is no longer the sole concern; issues such as survival, liquidity, revenue maximisation and profitability loom large (Szymanski and Kuypers, 2000: 16; Guillianotti and Richardson, 2004: 554; Milanovic, 2005:883, Buraimo et al. 2006: 34; Gilmore and Gilson, 2007: 410).

Despite this transformation a number of scholars have argued that business management practices remain ill-suited to the challenges which have emerged. For instance, Cannon and Hamil (2000: 36) suggested that the 'amateur tradition' prevails in the boardrooms and the back offices of most clubs. They argued that clubs are still run predominantly by non-executive directors with little experience of the type of business issues facing contemporary football. Likewise, Banks (2002: 139) explored the financial aspects of the sport and observed that 'amateur practices' were instrumental in the difficulties faced by clubs. Similarly, Syzmanski and Kuypers (2000: 79) commented that clubs have hardly advanced beyond Victorian business practices. Typically, Boards of Directors were composed of '...the butchers, bakers, candlestick-makers of local industry', who had part time involvement in their clubs. Their motivation to become involved was driven by a number of factors. For instance, the pursuit of local prestige was important. One manager respondent (2005) commented that in some instances individuals chose to own their local clubs because '[their]...dads took them to watch the team from the terraces when they were twelve'. These individuals acted as benefactors to their clubs and in return gained local prestige; prominent examples include Jack Walker of Blackburn Rovers and Jack Hayward of Wolves. Similarly, a senior football executive respondent (2005) commented 'It certainly seemed to be a matter of local pride to get selected to join [the Board of] the local football club in those days.' An ex-football player respondent (2006) reinforced this view and suggested that for some, football clubs were '...a little bit of a plaything' and that association with a successful club could provide '...an awful lot of personal kudos'.

These observations highlight an apparent paradox: on one hand the football industry has experienced an unprecedented period of growth and commercial success and celebrity in its own right, but on the other business management practices are regarded by many as being unsophisticated and out-dated. In essence a successful, dynamic twenty-first century industry appears to be dominated by commercial practices and modes of operation that would not look out of place in the late nineteenth century. This has consequences for the production of the various 'elites' within the industry and the processes required in order to access them.

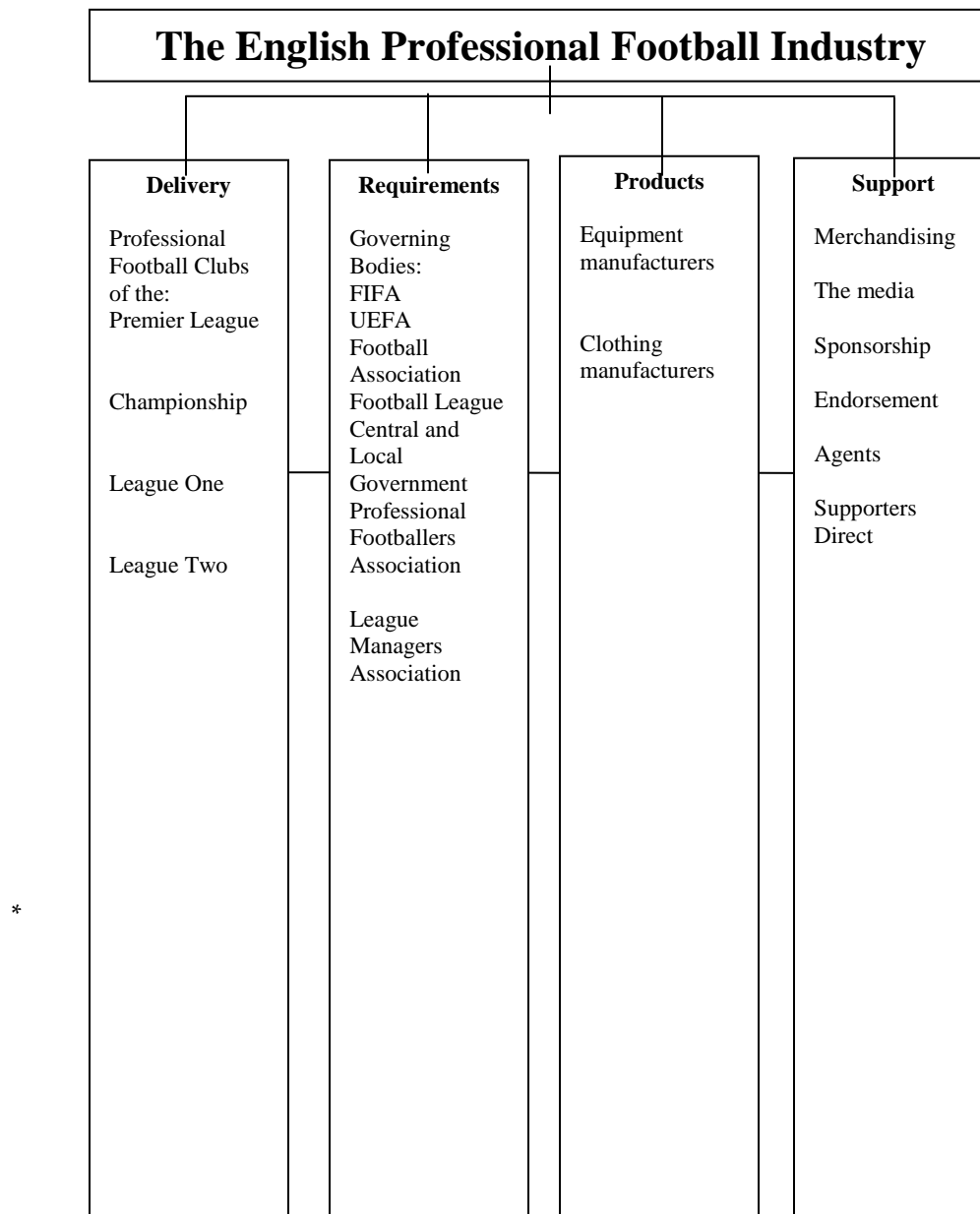
### **The English Professional Football Industry**

Although many scholars accept that English football has become an industry in its own right a comprehensive definition of the term 'English professional football industry' does not exist (see Haynes, 2007: 362; Breitbarth and Harris, 2008: 180; Edensor and Millington, 2008: 18). In order to address this lacuna, and define the scope of this paper is, it is helpful to begin by briefly considering the works of those who have focused upon defining the wider sport industry. Overwhelmingly, scholars working this area have concentrated upon identifying and categorising the component parts of the industry (Robinson, 2003: 171; De Schriver and Mahon, 2007: 267; Humphreys and Howard, 2008: 27).



For instance, Chelladurai (1994: 8) suggested that the sport industry could be divided into two fundamental elements: participatory activities and spectator activities. The former is categorised in terms of the motives of participants, for instance health and fitness or the pursuit of pleasure, excellence or skill, and the latter is divided in terms of whether the sport offers commercial entertainment (i.e. professional sport) or non-commercial entertainment (i.e. amateur sport). Similarly, Pitts et al. (1994: 17) investigated the component parts of the sport industry and identified three segments: sport performance (i.e. the spectators and participants who consume the sport); sport production (i.e. the training, sportswear and equipment utilised in playing the sport); and sport promotion (i.e. individuals, organisations and products used to market and promote the sport). Building on these works, Robinson (2003: 172) suggested that the sport industry comprised four inter-linked elements: sport delivery, sport requirements, sport products and sport support services. The first segment, sport delivery, is the means by which sport is offered to the spectator, participant or customer and comprises amateur and professional sport. The second component, sport requirements, consists of the products and services needed to produce or enhance the quality of the sport. Key elements in this category include governing bodies and officials. The third area, sport products, incorporates the enterprises which produce goods for the sport industry (for example equipment and clothing manufacturers). The final category, sport support services, consists of those products or services that support and promote sport. For instance, this segment consists of the media, merchandising organisations and those engaged in endorsements and sponsorship.

In attempting to define the English professional football industry Robinson's work is of particular interest because, unlike other works, it emphasises the inter-connectedness of the industry's components and in so doing goes beyond merely identifying and labelling them. In essence, by considering the relationship between the segments which constitute the industry as a whole this approach more clearly captures its complexity and multifaceted nature. For the purpose of explaining the scope of the sector under consideration here Figure 1 shows an adapted version of Robinson's framework which has been applied to English professional football.

*Figure 1 The Components of the English Professional Football Industry*

(Source: Adapted from Robinson, 2003: 172)

Figure 1 shows the principal actors involved in the English professional football industry and locates these within the components identified by Robinson. The figure effectively illustrates the breadth and depth of the industry and in so doing emphasises the obligatory limits to the scope of an investigation of this type. Indeed, a study which attempted to explore all constituencies of the industry would be either need to be extraordinarily extensive or ill-conceived, unmanageable and lacking in focus.

In parallel with the growth of the 'business of football' the cult of footballer celebrity has grown hand-in-hand with the growing wealth that is associated with the game. Commensurately, many of the people involved in the support or off-field game have also grown to receive celebrity status. They have also emerged as elites displaying many of the traits of elite bodies in that they are a minority, they exercise control and power of a larger section of a sphere, and they have professional bodies and affiliations. However, unlike many professional elite organizations (for example, accountants, solicitors, judges and so on and so forth) footballers cannot be said to be drawn predominantly from a middle-class context. This was a significant observation in the data. Many professional elites are drawn from well-educated, middle-class contexts. Illustrations might include, for example, senior judges, top architects, senior public officials and so on and so forth. Traditionally, it is not uncommon for English contingents of footballers to be drawn from lower or less privileged socio-economic groupings and classes (although the overall team may well be made up of international players for whom the same may, to some greater or lesser extent, hold true or not). In this regard, they perhaps have much in kind with other sports personalities and indeed the world of entertainment wherein people rise to elite status and celebrity from humble or disadvantaged origins. Moreover these domains, including football, bring celebrity and elite readily together and perhaps more easily than professional fields such as, for instance, medical doctors, architects or a majority of politicians. Equally, the aforementioned professional groupings typically exhibit celebrity less readily than football or entertainment. They are often unknown to the wider public and they do not have their identity or influence conferred on them by public opinion.

### **Methodology – Interviewing Elites**

The research into elite interviewing took place in an English Professional Football organizational context. The intention was to examine and experience elite interviewing in a novel context in contrast to much of the extant research conducted in the elite interviewing literature hitherto. The research undertook an inductive and interpretivistic approach that involved the use of semi-structured and unstructured interviews with people working in the football industry (Van Maanan, 1988, 2010; Maylor and Blackmon, 2005; Eriksson and Kovalainen, 2008). The questions concerned the nature of living and working in the 'business' of the football industry and provided insight into the celebrity, personality and notion of elites in relation to this context.

The study took place over three years with the interviewing taking place between June 2005 – June 2009. A total of thirty-four participants were interviewed. The interviews lasted between thirty and ninety minutes. These were tape recorded and later transcribed and the tapes were subsequently returned to the interviews. The interviews were supplemented and complemented by non-participant observation at two non-Premiership clubs. This included shadowing of senior managers during the course of match days. The building of the interviewee databank was

achieved through a snowballing technique based on personal recommendation of one interviewee to another (Collis and Hussey, 2009:158).

Semi-structured interviews were deemed to be the most appropriate data collection method because they are congruent with the interpretive approach in that they enable contributors to 'tell their own story', thereby enabling the interviewer to gain a more comprehensive understanding of the participants' 'world' (Bryman and Bell, 2003: 477; Barbour and Schostak, 2005: 42-44; Polonsky and Waller, 2005: 131; Easterby-Smith *et al.* 2008, 88; Gray, 2009: 373). To this end, only a small number of pre-prepared questions were used during this interview phase. Here the aim was to encourage participants to provide a rich picture and consequently it was important to adopt a highly flexible approach which allowed interviewees to digress if necessary. The need for this type of flexibility was emphasised by Polonsky and Waller (2005: 106). They commented that 'The method chosen should match the degree of flexibility you require in terms of informational needs' and went on to explain that in '...exploratory research, you may need a method that provides room for respondents to give answers that the researcher may not have anticipated.' The data were analysed through intensive reading and rereading in order to allow prevalent themes, issues and phraseology to crystallise. This process, combined with the overall approach to the research, acknowledged and embraced issues of reflexivity in the research recognising the relation and impact of the researcher on the researched and vice-versa.

In relation to necessary issues of validity and reliability, the research followed normative protocols for interview processes. This involved use of the same questions for the semi-structured questions and use of the same introductory questions and passages for the interviews which took on a more unstructured nature. Given that interpretivism is the espoused methodological approach of the research it was reasonable to state that the findings carried resonance for many people working in a United Kingdom football context. It could not automatically be suggested that the research, so constructed, would be applicable to other contexts however it is possible that relevance might be found for other settings.

### **Findings and Discussion - Recontextualising Elites in English Football?**

The convergence of the review of relevant literatures with the field data provided a range of interesting insights and questions. At the core of these was the re-emergence of the questions concerning the challenge of defining elites and celebrity in differing sector and organizational contexts.

Based on our research, we would suggest that the precise dimensions of celebrity and elite may well vary in relation to the sector or context under examination by the research. This develops, but is kindred with, Delaney's (2007) work. For example, certain high ranking administrators are celebrities *within* the 'world' of football but are largely unknown as public figures. In the model

below, we could characterise this as 'public background figure'. In addition, we need to be careful how far we argue the presence of elites in football because many of the people interviewed were indeed elites but were could not be consider celebrities as such. The paper recognizes that this phenomenon is present and able to be observed in other organizational contexts beyond football. In the football context examined it was seen that this provided a particularly interesting context where the two entities seemingly overlap. It is possible to identify a number of factors that drive the convergence of this interaction, however, issues of power and familiarity to the public possibly constituted some of the more important ones. Power and the factors of power are starkly evident in the football context, as one administrator noted:

'If you are not a player you are treated abysmally. For instance, our players arrive at the training ground, they park their Porsche, and their first stop is the kit room where they meet Elaine and Lesley, on £7k a year. They will have washed the kit overnight and will have it ready for when they come in. So you've got a player on £1.5 million, £2 million a year taking kit and exchanging good mornings with a girl on £7k. The dichotomy for football clubs is that the investment in certain groups of people is absolutely massive, sometimes unimaginable, and yet the rest of the people surrounding them are on the basic wage. I would suspect that in many clubs they don't even bother to address this issue but we have tried to deal with it. Players can be very generous when directed in the right fashion. But it's harder to get a wage increase for a basic employee than it is for a £2 million a year player.' (Administrator – Manager – A, 2008)

This issue in combination with the literature and filed data analysis provide the opportunity for the evolution of a proposed model indicated below:

<i>High Power</i>	
<i>Macro-Elite/Celebrity</i>  <i>Players: Messi, Ronaldo</i> <i>Former Players: Pele, Cantona</i> <i>Certain Managers: Alex Ferguson. (Akin to</i> <i>Cashmere's 'Global Celebrity'.)</i>	<i>Micro-Local Elite/ Public 'Background'</i> <i>Figure</i>  <i>Certain Managers – the majority</i> <i>Team coaches and staff</i> <i>Administrative staff</i>
<i>Eclipsed-Faded -Fallen Elite/ Celebrity</i>  <i>Personality/'Character'</i> <i>Players: Gazza (Paul Gascoigne)</i> <i>Some managers and team staff – high profile</i> <i>newly promoted but vulnerable teams for</i> <i>example.</i>	<i>Member of the Public – Man or Woman</i> <i>in the Street</i>  <i>Warhol's 15 minutes of fame</i>
<i>Low Power</i>	
<i>Profile - Well Known</i>	<i>Profile - Unknown</i>

Figure 2: A Recontextualisation of the Celebrity-Elite Interface in a English Professional Football Context.

Figure 2 works to illustrate, drawing on the data, a number of aspects of elites in a United Kingdom football context. Power and the extent to which people are in a particular public consciousness (here termed 'knownness') emerged as important aspects of the data. Herein the data analysis is infused with a spirit drawn from the tradition of Critical Management Studies (see Stokes, 2011) which is centrally concerned with discussions on the subjectivities of issues such as power, discourse, identity, sexuality).

The model embraces these elements and points up the manner in which, in relation to continuua of 'power' and 'knownness' (i.e. known or unknown) the Macro-Elite Celebrity operates in different spaces to the Micro-Local Elite/ Public 'Background' Figure of the game. In this way the upper two boxes share a similar temporal space or moment – in other words they are both elites and celebrity but in the case of the 'Local' elite the extent and coverage ('knownness' is limited to a micro or very localised context).

On the other hand, where the power is low we see a different form of celebrity. We see forms of Eclipsed-Faded -Fallen Elite/ Celebrity. These may well have once belong to the upper boxes of Macro or Micro Elite/Celebrities but now have slipped into some marginalised domain. In this manner, in many instances they are a close step away from reintegrating into the role of a member of the public. The table presents a range of environments and 'worlds' in which elite and

celebrity identities play out with varying degree of power and profile. They also model the dynamic and changeability of these identities over relatively short periods of time. Indeed, in relation to the grid in Figure 1, it is possible to introduce the term and notion of 'elite/celebrity eco-systems'. The metaphor of elite/celebrity eco-system is a useful one in that it provides a model that attempts to integrate and show the relationship between a range of dynamic facets: power, profile, the temporal and the spatial intertwined with identity within global or localised realms. This notion of the lack of homogeneity in elites was alluded to by Aberbach and Rockman (2002) in the literature above however the analysis of the particular organizational context of football both illustrates and develops understanding of the phenomenon.

As a consequence, it can be seen how the model and its variable/typologies might equally be adapted for realms beyond football. For example, the world of entertainment may offer a kindred field and indeed, although football is suggested as a business or industry it is equally part of the worlds of leisure and entertainment. A range of data moments underpinned the building of the model. In most instances interviewees requested that they met in a location of their choice – often a prestigious location (e.g. A famous ex-manager and TV pundit at the All England Club Wimbledon; A football entrepreneur owner-director at Arsenal's Highbury Stadium; A former player at Liverpool's Anfield Stadium; a football executive at Football League HQ Preston; An old ex-player at PFA HQ Manchester). Location and 'space'/place could have had an influence on the process i.e. 'in awe of the surroundings' – difficult to maintain objectivity – danger of 'seduction' (Delaney, 2007). Meeting and interviewing somebody who you feel that you know because you've grown up watching them on the TV or because you see them regularly in the media (read about them in the papers/ seen them interviewed elsewhere etc.) challenges objectivity and may increase bias, prejudice etc. It could be argued that this isn't such a big problem for those who just interview mainstream elites – but when you are interviewing elites who are also celebrities this may be an issue.

On some occasions interviews were interrupted by phone calls etc – clearly my interviewees were busy people – on a number of occasions the interruptions were made by other celebrities (i.e. when interviewing Phil Thompson he received 2 phone calls – Stephen Gerrard and Gerrard Houllier; when interviewing Dave Basset we were interrupted by Denise Wise – in person; Bill Beswick took a call from Steve McClaren). From an interviewer's perspective these were 'surreal' experiences – they emphasised the status and power of the interviewee [degrees of separation?]. Indeed interviewees were keen to point out who they'd been speaking to – an effort to impress/name dropping!!

One feature that was particularly striking in the interviews conducted was the tendency of many individuals to go through the motions of 'trotting out the patter' often from their autobiography – so in fact producing 'an account from an account' so to speak. This offered

almost a self-caricatured portrayal and representation of the respondent by the respondent. As one friendly club colleague intimated - If we could devise a way of 'cutting through the c\*\*p' that would be great'

One issue that is strongly evident in the data is the phenomenon of insider/outsider in the football 'world' (akin to the work of Becker, 1995; Herod, 1999; Sabot, 1999, Desmond, 2004). Herod (1999:314-324 in wider contexts). Football is, and remains, a protected world and this presents a major challenge for the elite interviewer. In many regards, perhaps this is little different from many celebrity elite contexts (see for example, Shenton and Hayter (2004)). However, as a contextual factor it is worthy of note as it repeatedly resurfaced in the data:

'In general in clubs there is no big picture feel. In other industries you get coordinating groups. But in football there is no formal exchange, there is no sharing of competitive strategies. Football sees itself as a competitive industry, whereas, in fact it should be a cooperative industry.' (Former Manager and Football Celebrity - H, 2007).

'Football clubs remain isolated and suspicious of outside influences. This has led to a 'sclerosis' that has severely limited their ability to modernise and develop.' (Former Manager and Industry Commentator - L, 2009)

It might be argued that this engenders a power-centric arrogance in some individuals. And, indeed, this might well be identified as a potential trait in the identity of elites and celebrity. In the case of the football industry this appeared to be compounded with issues of amateurism in the back room/ administrative operations. This seemed a heady and dangerous cocktail with potentially serious consequences. In the data this manifested itself in a number of ways:

'A highly placed football administrator recounted how the fan approached the Chairman and berated him about recent incidents at the club. The Chairman responded and said 'My man, how do you expect to have any say in these matters if you are not a shareholder?' A few months later the fan approached the Chairman again and informed him that he was now the proud owner of a single share. He went on to enquire as to whether this now meant that he could have more access to the club. The Chairman replied 'No, becoming a shareholder means that you will still know bugger all, but quicker!'

(Administrator - B, 2007)

'Whether it was girls who cleaned the floors, to any people who worked in the offices, the club felt they should have been working for nothing because it was a real delight and it was an honour - when people asked for pay rises club officials would say "What are you asking for a pay rise for? What an opportunity you have to work for this club!'"

(Football club Employee - G, 2008)



‘Surprisingly, the outgoing accountant thought that the post of Financial Controller was a part-time role. But I learned fairly early on that it clearly wasn’t!...Things were very lax - I had to spend literally three or four months getting everything bang up to date, it was a complete baptism of fire!’

(Senior Administrator – M, 2008)

The notion of amateurism, or perhaps alternatively expressed unprofessionalism, is an interesting finding and situation in the data with which the elite interviewer had to contend in this particular context. There is often an assumption, perhaps, that elites will be organised, well-aware and generally coherent given the journey they have undertaken to arrive at their ‘eliteness’. In the particular context of football this was not at all uniformly the case. This further provides evidence of a variable aspect in the assumptions sometimes made regarding the variability of elites.

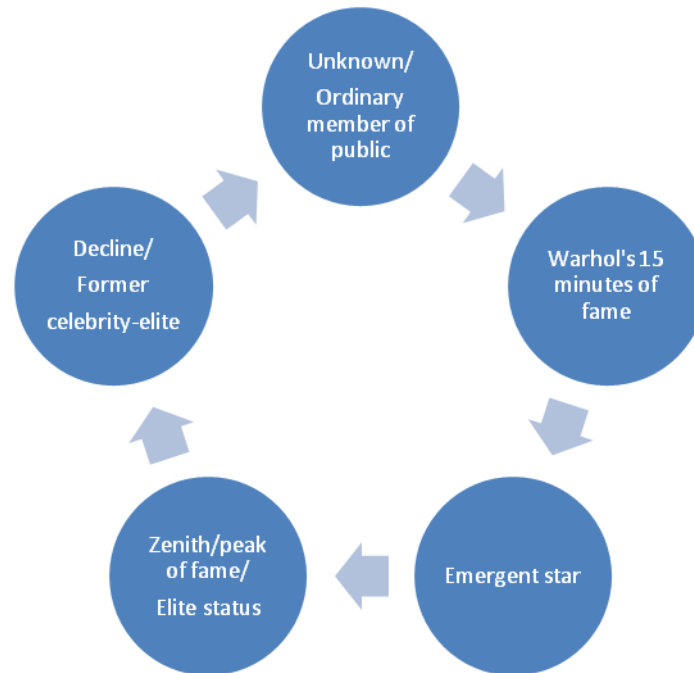
The redefinition of elites needs to take account of ‘new elites’ phenomenon in the 21st century and this may be particularly relevant in the changed and changing world of football. One particular aspect of this has been the tendency for rich local people to buy clubs. Of course, in more recent times this has escalated into Russian, American and Arab Oligarchs and business people taking a business interest in clubs. It might be argued that this is driven by celebrity issues as much as business aspects:

‘...a little bit of a plaything that could provide an awful lot of personal kudos’ (Manager C, 2009)

For employees – administrators and managers at clubs, the celebrity or glamour can seem significantly more ephemeral and transient:

‘Football doesn’t mind if you work 60 hours every week. The problem is if you aren’t prepared to work hard and you want a family life - you’re going to get kicked out. If you say, “I can’t come on Saturday because I’m taking the kids to the funfair”. You might get away with that once, but if you start doing that a couple of times you’re going to be gone. A lot of people come in and survive six months and then say “Right I’m off”. There are some glamorous times but suddenly they realise they’re in a job and unless you’re fully committed you aren’t going to survive.’ [Emphasis added] (Senior Administrator F, 2007)

In reference to the proposed box diagram it is possible to identify processes of creation and re-creation, or social construction of identity, fame, celebrity and eliteness:



*Figure 3: A Tentative Model of the Processes of Celebrity*

The construction of a research methodology approach allows interviewing and elite interviewing to be seen a process rather than seeing elite interviewing as a tool or device – i.e. an end in itself. Rather, an examination of elite interviewing allows us to see the experience more as a process or narrative. This in turn invokes a consideration of the role of narrative methodologies in elite interviewing.

It is valid to see football as a number of things in its modern context. On the one hand it is a business and an industry in which markets, careers and profits are pursued. At the same time it is a leisure and entertainment domain that offers drama and show-business. In all of these regards, football is little different to many other organizations in that they have celebrity and personality that occasionally reaches the press and media. There is scope to use inter-disciplinary sources, such as for example, journalism, media or social studies. This might contrast with existing approaches which tend to see football examined through sport, leisure, tourism and management frames of references

At the outset of the paper, it was noted that the field of politics and political studies has played an important, indeed rather dominant role, in relation to the interviewing of elites. This work has therefore primarily resided in the area of the liberal arts and wider humanities. However, there is no doubt that other literatures, for example – media studies, social studies and journalism have also played a role in this regard. All of this laudable effort is to be strongly commended,

however, in the fields of business, management and organization it can be seen that elite interviewing has been largely overlooked and marginalised. This is strange given that the world of business and commerce is not alien to the notion and practice of elites and celebrity.

We have conducted our study and investigation of the concept of 'elite' as an a priori point of departure for a consideration of how to undertake research in relation to them. There may well be a 'world' of the elite that needs to be understood as a separate world and the dividing act of creating elites and de-facto non-elites.

In reflecting on the analysis of the data thus far, and considering the future directions in which to develop the working of the data and the evolution of the study, there is scope to introduce and consider a number of frameworks to elite interviewing. For instance, social construction processes around elite identity (Berger and Luckmann, 1966; Watson and Harris, 1999) can be seen to offer a useful elaboration for why variation in identity and behaviour occurs across elite groupings. This shows us the emergence and formation of notions of elite and celebrity rather than, as is so often the case taking them as a homogenous fait accompli. By better understanding these it may provide insight to the research method of elite interviewing and contribute to what seems to be something of a theoretical void around the area. Overall, this underscores a need to consider processes of representation for elites and how these might be scrutinised through various research methods. Moreover it points up a role for approaches which can challenge orthodoxy and reveal some of the marginalised areas. Critical perspectives /Critical Management has been an underlying influence in the data analysis of the present paper and there is scope to consider that the subjecting of elite interviewing in a range of different organizational contexts to CMS (and its concern for issues such as power, discourse, sexuality, identity and so on and so forth) may yet reveal further insights.

Overall, there is scope to consider and debate elite interviewing to a greater extent in the field of business organization and management. This paper has worked to carry forward this process in relation to a football business organization and management context.

## **Conclusion**

The paper from reflection on the literature has offered novel insights and contributions in a number of regards. We have identified the paucity of literature on elite interviewing in the management and organization field. This is especially the case in relation to textbooks. As was indicated above, custom and practice indicates that textbooks are the primary source of information for students in relation to research methodology. Yet the search of thirty of the most widely used texts showed virtually no references to the specific field of elite interviewing. It was noted that a journal literature is available but regrettably many students show a reluctance to access journals especially in relation to research methodology (Stokes and Martin, 2006, 2008).

We have revisited and challenged the very nature and character of the concept of 'elite' in relation to elite interviewing. In relation to this we have highlighted and re-profiled the role and importance of developing alternative frameworks and schema for elite interviewing. By examining elite interviewing in the setting of United Kingdom football, we have illustrated the role of specific contexts both at national level and also at the micro and meso-community levels.

The elected case of football was shown to provide a clear illustration of how elites operate in differing ways in various contexts. In the case of the English football industry the relative informality and amateur legacy that operates in what are essentially multi-million pound corporate businesses produced interesting insights into accessing, even becoming assimilated to, elites during the course of the research. It appears to the authors that the way that different manners and cultures impact on issues of access, reflexivity and assimilation a particular aspect of elite interviewing worthy of further research across different sectors and contexts.

These processes have been contextualised against an analysis of background literatures that has sought to show the act of interviewing elites in the richest and fullest light possible. The impression is all too often given that elite interviewing draws on a particular literature base whereas there is scope to draw on a wide inter-disciplinary base.

The research was able to develop a form of typology of elites, generated by the interview data, in relation to an English football organizational setting. This provides a useful template to be employed in future research in approaching football elites. Equally, the research was able to identify and consider the language and patterns of communication used by elites in English football during the interview processes. In undertaking the above processes we have attempted translations of the data secured into working conceptual frameworks. It is for future research to test and extend these models.

Furthermore, we have worked to profile issues of identity and power in elite interviewing together with processes of autobiography, narrative, reflexivity and social constructionism and this is work that needs to be developed further within a critical frame of reference. In conducting all of the above stated work we have initiated a debate to recontextualise elite interviewing in relation to business, organization and management and believe that there is scope for a range of work to pursue this further in the future.

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## EGYPT'S RANKING ON THE KNOWLEDGE ECONOMY INDEX: BARRIERS TO TRANSFORMATION IN REVOLUTIONARY TIMES

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### Abstract

This article seeks to bridge the gap in literature between Knowledge Management as a prerequisite to innovation and transformation of developing countries such as Egypt. Several articles and research studies have been conducted on this relationship, yet none has been extended to North Africa. Egypt is currently walking a thin line between revolutionary change that can aid the country in regaining its former glory and long-lasting chaos. The authors have conducted interviews with 50 junior and senior level managers in the ICT and FMCG sector in Egypt according to a structured questionnaire that seeks to identify Egypt's position on Knowledge Management and innovation. The results of the individual companies provide us with an aggregate picture of the economy, enabling us to assemble the first SWOT analysis for Egypt's current position.

The Egyptian economy possesses high potential given the existence of the enabling tools that allow Knowledge Transfer. Yet, the enduring weaknesses of a deeply rooted culture that defies Knowledge Transfer, corruption and an outdated educational system pose a threat to the economy's ability to innovate and advance. These findings justify the World Bank's ranking of Egypt on both the Knowledge Index (KI) and Knowledge Economy Index (KEI) for 2009. The value of this research resides in compiling a SWOT analysis that would be of value for practitioners and policy makers in Egypt and allow them to fathom the justification behind the World Bank's ranking of Egypt. This information should formulate a solid base for Egypt's transformation path.

**Keywords:** Knowledge Management, innovation, SWOT Analysis, Egypt, Knowledge Index (KI), Knowledge Economy Index (KEI)

### Introduction

The management of knowledge is frequently identified as an important antecedent of innovation (Darroch and McNaughton, 2002). The Knowledge Assessment Methodology (KAM) is an internet-based benchmarking tool developed by the Knowledge for Development Program of the World Bank. The tool provides a basic assessment for the knowledge economy readiness for 128 countries in 9 regional groupings (Chen and Dahlman, 2005). The World Bank has identified four pillars to gauge whether or not a country is conducive for the development of a



knowledge economy; namely economic incentive and institutional regime, education, innovation and ICT. This signifies a correlation between both Knowledge Management and innovation that is worthy of research.

Accordingly, this article aims to discuss the marketplace trends in Knowledge Management and innovation in Egypt through constructing a SWOT analysis for the Egyptian economy. This aims to demonstrate that Knowledge Management and innovation are inter-related, and that the management of knowledge and human capital should be an essential element of running any type of business (Gloet and Terziovski, 2004).

## **Literature Review**

### **Definition of Knowledge Management**

Knowledge is a broad and abstract notion that has defined epistemological debate in western philosophy since the classical Greek era. In the past few years, however, there has been a growing interest in treating knowledge as a significant organizational resource (Alavi and Leidner, 2001). Accordingly, researchers and practitioners have realized the importance of the concept and transformed it into the efficient and effective management and classification of knowledge, which if properly administered might bring about fruitful returns. Literature is satiated with definitions of the term including that of Frappaolo (2006), Hansen et al. (1999), Malhorta (1998), O'Dell and Grayson (1998) and Groff and Jones (2003), to name but a few.

In 1998 Malhorta proposed a definition, which he suggested found a general consensus amongst scholars and practitioners across the world. He states that 'Knowledge Management refers to the critical issues of organizational adaptation, survival and competence against discontinuous environmental change. Essentially, it embodies organizational processes that seek synergistic combination of data and information processing capacity of information technologies, and the creative and innovative capacity of human beings'. Although some definitions are a mere recitation of the stages or processes of Knowledge Management and may seem outdated, others take into account the dynamic nature of knowledge and, through their definitions, have been able to demonstrate the impact of this concept on key outcomes such as organizational performance, innovation, organizational adaptation and responsiveness (Nafie and Jones, 2011, forthcoming).

Simply stated, Knowledge Management includes making knowledge available in organizations whereby employees that need information have immediate access to it. Making this knowledge available poses a challenge since there are two types of knowledge tacit and explicit and there are several knowledge enablers that have been identified by researchers that need to be present for knowledge to be transferred within the organization.

Unfortunately, until now implementing Knowledge Management (KM) has been like nailing jelly to the wall (Tiwana, 2000), as such Cortada and Woods (1999) proposed eight major categories of knowledge-focused activities that could be managed within an organization to provide the broad and complex concept with clear and identifiable dimensions that one could specifically refer to when discussing / measuring Knowledge Management.

- Generating new knowledge
- Accessing valuable knowledge from outside sources
- Using accessible knowledge in decision making
- Embedding knowledge in processes, products and/or services
- Representing knowledge in documents, databases and software
- Facilitating knowledge growth through culture and incentives
- Transferring existing knowledge into other parts of the organization

## **Measuring the value of knowledge assets and/or impact of Knowledge Management**

### **Types of Knowledge**

'There seems to be a clear accord in much of the Knowledge Management literature that there are two main types of knowledge – tacit and explicit. Authors such as Groff and Jones (2003), O'Dell and Grayson (1998), Ikujiro Nonaka (1991), Frappaolo (2006), and Tiwana (2000) among others have proposed similar definitions. Nonaka (1991) simply states that *explicit knowledge* is "formal and systematic and for this reason can be easily communicated and shared" while *tacit knowledge* is "highly personal and hard to formalize and, therefore, difficult to communicate to others". Frappaolo adds to this by explaining that *explicit* knowledge is articulated in formal language while *tacit* knowledge is embedded in individual experience and involving such intangible factors as personal belief, perspective, instinct and value (2006, p.10)' (Nafie and Jones, 2009).

### **Knowledge Management Enablers and barriers**

To ensure effective implementation of Knowledge Management, several authors have identified various factors that need to be present if the endeavor is to succeed. Heeseok and Byounggu (2003) proposed a model of seven enablers including: collaboration, trust, learning, centralization, formalization, T-shaped skills, and information technology support, while O'Dell and Grayson (1998) proposed only culture, technology, infrastructure and measure. Apparently, there seems to be a consensus among researchers that technological support and culture are essential to building a successful Knowledge Management base. This includes basic IT hardware

and software as well as appropriate IT solutions that will facilitate the process of knowledge dissemination.

Research results in Egypt have shown that the IT tools are available in all companies. Organizations invest heavily in upgrading their technology with internet access available to all employees and knowledge repositories created to promote sharing. Borghoff and Pareschi (1998) call this repository a corporate memory and state that a corporate memory is an explicit, disembodied, persistent representation of knowledge and information in an organization. Yet, interviews show that although repositories are available, access is granted via a username and password on a need to know basis. Knowledge remains highly guarded and closely held to top management. It remains a symbol of status and wisdom. Moreover, local companies and government institutions inaugurate sophisticated systems in place through tenders, but do not walk the extra mile by training employees to use the system and give them sufficient time for the transformation phase. As such, IT systems are not used to their full potential with frequent setbacks occurring. Helpless employees are asked to contact the solutions provider and work the problem over the phone, which rarely proves effective. Finally, employees lose hope in the new system and either revert back to their old ways or try to endure the problems of a perfectly functional system that was not designed for them!

Culture, the second Knowledge Management enabler, can present itself in two ways; on the outer circle is the national culture defined as '...patterned ways of thinking, feeling and reacting, acquired and transmitted mainly by symbols, constituting the distinctive achievements of human groups, including their embodiments on artifacts; the essential core of culture consists of traditional ideas and especially their attached values' (Hofstede, 2001). While in the inner circle, organizational culture is defined by Trompenaars and Hampden-Turner (1998) as the way in which a group of people solves problems and reconciles dilemmas (1998). Organizations with a culture based on trust and mutual cooperation represent a formula for success and a fertile ground for innovation since employees build on each others' experiences and don't squander time reinventing the wheel. Accordingly, researches have shown the importance of culture to knowledge sharing and transfer (Hill et al., 1998, Jones, 2007), where both authors give examples of instilling new technologies and training employees in the Arab world; nevertheless, they confront the barrier of both the corporate and national cultures.

Interview results in both local and multinational companies in Egypt show that the situation is no different with a majority stating that national culture is not conducive to Knowledge Transfer given deeply rooted cultural heritage that dates to the Pharaohs, which does not promote the sharing of knowledge with subordinates further down the hierarchy. The authors found exceptions in two multinational ICT companies, whereby the existence of a strong corporate culture outweighed the effect of the national culture, compelling employees to follow the

companies' way of doing things. The ICT sector is characterized by innovation and rapid change, justifying why the results are different from the FMCG sector, where corporate cultures were weak and strategies dictated by headquarters. From the above we can deduce that culture can act as both an enabler and an impediment to success. It seems that change is sluggishly taking place, following the Spring Revolution where results have shown a sharp shift in the national culture, but have not yet permeated the intricate workings of the economy (Nafie, 2011).

Interpersonal trust has been stated as an imperative pillar in allowing effective and amplified exchange of knowledge between employees and silos of an organization (Levin et al., 2002). According to Nahapiet & Ghoshal (1998) trust lubricates cooperation, and cooperation itself breeds trust. This shows a mutual synergistic relationship between both factors that has been afororganizationed by many researchers to have a colossal bearing on Knowledge Management activities within organizations (Park, 2006, Levin et al., 2002). Although important, research results shows that this enabler is in fact an impediment to Knowledge Management activities in Egypt. Interview results showed that more than 90% of interviewees explicitly stated that most people cannot be trusted. This has several drawbacks: the obvious is a lack of cooperation between employees and silos of an organization, hindering efforts to collaborate and innovate to bring new products to the market. This might be an important reason for Egypt's loss of its global competitive position and inability to compete internationally.

### **Knowledge Assessment Methodology**

In order to facilitate countries trying to make the transition to the knowledge economy, the *Knowledge Assessment Methodology* (KAM) was developed by the World Bank Institute. The user-friendly, interactive, internet-based tool was designed to provide a basic assessment of countries' readiness for the knowledge economy, and identifies sectors or specific areas where policymakers may need to focus more attention or future investments (Chen and Dahlamn, 2005). The authors have utilized the results of this interesting assessment as an input into the SWOT analysis, which will illustrate Egypt's situation to date. KAM has been developed for 128 countries within 9 regions with results ranked on an ordinal scale from 0 (weakest) to 10 (strongest). The four pillars that constitute the basis of this methodology are important determinants of long-term economic growth (Ibid, 2005).

Prior research results have shown the importance of education on per capita GDP (Barro, 1991) and economic growth (Cohen and Soto, 2001). Educated individuals have increased capacity to learn and contribute to an economy's skilled labor force. This labor force is the basis for economic development and productivity within a nation and it is their contribution to R&D and innovation that is of value. An effective innovation system is one that provides an environment that nurtures research and development (R&D), which results in new goods, new processes and new knowledge, and hence is a major source of technical progress (Chen and Dahlman, 2005). Adams conducted a research that shows a significant correlation between the number of scientific

papers contributed and growth in productivity in manufacturing industries based in the United States in the 1953 – 1980 period.

An adequate information infrastructure, commonly referred to as ICT, includes a country's usage of technology. This includes telephone lines, computer availability and usage as well as internet usage within a country. Technology has transformed economies around the world leading some of them to leapfrog (such as the South East Asian countries). A study by Oliner and Sichel (2000) shows how the usage of ICT has led to increased economic growth during the past decade. Finally, the previous three pillars cannot function effectively without an economic incentive and institutional regime where well-grounded and transparent macroeconomic, competition and regulatory policies exist (Chen and Dahlman, 2005).

Table1: Egypt's rating on the Knowledge Economy Pillars - 2000

<i>Index</i>	<i>Egypt, Arab Rep.</i>
1. Knowledge Economy Index (Average of 3,4,5,6)	4.31
2. Knowledge Index (Average of 4,5,6)	4.50
3. Economic Incentive and Institutional Regime	3.73
4. Education	4.70
5. Innovation	5.03
6. ICT	3.78

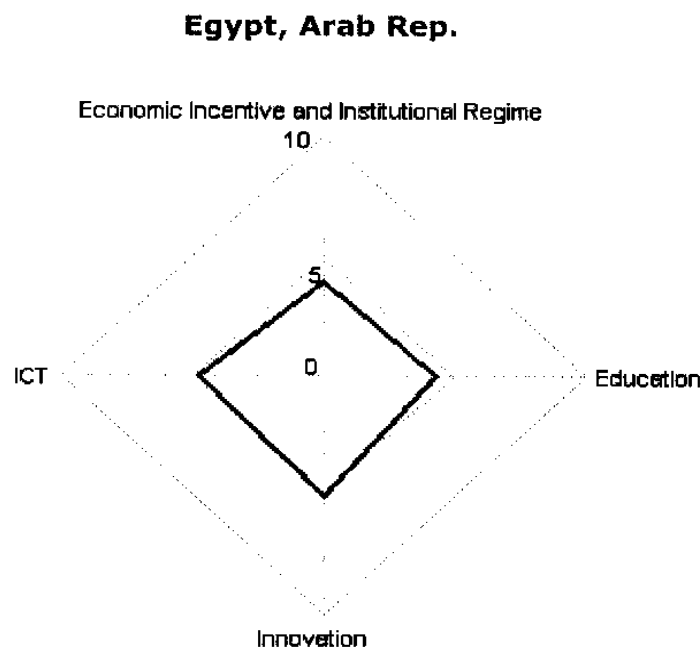


Figure 1: Knowledge Economy pillars for year 2000 in graphical form  
[http://info.worldbank.org/etools/kam2/scorecard\\_bs\\_separate.asp?chart=1](http://info.worldbank.org/etools/kam2/scorecard_bs_separate.asp?chart=1)

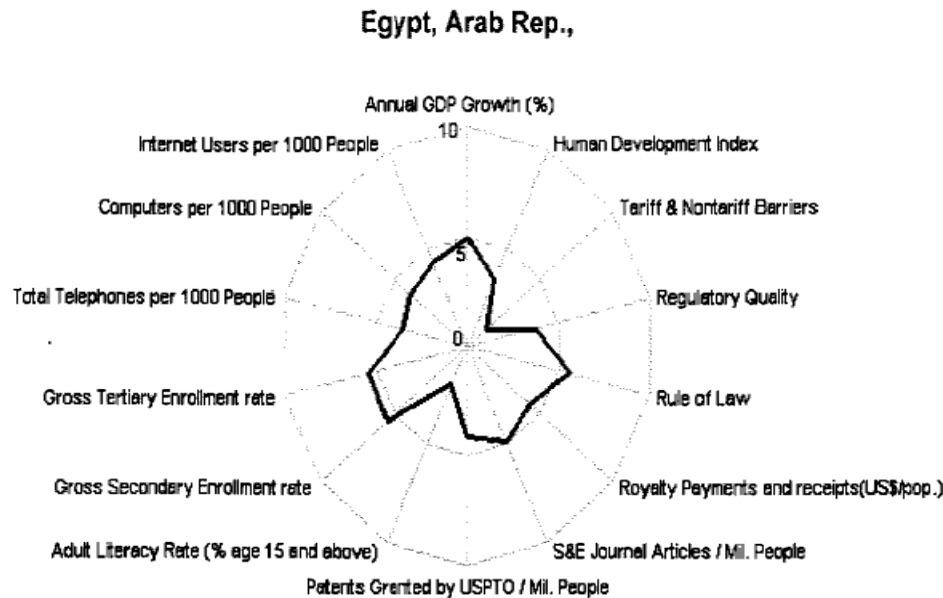


Figure 2: Egypt's ranking on variables representing the different pillars  
[http://info.worldbank.org/etools/kam2/scorecard\\_bs\\_separate.asp?chart=1](http://info.worldbank.org/etools/kam2/scorecard_bs_separate.asp?chart=1)

## Findings

Empirical evidence supports the view that organizations with a Knowledge Management capability will use resources more efficiently and so will be more innovative and perform better (Darroch, 2005). Interviews with 50 junior and senior level managers at local and multinational companies in the ICT and FMCG sector since the Spring Revolution has determined the following marketplace development and trends that are worthy of discussion:

- Almost all of the companies visited are directed by functions and not business units, which implies that centralization in decision making persists. This has serious implications on Knowledge Management efforts within corporations since knowledge dissemination and sharing within such organizations tends to be sluggish and complex.
- All interviewees have indicated that a relationship outside the office exists with colleagues. This informal, one-on-one rapport acts as a lubricant in all companies. Most interviewees indicated that without it, they would not exchange knowledge or trust peers easily.
- Organizations in Egypt do not highly rate Knowledge Management efforts within their priorities. As such, no formal endeavors are taken by company management to raise

awareness on the importance of the subject and its implications on future competitiveness.

- Organizations do not free up employees' time for socialization or dedicate specific time for formal coffee breaks where employees can engage in work-related discussions.
- All organizations have state-of-the-art software ICT software and hardware including knowledge repositories where all the company's information is stored for future retrieval and reference. Nevertheless, access is granted on an individual basis depending on their 'need to know' and its degree of confidentiality. Usernames and passwords which expire once used, have been created to guard the repository with only general knowledge such as seminars and manuals available to all.
- Following the above points, all organizations possess intranet systems, but no active efforts are taken to encourage employees to access the system and discover material that might be of use for innovation such as novel ideas and processes.
- Employee handover efforts as part of Knowledge Transfer and Knowledge Management at large are a mere formality in most organizations. Interviewees stated that employees are usually in a hurry to leave and hence time is of the essence. New employees are left to navigate the system and search for the required knowledge at their own pace. This causes more harm than good, since productivity slumps for a period and other dependant personnel / departments are obliged to wait until the employee is properly aligned to the new system and ready to function.
- Companies usually do not assign a mentor / coach to new employees since the workload is high and demanding. Accordingly, new employees only receive a formal orientation, leaving them to discover the intricacies of their new job.
- Employees are not encouraged to innovate or think out of the box. Only a few multinational companies from those interviewed stated that this is the norm at the workplace. The reasons attributed by interviewed managers include a desire to maintain the status quo, and a solemn adherence to the motto 'knowledge is power'. Ideas and innovations have to pass through management, who either are apathetic to employee efforts or discredit employees in favor of themselves. Over time, this has created a de-moralizing atmosphere which has not only nipped innovation attempts in the bud, but also diminished Knowledge Management significantly across organizations.

The above key findings show that Egypt's rating on the KAM is well-grounded. ICT scores 3.78, which may be related to lack of employee training on technology and thus their inability to use it

effectively as well as the inexistent management support to utilize the organization's intranet. As for economic incentive and institutional regime, a rating of 3.73 is justified by Egypt's recent unstable economic and political situation in addition to its historical corrupt regime that has been overthrown leaving the nation with poor economic indicators of inflation and unemployment. Regulatory quality and rule of law are minimal given the regime's desire for personal gains instead of the nation's welfare. The interconnected pillars of education and innovation scoring 4.70 and 5.03 respectively are attributed to low adult literacy rates as seen in figure 2 above. A nation with high illiteracy is challenging to advance. Nevertheless, innovation is mediocre given the large amount of scientists engaging in R&D as evidenced by the decent amount of journal articles published per million (in figure 2 above).

Carneiro (2000) examines the relationships between organizations' competitiveness, innovation advancements, and Knowledge Management and presents a set of considerations regarding how these relationships affect strategic management and the formulation of competitive strategies. In Egypt, the relationship between these factors is imperative especially in light of the current situation where expectations are high and hopes of ameliorating the political and economic situation are eminent. Knowledge needs to be managed, with the assistance and continuous support of higher management. A commitment to sharing information with the aim of creating a change is the goal of the coming era. Not only will this encourage innovation, but also create an atmosphere of trust and collaboration, which is a requirement for both innovation and Knowledge Management. A nation with the said determinants will be able to increase its productivity and hence global competitiveness. Egypt, formerly the largest exporter of cotton during the 1950s is currently a net importer.

## Discussion

Egypt ranks 89 out of 128 countries in the results of the Knowledge Economy Index (KEI) published by the World Bank in 2009 rating the country at 4.31 / 10. The KEI takes into account whether the environment is conducive for knowledge to be used effectively for economic development based on the four pillars. This depicts a below-average rating especially when compared with neighboring Middle Eastern countries such as Qatar and the UAE scoring 6.06 and 5.96 respectively and ranking 49 and 50 respectively. Changing economic policies and a corrupt political regime have left Egypt burdened by debt, a problem which has been exacerbated following the Spring Revolution with the flight of investor capital from the country and the halt of production in almost all economic sectors, demanding their long-forgotten rights of workplace equality, raises and yearly bonuses. This might explain Egypt's score of 3.73 on the economic incentive pillar as opposed to 6.63 and 7.71 by Qatar and the UAE respectively as an example of economies that strive to furnish investors with an environment conducive to production by instating abiding rules of law.



As stated above, education and innovation are closely related with Egypt scoring 4.70 and 5.03 respectively. This is quite shocking for a nation with a strong cultural heritage such as Egypt especially with Egypt having a significant number of scientists working in R&D (Zeng, 2006). Although Nobel Laureates Dr. Ahmed Zuwail, novelist Naguib Mahfouz, renowned cardiologist Magdy Yacoub and Dr. Mohamed El Baradei, previous Director General of the International Atomic Energy Agency, are all Egyptians, the problem still persists. Almost all TV programs following the Spring Revolution have been calling for an overhaul of the educational system, which was once able to produce such scientists, but has now become outdated and graduates are not employable. Nour (2005) tries to explain the lack of innovation in Egypt through looking at a failure to build human capital. She states that public expenditure on education was highest in the case of the 26.1% spent by Morocco. On the contrary, Egypt's % is in single digits, despite recording the appointment of 493 senior scientists during 1996-2000, the highest in the Arab world (Nafie and Jones, 2011, forthcoming).

Although ICT tools are available in Egypt, they have not been properly put to use as a result of a lack of training on the new systems as well as a work force that is resistant to change. The educational system has produced a laborious workforce that is incapable of thinking out of the box and embracing new technologies. As a result Egypt has scored 3.78 on this pillar compared to 7.06 and 7.91 by Qatar and UAE respectively. Although these countries are heavily dependant on expatriate labor, it is this qualified, well-educated and flexible labor force that is equipped to adapt to new and changing ICT systems in order to produce high quality output in response to lucrative incentive systems set by organizations.

From the above information, the authors have compiled the following SWOT analysis to demonstrate the nation's strengths and weaknesses providing policy makers and investors with a viewpoint at the situation.

**Strengths:**

- Egypt has a prime geographical and logistical location on both the Red and Mediterranean Sea, in addition to the presence of the Suez Canal.
- Substantial water supply from the Nile River allowing for the irrigation of the country's fertile land.
- Large population size approaching 83 million. Egypt ranks 27<sup>th</sup> in domestic and foreign market size, rating it as a lucrative market for Foreign Direct Investment (FDI).
- Hub for investment in the Middle East that has attracted more than 880 multinational companies in 37 different sectors (Foreign Companies Yearbook, 2008).
- Sizeable skilled and semi-skilled labor force.

- Strong political power in the Middle East and North Africa with influential decision making capabilities within the region.
- Egypt has recorded the appointment of 493 senior scientists within the last decade (Nour, 2005).
- Egypt has the largest army within the Arab world allowing for protection of its boundaries and providing it with the required stability.
- One of the world's largest markets for tourism.

Weaknesses:

- Egypt is currently in a state of upheaval given the Spring Revolution.
- Egypt's public expenditure on education is only 12% (UNICEF statistics).
- An outdated and underdeveloped educational system that produces a labor force that is possibly unemployable.
- Changing economic policies.
- High levels of poverty: 13.7 million Egyptians were recorded to live below the poverty line in 1996 (Hassanin, 1999).
- High unemployment rates reaching 11.3% in 1996 (Hassanin, 1999).
- Egypt lacks innovation capabilities attributed to the educational sector and high illiteracy rates reaching 66% in 2005-2008 (UNICEF statistics).
- Egypt ranks 81 out of 139 participating countries on global competitiveness and 109 and 74 on innovation and company spending in R&D respectively according to the results of the World Economic Forum – Global Competitiveness Report.
- According to the Knowledge Assessment Methodology, regulatory quality in Egypt is weak, which might imply a lack of trust for foreign investors.
- Strong national culture characteristics which act as an obstacle to Knowledge Transfer in both local and multinational companies (Nafie and Jones, 2011, forthcoming).

Opportunities:

- The abundance of undeveloped and urban land presents an opportunity for the development of large-scale urbanization projects.
- The large population poses a diverse market for a multitude of investors providing different products at varying prices to cater for the demand of a diverse base where the distribution of income is different.

- Unemployment represents opportunities for companies to recruit labor at low cost.
- International organizations such as UNICEF have the chance to intervene to bestow grants and establish projects to alleviate poverty and raise literacy levels. Not only will this will raise the economic standard of living, but also create a ripple of organizations that are willing to aid the organizations, thus driving the economy forward.
- The Spring Revolution has overthrown the corrupt regime. A new political system which aims to alleviate corruption and promote equity is in the pipeline. This will act as an incentive for foreign investors that wish to penetrate the Egyptian market.
- Egypt's senior scientists, including Nobel Laureate Dr. Ahmed Zuwail, are promoting various efforts to overhaul the educational sector.

Threats:

- Reform might take time rendering the economy in a state of chaos for some time.
- Egypt is highly indebted and thus funds for development of the economy in the short-term are unavailable. This has forced the economy to turn to the International Monetary Fund (IMF) for loans, which might overburden the economy if reform does not take place fast.
- The internal security situation in Egypt is volatile given several demonstrations, which might jeopardize tourism efforts that provide a base for Egypt's GDP.

## Conclusion

The relationship between Knowledge Management and innovation is an important one. Not only does it impact productivity and competitiveness, but also a country's ability to leapfrog and advance into a different dimension. Egypt has been reborn following the Spring Revolution and stands a high chance of success if the current problems are addressed. According to the interviews, problems persist with management support and ICT implementation within organizations. Suppressed innovation efforts and inability to cause change are a hindrance to competitiveness. The lack of trust felt by most interviewees results in diminished cooperation between employees, again impacting innovation. An underlying problem to all challenges is the outdated educational system, which needs immediate attention in order to produce a qualified and employable labor force. Such a transformed labor force will revolutionize industries, increase productivity and produce novel products, services and processes to cater for a growing and diverse market. The situation within Egyptian organizations needs to be transformed to keep up with the pace of globalization. Additional chances may not come by again!

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**EMERGENCE AND INTRODUCTION OF THE NEW OCCUPATIONS AND  
QUALIFICATIONS IN THE NATIONAL SYSTEMS OF OCCUPATIONS AND  
QUALIFICATIONS – THEORETICAL AND PRACTICAL ISSUES**

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**Abstract**

Considering the growing influence of the emergence and introduction of new occupations and qualifications in the national systems of occupations and qualifications to the development of economy, human resource management, employment and lifelong learning and the lack of systemic and in-depth research of these processes, the purpose of research is to disclose the features and factors of the processes of emergence and introduction of the new occupations and qualifications to the national systems of occupations and qualifications.

Approach of research is based on the systemic analysis of the factors and processes of the emergence and introduction of new occupations and qualifications. Methodology of research consists of the analysis of scientific literature and interviews with the human resource managers and developers of enterprises.

The paper provides systemic approach for research of the emergence and introduction of the new occupations and qualifications, discloses the specificities of these processes in the transitional economy and proposes theoretical framework for their analysis, monitoring and forecasting.

**Keywords:** New occupations, new qualifications, emergence of occupations, introduction of qualifications, national system of occupations, national system of qualifications.

**Introduction**

Emergence of new occupations and qualifications today is very common feature of the changing labour markets, economies and systems of qualifications. Changes in the national and global economies, labour market, technological development and dynamically changing business competition strategies and work organization forms, mobility of workforce and workplaces create conditions for fast development of new occupations and qualifications. Despite of that, the process of emergence and development of new occupations and qualifications lacks systemic theoretical and empirical research. Current attempts to research this process are too much concentrated on quantitative research and forecasting of the development trends, very often

ignoring important qualitative aspects of the process of emergence and introduction of new occupations and qualifications in the national systems of occupations and qualifications. Besides, there is a lack of research of these processes in the countries of transitional economies, where the emergence and introduction of new occupations and qualifications has specific character and plays specific role in the socioeconomic change.

Therefore the **aim** of this paper is to disclose the features and factors of the processes of emergence and introduction of the new occupations and qualifications to the national systems of occupations and qualifications referring to the cases of emergence and introduction of new occupations and qualifications in Lithuania.

This aim is achieved by:

- Disclosing and describing the factors of emergence and /or introduction of new occupations and qualifications in the national systems of occupations and qualifications, by considering commonalities and differences of these factors.
- Defining and characterising the processes of emergence and introduction of new occupations and qualifications in the national systems of occupations and qualifications by disclosing the structure and contents of these processes.
- Empirically researching the features of emergence and introduction of new occupations and qualifications in the national system of occupations and qualifications in Lithuania.

There are discerned the following *questions of research*:

What factors influence and shape processes of emergence and introduction of new occupations and qualifications in the national systems of occupations and qualifications?

What are the main pathways of the processes of emergence and introduction of new occupations and qualifications? What are the typical features of these pathways in Lithuania?

Theoretical and empirical research in this paper is based on the following concepts:

*Occupation* – professional activity, economically purposeful work and employment.

*Qualification* – a formal outcome of an assessment and validation process which is obtained when a competent body determines that an individual has achieved learning outcomes to given standards (European Commission, 2008)

*National system of occupations* – totality of occupations and professions in the country, systemically interrelated with different functional, processual, socioeconomic and cultural links and relations. System of occupations is also often referred as the world of work, but this concept is more generic and does not refer to the national level.

*National system of qualifications* – systemically interrelated and structured qualifications, developed in the national-level processes of their design, provision (training and learning), assessment of learning outcomes and awarding. National system of qualifications comprises qualifications, instruments of their structuring and regulation (National Qualifications Frameworks, legal basis), the processes of their design, provision (training and learning), assessment of learning outcomes and awarding.

There were applied the following research methods:

- analysis of scientific literature and documents (desktop research);
- semi-structured interviews with the representatives of the enterprises responsible for human resource management seeking to disclose the features of the cases of emergence of new occupations and qualifications.

### **The system of factors influencing emergence and introduction of new occupations and qualifications**

New occupations and qualifications emerge or are being introduced in the rich context of different factors. In order to grasp this complex variety of factors influencing emergence of new occupations and introduction of new qualifications in the national systems of occupations and qualifications we will refer to the scope of origin and action of factors (local, global) and to the relationships with the labour market and human resource management (demand and supply of human resources). Following this logics we can discern the following main categories of factors: local factors, global factors, factors related to demand of human resources in the labour market and factors related to supply of human resources ensured by the systems of education and training and lifelong learning.

**Local factors** – factors, which enhance or suppress emergence or introduction of new occupations and qualifications in the country or region originating from local social, economical, cultural conditions and context.

**Global factors** – factors, which enhance or suppress emergence or introduction of new occupations and qualifications in many countries and regions originating from the global (international) social, economical, cultural conditions and context.

**Factors related to human resource demand in the labour market** – features and processes of human resource demand and it's change, which enhance or suppress emergence or introduction of new occupations and qualifications.

**Factors related to supply of human resources** - features and processes of human resource supply and its change, which enhance or suppress emergence or introduction of new occupations and qualifications. .



By analyzing the relationships of these categories of factors there can be derived the following four categories:

- local factors related to human resource demand in the labour market;
- global factors related to human resource demand in the labour market;
- local factors related to supply human resources;
- global factors related to supply human resources.

We will briefly overview some typical factors belonging to these categories and will estimate their influence to the emergence and introduction of new occupations and qualifications.

### **Local factors related to human resource demand in the labour market**

There can be discerned the following factors belonging to this category:

*Economical development of the country or region and it's influence to the labour market, occupations and demand of qualifications.* Economic growth and development of production can create favourable conditions for emergence and development of new occupations and qualifications, because these processes enhance investments of enterprises to the new technologies, as well as foster introduction and development of new products and services, search of the new markets etc., leading to the emergence of the new functions and tasks of work. Economic decline has adversary effect on the emergence of new occupations and qualifications, because it reduces the number of workplaces and makes enterprises and business actors to concentrate on the challenges of survival in the market often forcing them to follow more restrictive pathways of human resource management and development.

*Specificities of the structure of regional or national economy, such as features of dominating sectors, size of enterprises, level of economical and technological development of enterprises, etc.* The features of the development of economical sectors, such as level of technological development, dominating approaches and strategies of competition, innovativeness, level of openness to international competition and others can either enhance or suppress the emergence, transfer and introduction of new occupations and qualifications. For example, sectors dominated by the big enterprises internationally competing by quality and innovations tend to create much more opportunities for emergence of new occupations and qualifications or their 'advent' from other countries, than those sectors, which are dominated by the small and medium enterprises competing locally by price.

*Specificities of the national or regional labour market, such as socioeconomic pattern of local labour market defined by the division of roles and responsibilities of state and social stakeholders, the ratio between the supply and demand of workforce in the local labour market, etc.* State regulated labour markets with

well developed social dialogue in the fields of employment and training supports establishment of favourable institutional conditions for effective and proactive introduction of new qualifications in responding or preceding the emergence of new occupations.

*Specificities and changes of the national public regulation of occupations and professions, such as introduction of national regulations based on qualifications.* For example, very rigid and highly bureaucratic regulations of qualifications can impede introduction of the new qualifications in responding to the needs of labour market or to make this process more complicated and time-consuming.

### **Global factors related to human resource demand in the labour market**

There can be discerned the following factors belonging to this category:

Intensifying international competition and economic globalization, changes of the competition patterns. These processes enhance the shifts and changes of the international division of labour, facilitate migration of workforce and workplaces caused by subcontracting and outsourcing (Brown, Lauder, Ashton, 2011). In turn, such situation facilitates the 'migration' of occupations and qualifications between countries, especially in those countries, which attract foreign investments and relocated workplaces and jobs.

'Global auction' in the international labour market together with the wars for talents amongst enterprises and positional competition for the attractive employment positions amongst learners and job seekers influence the changes in the contents of occupations and qualifications by changing requirements of employability, increasing the weight of social skills and personal attitudes, creating the pressure to seek for higher standards of education and qualifications (Brown, Lauder, Ashton, 2011). These authors also forecast that increasing international competition for skilled work could enhance the emergence of the new fields of paid employment and new occupations in such fields as social services and services to persons, voluntary work in the postindustrial societies. From the other side, global auction in the labour market widen the possibilities for the migration of 'new' occupations to the developing countries through the processes of outsourcing, relocation of production, etc.

Global trends in the technological development and changes of work organization. For example, the process of 'digital taylorism' through standardization of intellectual and knowledge based work processes change the contents and requirements of some former high skilled jobs and qualifications (Brown, Lauder, Ashton, 2011).

### **Local factors related to supply human resources**

There can be discerned the following factors belonging to this category:

Features and specificities of national systems of education and training - for example, specificities of the institutional model of education system, relationships between the system of education and training and labour market, features of contents and structure of competences and qualifications provided by the institutions and VET and higher education. These features influence *development of the national systems of qualifications, emergence and development of the new pathways and possibilities for the acquisition of skills and qualifications*, for example, by assessment and recognition of skills and competences acquired through informal and non-formal learning. Some systems and models of education and training are more open and flexible to the different ways and patterns of learning and acquisition of skills and knowledge and tend to 'produce' qualifications with flexible structure and contents, thus creating favourable conditions for their change and emergence of new qualifications, while other systems and models of education systems emphasize the school based ways of training and 'produce' solid qualifications, which are more resistant to change (Cedefop, 2010). Other important factor here is the patterns of social dialogue in the field of education and training. Qualifications and their related processes play different roles and attain different attention in the agendas of the social partnerships depending on the model of social partnership (Winterton, 2007). For example, the model of deregulated, disorganized approach with decentralized collective bargaining on the enterprise level (UK) facilitates more active involvement of trade unions in the operative matters related to provision and upgrading of qualifications. Trade unions in this model tend to care for the better access to qualifications for the low-skilled and unskilled workforce by raising the demand for training and learning and enhancing of the involvement of these employees in learning and training opportunities (Stuart, 2007). Here the social dialogue focuses on the operative and local applications and benefits of qualifications to the employability and job status of employees, especially in the conditions of the restructuring of work organisation or technological changes. Therefore here social dialogue can facilitate and enhance the changes in the contents of qualifications. In the model of concerted social dialogue on the sectoral and national levels (Germany) the qualifications represent an important topic in the agenda of strategic discussions and negotiations between the social stakeholders. Here social stakeholders and partners share the strategic responsibilities and obligations related to their involvement in the design, provision and awarding of qualifications. Such social dialogue is favourable for setting and implementation of the national strategies of skills formation and qualifications. In the model of concerted social dialogue with the strong influence of the state (France, Sweden, Denmark) qualifications and their related measures usually become very important part of the national policy agenda.. Such model of social dialogue facilitates the development of a rather complex understanding of qualification, which encompasses the functions of human resource development and social cohesion, stressing that acquisition of qualifications is one of the basic citizen rights. For example, the introduction of the recognition of experiential learning (*validation des acquis de l'expérience*,

VAE) in France together with other corresponding instruments (individual right to continuing training - le Droit Individuel à la Formation (DIF), individual training leave - Le congé individuel de formation (CIF) opening wider and more equal opportunities for citizens to acquire the qualification can illustrate this case.

*Competition patterns of the providers of training, as well as marketing of provided training services.* Active and intensive competition of training providers and appliance of competition strategies based on the new and innovative training services can enhance the initiatives of training providers in offering new qualifications to the local market.

*Local features of the provision of continuing vocational training and human resource development in the enterprises.* Continuing vocational training and human resource development in the enterprises influence the emergence and development of the enterprise based qualifications.

*Changes of the curriculum design and provision of vocational education and training and higher education, influencing the changes of volume and contents of provided qualifications.* For example, introduction of modular training and competence-based qualifications imply more flexible approach in design and provision of qualifications, thus facilitating emergence and development of new qualifications.

### **Global factors related to supply human resources**

There can be discerned the following factors belonging to this category:

*International competition of the providers of vocational training and higher education and it's intensification.* Intensive competition of training providers and appliance of competition strategies based on the new and innovative training services can enhance the initiatives of training providers in offering new qualifications to the international market.

*Mobility of learners, job seekers and workforce, migration processes.* Mobility and migration create necessary medium for the transfer and exchange of qualifications between the countries.

Changing attitudes of people to education, qualifications and career, emphasising market needs and adaptation of personal profile of human capital to these needs seeking to gain the better positions in highly competitive labour market (Brown, Lauder, Ashton, 2011).

### **Structure and contents of processes of emergence and introduction of new occupations and qualifications in the national systems of occupations and qualifications**

Processes of emergence and introduction of new occupations and qualifications in the national systems of occupations and qualifications are complex and multidimensional. These features enable to analyse these processes by using very different methodological approaches. The

authors of this paper will analyse the different features of the processes of emergence and introduction of new occupations and qualifications paying special attention on how the changes in the system of occupations (emergence of the new occupations, changes in the contents of occupations) influence the changes in the national systems of qualifications (introduction of the new qualifications or changes in the contents of existing qualifications).

At the beginning we will examine some approaches in analyzing the processes of change of occupations and work. One of such approaches is based on distinguishing different hierarchically structured and interrelated dimensions of change in occupations. For example, P. Zarifian (2004, 2009) distinguishes the following dimensions of the change of occupations (Fig. No.1):

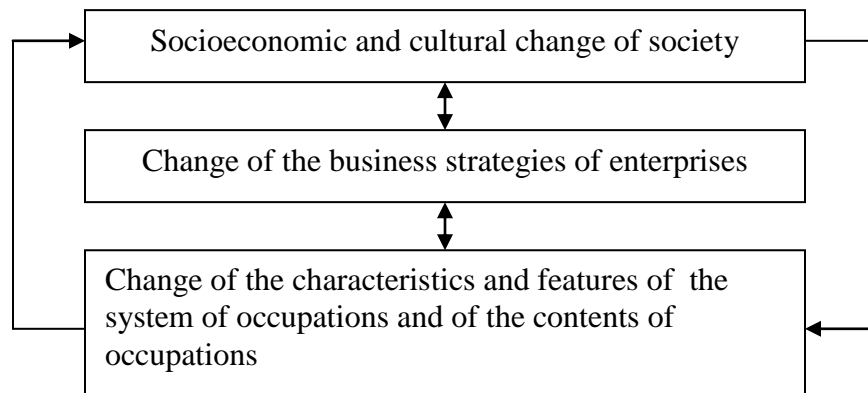
1. Socioeconomic and cultural changes of contemporary society (for example, growing consumerism) and their influence to the changes of business strategies and professional activities.

2. Change of the business strategies enhancing integration of the work tasks and their increasing complexity, for example:

- orientation to the specialized market niches by sustaining and enhancing the differentiation and variety of the needs of consumers,
- competition, which is based on the constant and continuous innovations of products, services and technologies.

3. Changes of the features of contemporary professional activities:

- increasing changeability of the contents of activities and it's unpredictability, demanding more and more initiatives from the performers of activities;
- increasing importance of the interpersonal communication in the performance of activities leading to the fast expansion of the contents of activities and it's enrichment with the tasks related to communication with customers, consumers, providers, colleagues, community and increasing requirements of communication and cooperation skills;
- growing importance of the processes of creation and implementation of innovations requiring from the performers more creativity and initiatives.



*Fig. No.1 Structure of the process of change of occupations (prepared according to P. Zarifian)*

Other methodological approach which can help to distinguish and evaluate the features of change process and outcomes of change is the methodology of institutional change. Thelen and Streeck (2009) suggest to analyse and classify the processes of institutional change by evaluating the inter-relations between the character of change process (incremental change, abrupt change) and results of change (continuity and discontinuity of development pathway). Using this methodological approach, there can be discerned the following types of the process of emergence and introduction of the occupations and qualifications in the national systems of occupations and qualifications:

		<i>Result of change in the systems of occupations and qualifications</i>	
		<i>Continuity – changes in the structure and contents of occupations and qualifications do not change the existing pathway of development of the existing structure and practices in the systems of occupations and qualifications.</i>	<i>Discontinuity – changes in the structure and contents of occupations and qualifications are driven by the purposeful policy measures which change the existing structures and practices in the systems of occupations and qualifications.</i>
<i>Process of change in the system of occupations and qualifications</i>	<i>Incremental change: changes in the contents and structure of occupations and qualifications are slow, gradual, developing and can be foreseen in advance.</i>	<i>Reproduction of the existing structure and contents of the system of occupations and qualifications by adaptation. Occurring changes in the system of occupations and labour market do not result in significant rise and development of new occupations and qualifications, but slowly change the contents of existing occupations and qualifications by changing the work tasks and related competences.</i>	<i>Gradual transformation of the existing system of occupations and qualifications. The changes of the structure and contents of occupations and qualifications, as well as of the socioeconomic and technological context of work are incremental and gradually lead to the development of the new occupations and qualifications.</i>
	<i>Abrupt change: changes in the contents and structure of occupations and qualifications are sudden, revolutionary and caused by unpredictable events and shifts in the system of occupations and qualifications, as well as in the external socioeconomic environment.</i>	<i>Survival and return of the occupations and qualifications in the context of changes of the system of occupations and qualifications. This change is often caused by certain return or regeneration of institutional and socioeconomic order which was abrupt in the pathway of it's development.</i>	<i>Change of the contents of existing occupations and generation and rise of new occupations caused by the different factors (sometimes of revolutionary character): technological innovations, shifts and upturns in the work organization.</i>

Table No. 1. Institutional change approaches in analyzing the development of new occupations and qualifications: processes and results. Adapted from Thelen, Streeck, 2009.

Looking from the perspective of the impact of the new emerging occupations and qualifications to the existing system of occupations and qualifications the processes of emergence of new occupations and qualifications can be analysed by discerning the following types:

- Emergence of new occupations and qualifications as the substitution of the existing ones, when newly emerged occupations and qualifications eliminate and replace some of the existing occupations and qualifications (Tessaring, 1997).
- Emergence of new occupations and qualifications as the complementing to the existing system of occupations, when newly emerged occupations and qualifications add to the existing ones without changing or replacing them (Tessaring, 1997).
- Emergence of new occupations and qualifications as reproduction and development of the existing system of occupations and qualifications, when the newly emerged occupations and qualifications enhance the emergence of another new qualifications.
- These impacts can occur and act on two levels:
  - level of the structure of the system of occupations and qualifications (macro level), where occur the changes related to emergence, transfer or introduction of new occupations and qualifications,
  - level of the contents of occupations and qualifications (micro level), where occur the changes of work tasks, specifications, requirements and corresponding competences.

We will examine the possible interrelations of these types and levels of impacts:



<i>Level of impact</i>	<i>Emergence by substituting</i>	<i>Emergence by complementing</i>	<i>Emergence with reproduction and development</i>
<i>Contents of occupations and qualifications (micro level)</i>	<p><i>There emerge new work tasks and objectives, which replace certain existing tasks and objectives. This process also creates the new needs of competences in the same time reducing or making obsolete certain competences which were applied before. The most typical factors influencing this process are gradual technological change and development of work organization, when new technologies and work organization replace the existing ones.</i></p> <p><i>In the most cases it leads to the gradual transformation of existing occupations and qualifications and this transformation can be of the different extent: partial transformation, when emerged new tasks and corresponding competences does not change essential features of the objective of occupation or qualification, or total transformation when the occurred changes of tasks and competences imply change the objective of occupation or qualification and lead to development of new occupation and qualification.</i></p>	<p><i>Emerging and developing new work tasks and competences enrich the existing occupations and qualifications in the same time sustaining the existing work tasks and competences. The contents of work and qualification are enriched and expanded. This process can be caused by the processes of gradual technological and organizational development when new technologies and instruments of work organization complement the existing ones.</i></p>	<p><i>The process of complementary enrichment of work tasks and competences can become cumulative and self-enhancing process, when newly introduced work tasks and competences enhance the emergence on the new ones. Such situation can reach the point, when the accumulation of new work tasks and competences can no longer be sustained in one occupation and qualification because of the resulted complexities in the processes of human resource management, human resource development and provision of training. This situation leads to the split of enriched occupations and qualifications into smaller separate ones. In this way there can emerge new occupations and qualifications.</i></p>
<i>Level of impact</i>	<i>Emergence by substituting</i>	<i>Emergence by complementing</i>	<i>Emergence with reproduction and development</i>
<i>Structure of the system of occupations and qualifications (macro level)</i>	<p><i>Emerged new occupations and qualifications replace the existing ones. These changes occur due to the radical technological development, introduction of new work organization forms, exporting and importing of the new workplaces through the outsourcing processes and other factors</i></p>	<p><i>Emerged new occupations and qualifications complement the existing ones without further change of the systems of occupations and qualifications. The factors causing this change do not replace the existing work requirements, technologies, tasks of specifications but enhance the emergence of additional</i></p>	<p><i>Emergence of new occupations enhances development and expansion of new sectors and sub-sectors of activities and opening new employment possibilities. This is very typical for the innovative and emerging sectors of economy (IT, communications, high-tech sectors). Emergence of new occupations can also</i></p>

	<p><i>which replace previously applied technologies, work organization practices or other important features of work. New occupations and qualifications in this case usually emerge and develop with rather different speed. Very often at the initial stage of emergence of new occupation needed knowledge and skills are provided by continuing learning and training at the workplaces. Formal provision of knowledge and skills of new occupations in the initial training institutions often depends on the workforce needs in these occupations, or on the rate of dissemination and development of new occupations in the labour market.</i></p>	<p><i>ones.</i></p>	<p><i>enhance the dynamic expansion in the design and provision of new qualifications.</i></p>
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*Table No.2: The types of processes of emergence of new occupations and qualifications from the perspective of the impact of the new emerging occupations and qualifications to the existing system of occupations and qualifications*

Current changes of the work features provide a lot of examples of this complex interactions between the changes **in the contents** of occupations (and qualifications) and the changes in the structures of the system of occupations (and qualifications). For example, the modularization of work and professional activities brings the new types of control of work, which are based on the control of engagement (Zarifian, 2009). Zarifian (2009) notices, that the control of engagement in the work is based on the accountability for the outcomes of work or the outcomes of performance. According to this sociologist, the responsibility for performance and for the proof of performance is delegated to the performers and the focus of control is shifted from the work productivity to profitability and cost-effectiveness of the human capital. Subsequently, qualifications can retain their importance and role only to the extent on how they contribute to or indicate the increase of the value of the engaged individual human capital.

Shift to the control of individual engagement in work significantly reduces the applicability and instrumentality of the formal qualifications, which have been traditionally used as measures to establish the correspondence between the workplace (or job status) and the real human capital of employees (knowledge, skills and competences) in this way ensuring certain balance and stability. The changes (and increasing changeability) of work organisation and contents exert the pressure on individuals to distinguish themselves from the others and outperform them to win the positional competition in the enterprise or on the labour market. In this context the traditional formal qualifications are being increasingly 'replaced' or dominated by the competence approach (Lallement, Zarifian).

Labour relations, employment status, wage setting and other elements of the world of work become increasingly dependent on the competences and assessment of competences. This individualised assessment starts to dominate over the collectively negotiated rules and regulations of the labour relations (of the industrial period) which are traditionally based on the formal qualifications (Winterton, 2007). This shift to the competences in the practices of human resource management and development in the enterprises, however has not endangered or challenged the strong positions of qualifications and their related measures in the agendas of the education systems and national skill formation policies. On the contrary, the expansive development of the national and international qualifications frameworks evidences, that qualifications are being increasingly used as policy devices in the field of education and national skills formation.

What are the implications of this shift of paradigms (from the paradigm of qualifications to the paradigm of competences) to the changes in the national systems of qualifications? There is noticed decrease of the role of qualifications-based approaches and increasing proliferation of competence-based approaches in the corporate management of human resources and in the relationships of socio-professional groups. Regarding the developments in the corporate management we can already evidence the increasing influence of competences in the

management of organizations and human resources development (for example, the rise of 'gestion par compétences' in France). The behaviour and attitude of socioprofessional groups towards the formal qualifications is increasingly influenced by the 'flexibilisation' of the career pathways, introduction of competence-based approaches in continuing vocational training and practices of the validation of non-formal and informal (experiential) learning. There are also noticed attempts to increase the flexibility of approaches towards qualifications in the dimensions of the education systems and national skills development policies by integrating competences in these approaches and seeking to establish a kind of 'mixed' or 'hybrid' approach oriented both to competences, as the outcomes of learning process applied in the activity and to qualifications, as the results of the legitimisation of these outcomes. The examples of such attempts can be the designing and development of the competence-based curricula in VET and the introduction of the competence or learning outcomes based national qualifications frameworks.

### **Features and scenarios of the emergence and introduction of new qualifications in the national systems of qualifications**

Cedefop study 'Changing Qualifications: a Review of Qualifications Policies and Practices' distinguishes four scenarios for the development of qualifications which are based on the extent of flexibility and solidity of qualifications and the governance of the national systems of qualifications (2010). We will analyse the implications of these scenarios to the introduction of the new qualifications in the national systems of qualifications.

#### **Features of the scenario 1:**

- Flexible qualifications, supply-driven.
- Learners can navigate qualifications flexibly, which leaves space for learners to choose how they qualify.
- Education and training providers are in control, emphasising traditional goals and values, efficiency, cost-effectiveness and making sure that large numbers can qualify.

In this scenario the flexibility of qualifications (for example, modular structure, wide choice of the pathways of acquisition and awarding) increases the possibilities of choice for learners in acquiring knowledge and skills leading to qualifications and facilitates wider access to qualifications. It can lead to certain limited increase of diversity in the contents of acquired qualifications and to development of the different new qualifications (in terms of their contents, volume and structure).

However, strong control of education and training providers in the field of designing and provision of qualifications limits the sensitivity of the system of qualifications to the changing needs of labour market and the system of activities. Designing of qualifications and curriculum design in this scenario is still based on the reactive approach to the labour market

and workplace needs. Therefore introduction of new qualifications in the national system of qualifications can be rather slow although certain applied approaches (modular curricula, modular design of qualifications) provide remedies to solve this problem. Comparatively low involvement of employees in the process of designing and provision of qualifications in combination with the increasing possibilities of choice to learners in acquisition of qualifications can lead to rather important incompatibilities between the acquired qualifications and labour market needs.

**Features of the scenario 2:**

- Flexible qualifications, demand-led.
- Learners can navigate qualifications flexibly, which leaves space for learners to choose how they qualify.
- Governance systems ensure that the social partners and community interests are strong partners in qualifications development, emphasising labour market signals, as well national and community values.

In this scenario the flexibility of contents and provision of qualifications combined with the strong involvement of social partners in the designing and provision of qualifications create the most favourable conditions for effective and timely introduction of the new qualifications.

However, the approach in the introduction of the new qualifications to the national system of qualifications can be still more reactive, because flexibility of qualifications permits operative modifications of the contents and structure of qualifications according to the changed labour market needs, while proactive (anticipative) change of qualifications require more holistic approach and consideration of the essential shifts and changes in the whole structure of the work process and qualification (such as introduction of completely new qualifications responding to the forecasted changes in the needs of sector and / or economy).

**Features of the scenario 3:**

- Solid, dependable qualifications, supply-driven.
- Learners face large, benchmark national qualifications and systems that govern access, participation and progression. This limits flexibility.
- Education and training providers are in control, emphasising traditional goals and values, efficiency, cost-effectiveness and making sure that large numbers can qualify.

In case of this scenario the introduction of the new qualifications in the national system of qualifications can be rather long and complicated process, because employers and other stakeholders from business and labour market are comparatively weakly involved in the designing and provision of qualifications. Besides, large national qualifications and solid processes of the designing and provision of qualifications imply big inertia in reacting to the

changing needs of labour market and workplaces. Orientation to the proactive approach in design and provision of qualifications would be very important for ensuring and sustaining long-term compatibility between the contents of qualifications and labour market needs in this scenario, but the big obstacle to achieve it can be the domination of education and training providers and lack of involvement of social partners in the design of qualifications.

#### **Features of the scenario 4:**

- Solid, dependable qualifications, demand-led.
- Learners face large, benchmark national qualifications and systems that govern access, participation and progression. This limits flexibility.
- Social partners and important groups in civil society have a lot of influence over how qualifications are structured, mainly at the national level.

In this scenario active role and important contribution of social partners in the designing, provision and awarding of qualifications together with the nationally regulated solid national qualifications and systems permit and facilitate effective and systemic processes of the introduction of new qualifications. This scenario is also favourable for the development of anticipative approach in the designing of qualifications and introduction of new qualifications, because it enhances and supports active participation of employers and other social partners in establishing and maintaining of the solid qualifications based on the holistic attitude to work process, skills and knowledge.

### **Processes of emergence and introduction of new occupations and qualifications in the national system of occupations and qualifications in Lithuania: empirical study**

Empirical research of the processes of emergence and introduction of new occupations and qualifications in the national system of occupations and qualifications in Lithuania was focused on the six different cases of these processes. There were interviewed human resource managers and developers of six enterprises working in the different sectors of activities:

<i>Field of activity</i>	<i>Occupation</i>
<i>ship loading</i>	<i>sales manager of towage shipping</i>
<i>production and installation of reed roofing</i>	<i>roofer of reed roofing</i>
<i>installation of lifting equipment and elevators</i>	<i>technician of assembling and maintenance of lifts and elevators</i>
<i>installation of wind power stations</i>	<i>technician of servicing and maintenance of wind power stations</i>
<i>production of equipment for food and chemical industry</i>	<i>operator of automatic welding equipment</i>
<i>production of biochemical products</i>	<i>researchers-engineers in biotechnologies</i>

*Table No.3 : Cases of empirical research*

Here we will present cases of the emergence of new occupations and qualifications by analysing:

the factors which influenced these processes;

the features of the contents and structure of the emergence and development of new occupations;

the features of contents and structure of the introduction of related new qualifications.

**Sales manager of towage shipping.** New occupation in the ship loading company: unification and integration of the existing occupations.

<i>Factors influencing emergence and introduction of new occupation and qualification:</i>	
<p><i>Intensifying competition in provision of ship loading services amongst the ship loading companies in the Baltic region forcing to look for the new services and market niches.</i></p> <p><i>Expansion of the activities of port and fuel terminal increasing demand of towing - ship loading company bought towboats in order to satisfy the needs of towing services for the ships in the port and fuel terminal.</i></p> <p><i>The integration of the services of loading and towing and combination of the activities of several fields – sales of services, shipping navigation, shipbuilding and repair of ships.</i></p>	
<i>Features of the contents and structure of the emergence and development of new occupations:</i>	<i>The features of contents and structure of the introduction of related new qualifications:</i>
<p><i>The new occupation emerged or developed on the basis of unification and integration of the existing occupations caused by the shift to production of new products or services.</i></p> <p><i>The emergence of this occupation has the features of the abrupt change sustaining the continuity in the system of occupations, because the new occupation emerged quite suddenly but this process did not changed the existing pathway of development of the field of activity.</i></p> <p><i>Emerged new occupation complement the existing ones without further change of the systems of occupations and qualifications.</i></p>	<p><i>As far as qualifications corresponding to these activities were being provided by the several initial VET and higher education institutions, the new qualification was provided by concluding the agreement between enterprise and training provider.</i></p> <p><i>New qualification was established by integrating of the competences and units of existing qualifications in the fields of sales of services, shipping navigation, shipbuilding and repair of ships.</i></p> <p><i>The process of the introduction of this new qualification is more close to above mentioned scenario No. 4 leading to establishment of solid, dependable and demand-led qualifications.</i></p>

**Roofer of reed roofing.** Revival of occupation: the case of production and installation of reed roofing

<i>Factors influencing emergence and introduction of new occupation and qualification</i>	
<p><i>Demand of previously vanished and replaced products or services in the market. The occupation of the roofer of reed roofing returned in the system of occupations of Lithuania after more than half of age of oblivion. The reed roofs were popular in the period between the two world wars and later, but in the Soviet period they were displaced by the standardized roofing technologies with the appliance of slate, tin or bitumen.</i></p> <p><i>Enterprising initiative of business to find the new niche of business in producing and installing reed roofing.</i></p> <p><i>There were no know-how and skills in the local labour market needed for this reintroduced occupation.</i></p>	
<i>Features of the contents and structure of the emergence and development of new occupations</i>	<i>The features of contents and structure of the introduction of related new qualifications</i>
<p><i>The occupation re-emerged after the period of it's oblivion.</i></p> <p><i>The emergence of the occupation of reed roofer has the features of the abrupt return of the occupation due to the changed external context (market conditions).</i></p> <p><i>Emerged new occupation complements the existing ones and enhanced the 'adoption' of other occupations related to reed roofing.</i></p>	<p><i>Due to the absence of know-how and skills in the new occupation, these were transferred from the foreign partners - the businessman went for training and acquisition of know-how to the company in the Netherlands.</i></p> <p><i>Now the needed knowledge and skills are provided to reed roofers by the on the job training in the company, because the need of skilled specialists in this field is comparatively small.</i></p> <p><i>The process of the introduction of the corresponding qualification is quite uncertain and undefined on the institutional level and is more close to above mentioned scenario No. 2 leading to establishment of flexible and demand-led qualifications.</i></p>

**Technician of assembling and maintenance of lifts and elevators.** The change of structure and contents of activity due to the expanded profile of activities of enterprise and enlargement of the range of provided products and services



<i>Factors influencing emergence and introduction of new occupation and qualification</i>	
<p><i>Enrichment and expansion of work tasks due to the expansion and development of the activities of enterprise. The enterprise working in the field of assembling and installation of lifts and elevators have expanded the profile of its activities and enlarged the range of offered products and services. In the Soviet period the enterprise was installing the lifts produced by one producer. The transition to market economy required to expand the range of offered services and to find new markets. This enterprise now installs and equips lifts, escalators and elevators, special lifting equipment for handicapped persons and other equipment. Besides these services it designs and produces certain units and elements of lifting equipment (benchboards of dispatching equipment and peripheral devices of lifts).</i></p> <p><i>Significant change of the profile of activities: from the narrow specialization in the field of installation of lifting equipment produced by other producer it became the original supplier of lifting equipment (started to assemble original equipment from the parts and elements purchased abroad and produced by themselves). Other new activity is the representation of the commercial interests of foreign producers and suppliers of lifting equipment in the local market.</i></p>	
<i>Features of the contents and structure of the emergence and development of new occupations</i>	<i>The features of contents and structure of the introduction of related new qualifications</i>
<p><i>Expansion of the range of activities had significant impact on the contents of the occupation of technician of assembling and maintenance of lifting equipment: there emerged the new tasks related to technological and technical activities, commercial activities and relationships with customers. This is a typical case of reproduction of the existing structure and contents of the system of occupations by adaptation to the new conditions and requirements, as well as the case when emerging and developing new work tasks enrich the existing occupations in the same time sustaining most of the previously existed tasks or reshaping them.</i></p>	<p><i>The biggest part of the new know-how and skills has been transferred from the foreign partners – producers of the lifting equipment in the Western Europe. Most of the technicians and other employees acquired needed know how and skills through the continuing training measures, provided by these foreign partners.</i></p> <p><i>Most of the new competences needed for this activity are closely related to specific technological know-how, what limits the possibilities to provide this know-how and skills in the initial vocational training.</i></p> <p><i>The process of the introduction of the corresponding qualification is quite uncertain and undefined on the institutional level and is more close to above mentioned scenario No. 2 leading to establishment of flexible and demand-led qualifications.</i></p>

**Technician of servicing and maintenance of wind power stations.** The case of not yet emerged, but expected occupation and qualification in the context of the rise of new sub-sectors of economy and market niches.

<i>Factors influencing emergence and introduction of new occupation and qualification</i>	
<p><i>Initial stage of the introduction of the new sub-sector of activity and new market niche due to the “import” of the new technology. Wind power station is a new technology in the energy sector of Lithuania. All wind power stations were installed and equipped by the foreign companies. The maintenance and servicing in the warranty period is provided by the producers of equipment. As far as this sub-sector of energy production is on the very initial stage of development and the number of installed wind power stations is quite modest, foreign suppliers can cost-effectively ensure maintenance and services by using their own technicians (currently there is no need to have local skilled technicians in the field).</i></p> <p><i>However, with the development of the sub-sector and increase of the number of wind power stations local operators of these stations and foreign suppliers of equipment see the need to have local skilled technicians and other specialists.</i></p>	
<i>Features of the contents and structure of the emergence and development of new occupations</i>	<i>The features of contents and structure of the introduction of related new qualifications</i>
<p><i>Emergence and initial stage of development of the new sub-sector of activities do not necessarily ‘bring’ new occupations to the system of activities. At the initial stage of formation of the new fields of activities new occupations can be economically inexpedient, until the development of these new fields of activities creates the needs for local workforce.</i></p> <p><i>This is a case of gradual transformation of the existing system of occupations and qualifications. Introduction of the new technology is incremental and gradually leads to the introduction and development of the new occupations. This is also the case when emerged new occupation will complement the existing ones in the sector.</i></p>	<p><i>The new know-how and skills will inevitably have to be transferred from the suppliers of the technology of wind power stations from abroad.</i></p> <p><i>At the initial stage the new qualifications will be provided only through continuing training measures, mainly by training courses and on the job training (provided by the suppliers of technologies).</i></p> <p><i>Most of the new competences needed for this activity are closely related to specific technological know-how, what limits the possibilities to provide this know-how and skills in the initial vocational training.</i></p>

**Operator of automatic welding equipment.** Emergence of new occupation and qualification due to the technological development of production enterprise.

<i>Factors influencing emergence and introduction of new occupation and qualification</i>	
<p><i>Development of applied production technologies by introducing the innovative production technologies. Enterprise producing equipment for food and chemical industries invested in the new production technologies (including automatic welding equipment) seeking to increase productivity and to achieve the highest quality standards, necessary for the development in the very competitive market.</i></p> <p><i>Presence of the skilled and experienced workforce in the field of welding.</i></p>	
<i>Features of the contents and structure of the emergence and development of new occupations</i>	<i>The features of contents and structure of the introduction of related new qualifications</i>
<p><i>Introduction of new production technologies (automatic welding) led to the introduction of the new occupation - operator of automatic welding.</i></p> <p><i>This is a case of abrupt change leading to the discontinuity in the occupational structure of the field of activities.</i></p> <p><i>Introduction of new production technology led to sudden emergence of new occupation.</i></p> <p><i>This is also the case when the introduced new occupation partially replaced the existing ones. Introduction of automatic welding permitted to execute all main welding operations (which were previously performed in the manual way) with automatic equipment. The need of manual welding operations has been very significantly reduced.</i></p>	<p><i>Introduction of new technologies, sudden introduction of the new occupation and absence of the automatic welding specialists in the labour market predefined the character of provision of required knowledge and skills by using on the job training.</i></p> <p><i>The training is provided by the suppliers of technologies and the acquired know-how and skills are “multiplied” by the internal apprenticeship. The common practice of training is when the representatives of supplier of equipment arrive to the company and train one operator and several representatives of technical staff – production technician, welding technologist or designer. The later do not work directly with the new equipment but serve as accumulators of competence and intermediaries of communication between operator and supplier of equipment. They help to operator to acquire new knowledge and skills after the training (for example, to learn to work with new additional functions of equipment) or communicate with supplier of equipment in case of technical problems. In case of the most sophisticated equipment the provider was sending for training not only the engineer, but also the experienced operator from the other enterprise in order to use the advantages of apprenticeship training.</i></p> <p><i>New know-how and skills were provided on the basis of existing human capital - new operators of automated welding equipment were prepared by training (re-qualifying) of the best skilled welders.</i></p> <p><i>The process of the introduction of the corresponding qualification is quite uncertain and undefined on the institutional level and is more close to above mentioned scenario No. 2 leading to establishment of flexible and demand-led qualifications.</i></p>

*Researchers - engineers in biotechnology. The case of new occupations emerged in the activities of creation and implementation of innovations.*

<i>Factors influencing emergence and introduction of new occupation and qualification</i>	
<p><i>The basis of activity is creation of the innovative and research based products</i></p> <p><i>Activities in the enterprise comprise scientific research and it's application in design and development of innovative products. Some biotechnological enterprises have their own departments or centres of scientific research and experimental development. These centres execute fundamental research and on the basis of this research develop new biotechnological products. Enterprises themselves create the forefront know-how in the field in parallel with other research institutions and universities.</i></p> <p><i>Company is part of international business structure.</i></p> <p><i>Sector of biotechnology in Lithuania was established on the basis of the executed scientific fundamental research.</i></p> <p><i>There is developed strong cooperation of the biotechnological enterprises with the universities in the field of organization of studies, practical training of students, even funding of studies.</i></p>	
<i>Features of the contents and structure of the emergence and development of new occupations</i>	<i>The features of contents and structure of the introduction of related new qualifications</i>
<p><i>Occupation of researchers-engineers in biotechnology developed from the symbiosis of scientific and engineering activities.</i></p> <p><i>High changeability of the contents of activities influences changes of work tasks and duties and development of new occupations. For example, recently there emerged the position of quality assurance and control engineer. It corresponds to the typical case when emergence of new occupations enhances the development of new work fields and open new employment possibilities.</i></p>	<p><i>The qualification is provided through the formal studies in higher education in combination with further continuing training.</i></p> <p><i>Skills development plays very important role in maintenance of the quality of human resources.</i></p> <p><i>Specialists are being sent for training foreign countries or foreign experts are invited to the enterprise for the purpose of training.</i></p> <p><i>The outcomes of continuing training (acquired know-how) is disseminated and shared through the reports of former trainees.</i></p> <p><i>The process of the introduction of this new qualification is more close to above mentioned scenario No. 4 leading to establishment of solid, dependable and demand-led qualifications.</i></p>

Comparing the analysed cases there can be drawn the following conclusions:

- In the all analysed cases new occupations and qualifications emerged due to the different dynamic changes in the system of occupations and the labour market. There can be noticed influences of the local (internal restructurings in the organization, changes of the profile of activity etc.) and global changes (international competition, international transfer of technologies) to the emergence or introduction of the new occupations.
- There can also be noticed certain typical features of the emergence and introduction of new occupations in the transitional economies:
  - Predominantly “borrowing” or “import-based” and adaptive character of the emerging of the new occupations. It can be explained by the essential restructuring of the system of occupations and qualifications in the transition

from planned economy to the market economy. Opening to the international competition inevitably required the adoption of the technologies, best practices of work organization, as well as adoption of certain occupations, their related work objectives and tasks.

- Domination of the continuing training forms in the provision and acquisition of know-how and skills needed for the new occupations. The main reason of this situation is absence of the related know-how, expertise and skills sources, importing of new technologies and know-how. The weak involvement of initial vocational training and higher education institutions in provision of training for new occupations can create important obstacles for the development of new qualifications in the new activities, because continuing vocational training often does not lead to the formal acquisition of qualifications.

## Conclusions

There can be discerned the following factors influencing the emergence and introduction of new occupations and qualifications in the national systems of occupations and qualifications:

- local factors related to human resource demand in the labour market (economical development of the country of region and its influence to the labour market; occupations and demand of qualifications, specificities of the structure of regional or national economy, such as features of dominating sectors, size of enterprises, level of economical and technological development of enterprises ; specificities of the national or regional labour market, such as socioeconomic pattern of local labour market defined by the division of roles and responsibilities of state and social stakeholders, the ratio between the supply and demand of workforce in the local labour market; specificities and changes of the national public regulation of occupations and professions, such as introduction of national regulations based on qualifications);
- global factors related to human resource demand in the labour market (intensifying international competition and economic globalization, changes of the competition patterns, 'global auction' of skills in the labour market) ;
- local factors related to supply human resources (features and specificities of national systems of education and training; development of the national systems of qualifications, emergence and development of the new pathways and possibilities for the acquisition of skills and qualifications, local competition patterns of the providers of training, as well as marketing of provided training services; local features and specificities of provision of continuing vocational training and human resource development in the enterprises; changes of the curriculum design and

provision of vocational education and training and higher education, influencing the changes of volume and contents of provided qualifications);

- global factors related to supply human resources (international competition of the providers of vocational training and higher education and it's intensification; mobility of learners, job seekers and workforce, migration processes).

Complexity and multidimensionality of the processes of emergence and introduction of the new occupations and qualifications in the national systems of occupations and qualifications requires to develop and use certain theoretical or methodological frameworks and schemes, which provides certain structure and logics for the analysis. This paper suggests to categorise these processes referring to methodological approaches of institutional change and from the perspective of the impact of the new emerging occupations and qualifications to the existing system of occupations and qualifications. The first approach in analyzing the emergence and introduction of the new occupations and qualifications permits to understand the dynamics and extent of incurred changes. The second approach discloses the impact of these changes (emergence and introduction of new occupations, qualifications and their elements) to the contents of existing occupations and to the existing system of occupations and qualifications.

All analysed cases new occupations and qualifications in Lithuania emerged due to the different dynamic changes in the system of occupations and the labour market. There can be noticed influences of the local (internal restructurings in the organization, changes of the profile of activity etc.) and global changes (international competition, international transfer of technologies) to the emergence or introduction of the new occupations. The analysed cases of emergence and introduction of new occupations in Lithuania have predominantly "borrowing based" or "import-based" and adaptive character. Regarding the provision of qualifications in the newly emerged or introduced occupations there can be noticed the domination of the continuing training forms in the provision and acquisition of know-how and skills needed for the new occupations.

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## ENHANCING INTERNATIONAL TOURISM TO THE DITSONG (SOUTH AFRICAN): NATIONAL MUSEUM OF MILITARY HISTORY

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### Abstract

Attractions such as military history museums which exhibit a wide range of important historical artefacts are fundamental sub-elements in any tourism systems, and yet their study suffers from lack of theoretical depth. Military history is an integral element of the history of any nation and countless varieties of tourists both local and international, visit military museums whenever the opportunity presents itself because museums are generally stimulating places of interest. This article focuses predominantly on international tourists visiting the Ditsong National Museum of Military History. In addition to the interest that such museums generate, they play a key role as the organizational foundation stones of modernity. It is via their many interesting exhibits that museums enlighten us about the past that intrinsically highlights its distance from the present era. Museums also selectively reconstitute aspects of history and in so doing alienate many artefacts from their original context and yet manage to impart deep understanding of events that shaped the modern world.

Museums of all types thus impart knowledge and have a wide range of tales to tell concerning the many and diverse assortments of objects they hold. National pride is an obvious reason for having a military museum where the comprehensive display of military equipment is exceptionally unique while exhibition halls also offer an educational narrative of a nation's history. What is also of interest to many visitors is the type of research that is carried out in a multiplicity of ways. The huge global growth in tourism in recent years has contributed to many museums radically altering their exhibits in both content and manner of exhibition. This is significant given the reciprocal impact that museums and tourism have on one another. The attractions in museums are regarded by many to be central to the tourism process and these are very often the main reason for many tourists visiting a particular destination. The particular focus of this article is the role of Ditsong (South African) National Museum of Military History in promoting tourism and it suggests possible areas of development for the museum which would enhance its offerings and increase the number of tourist visits.

### Introduction

There is a wide range of cultural attractions that tourists can visit including museums, heritage sites, parks and botanical gardens (Graham and Lennon, 2002). The Cambridge



Dictionary Online defines museums as "places of study, buildings where objects of historical, scientific or artistic interest are kept, preserved and exhibited". Rojek states that human beings, irrespective of cultural background, have an innate urge to travel to witness for themselves the 'extraordinary' and often 'wonderful' objects they have read about or been taught about at school (Rojek, 1997).

According to Bennett (1995), museums have always been tourist destinations and they have been created to educate the uneducated masses. Museums, viewed as attractions are precise permanent resources that are managed for the education, pleasure, enjoyment, leisure time of their visitors (Middelton & Clarke, 2001). Consequently, the exhibits in a museum and the manner in which they are set out, allow tourists to essentially rise above and beyond the exhibition halls of the museum, as they recreate the past, and shape individuals perceptions of the present.

The Ditsong National Museum of Military History in Johannesburg has always been a fascinating place to visit. Like similar museums abroad, it offers a very unique context for learning which is termed in literature as a "free-choice" learning environment (Falk & Dierking, 2000). The items on display in the museum are also distant enough to allow us to view the past and also look at ourselves in a different light. Visits to the museum are strongly related to the motivation and the characteristics of certain tourist typologies. The exhibits are special and very unique in an African context and yet more could be done to increase the number of tourist visits. The challenge for the museum is to better understand the needs of its diverse audience and provide experiences that meet and satisfy these needs in an environment of increasing global competition for tourists and huge scale socio-economic global change. It is said that 'museums are gatekeepers of modernity', if this is true then they have a great influence in affecting our perceptions.

### **Background to the museum**

The South African Prime Minister in 1947, Field Marshal JC Smuts, at the opening of the museum referred to World War II and stated:

"...We are gathered here today to open what may not unfairly be looked upon as a memorial to the greatest united effort our country has ever been called upon to produce. Memorials, of course, have more than one use. They serve to remind us of what is past, of great deeds of heroism and sacrifice; they also serve as a pointer, and sometimes as a warning to the future. It is in these senses that the South African War Museum may be regarded as a Memorial. It will remind us, I hope, not only of the part we played in the recent great struggle to save civilization, but also of the horrors, the loss of life and the devastation, and serve as a warning to us to create a world in which we shall never have to use again the weapons of death and destruction we see here today, or those dreadful weapons to follow them..."

After South Africa's participation in World War I (1914-1918), on the side of the allied forces, and her subsequent involvement in World War II (1939-1945), the official historian of the Union Defence Force, Captain J Agar-Hamilton came to the realization in 1940, that South Africa's involvement in World War I was not documented at all. Consequently, countless valuable artefacts and material heritage were lost, never again to be seen. As this was an unsatisfactory state of affairs, Captain J Agar-Hamilton began to put in place the fledgling South African War Museum. Due to his efforts, a very wide range of historical documents and military related materials were conserved. In addition to his efforts, the government of the day hired seven artists to document the war and set up a unique collection of roughly 850 works of art. In 1975, the name of the museum changed to the South African National Museum of Military History. The museum complex honours our nation's military and its many dedicated and exceptional soldiers, sailors and airmen. The complex spotlights the service and sacrifice of all South Africa's military through a variety of museum galleries dedicated to South Africa's military, both prior to and post the South African Democratic Revolution of 1994, and including inter-alia, the Anglo-Zulu War of 1879, Anglo-Boer War of 1899-1902, World War I, World War II, Korea (1950-1953) and the South African Liberation Struggle.

The museum's comprehensive collection of information, artefacts and images thus covers a wide range of events that shaped South Africa's history and keeps the nation's history alive. Although the scope and exhibitions have altered and new buildings had been constructed, every conflict that South Africa has ever been a part of is depicted in the Museum. The various sections in the exhibition halls follow an innovative progression that is generally chronological but they also reveal, within the various exhibits and assemblages, an almost thematic coherence. The museum also has a very important conservation and restoration role and it is this department which attracts a great many visitors due to the high standard of restoration projects. These are so well researched that they are known and appreciated internationally.

The Director of the Museum, Major John Keene, is doing a sterling job and has an able staff complement, amongst whom, are the curator Allan Sinclair, who also serves as a Communication Science/PR officer and art and aviation specialist and Hamish Paterson, an education coordinator who clearly loves his role of imparting knowledge to visitors to the museum. Despite having able staff, the Museum is clearly short-staffed and should employ more able-bodied staff if it is to become a truly great and globally recognised heritage site.

The primary function of the Museum is to make authentic information, collections and research available to a wide range of visitors. The Museum thus documents, monitors, collects, inspects, stores, examines and exhibits a wide range of historical artefacts of a military nature, which give evidence of and provide information about historic events, everyday life and the many achievements of South African soldiers and armed forces throughout

history. The research activities of the museum play an important role in its operation as well over 2 000 emails are received per annum and approximately 1 000 detailed answers are provided to information seekers by the curators. This is an important part of the educational activities where the museum is able to inform especially researchers, on specific items held at the museum.

A future short-term project of the Museum is to create a Transformation Display emphasizing the Liberation Struggle which should also prove to be of great interest to tourists. Tourists both local and international, military experts as well as military historians are afforded opportunities to gain valuable insight into the different historical periods which have contributed to the creation of present-day South Africa. Andreas Huyssen identified what he termed the “transnational movement of memory discourses”, and this plays a very important role in what and how museums exhibit artefacts (Huyssen, 2003). By attention to the legacy of South African involvement in wars, the museum should also play an important role in trying to show what the ‘enemy’ at any one time felt, and it should also to an extent focus on the importance of all war’s within the South African domestic culture. It has done this to an extent but more could be done.

Many South African and indeed foreign veterans and reserve soldiers view the Ditsong National Museum of Military History, as a sort of headquarters. They reminisce about their sacrifices in times of conflict, as well as their many fallen comrades as well as their victories. The museum is unique on the African continent in its coverage of conflicts involving especially the South African military apparatus and it provides for, and promotes, the study and appreciation of the history of modern war and war-time experiences. The Director of the Museum, Major John Keene and Susanne Blendulf who heads the Curatorial Department are clearly experts at what they do and having such employees is critical to the museum’s success.

The Museum, currently houses a collection of 44,000 items which are as wide-ranging as military aircraft, a single-man submarine, tanks, cannons, armoured vehicles, medals, uniforms, many weapon types, photographs and documentation, as well as memorials. The library possesses a unique collection of journals, archival materials and historical books covering over 150 years of South African and global history. The development of warfare weaponry is also exhibited, such as combat uniforms and medicines. It is important to mention some of the ‘one of a kind in the world’ exhibits that are on display and to note that they lure many military enthusiasts from across the globe. These include, for example, the Messerschmitt 262 night fighter which was a very powerful piston-engined plane and a deadly aerial combat opponent of the Allies during World War II, and the Italian Armoured Vehicle Autoblinda. The Ditsong National Museum of Military History has roughly 50,000-60,000 visitors per year which includes local and international tourists, students, scholars and groups that are sent by the South African National Defence Force. In addition to playing an

important role in the military history of South Africa, the Museum also caters for functions and presentations with a choice of conference rooms. There is also a museum shop for the purchase of memorabilia and a refreshment kiosk (<http://www.defencweb.co.za>).

### **Why are military museums Important?**

Traditionally, museums secure for us a living legacy of the past by holding in trust for society many important artefacts and their primary role is to advance and disseminate knowledge about the history of a nation. They generally gather documentation, interpret material evidence and preserve exhibits for the public benefit. Today, however, museums allow tourists and the general public to explore their many and varied collections for learning and enjoyment. They serve as vital sources of "living history" and provide visitors with insight into the upcoming fragile world we inhabit. Tourism is also a means to a better understanding of the dynamics of globalization and museums thus empower them in this regard. Military museums are especially important as they provide lessons from conflict around the globe which resonate with people from all walks of life. Decisions made in our history shaped how we view ourselves as a young nation today and many lessons may be learned in military museums. The Ditsong National Military History Museum has a huge opportunity to forge human identity as it allow visitors to access many and varied objects, sources of knowledge and invaluable information in very pleasant settings situated adjacent to the exceptional Johannesburg Zoological gardens.

The events they portray and memorialize are part and parcel of the global dialogue, promoted by the United Nations Organization, about justice and freedom for all. The museum can transform memory into action as it inspires and engages its visitors on the core lessons of war but has to an extent an unrealized potential. Gunn (1988) argues that attractions such as military museums exercise a magnetic "pulling power" over tourists since even classical times. This fascination consists of not only the interests and preferences of the tourist, but especially on the quality of the museum's design, its development, and the manner in which it operates. By learning about wars that have shaped the current world we are better able to provide for ourselves a clearer ethical and moral compass. Museums thus provide an ideal learning environment, for both formal and informal learning, active hands-on participation, or passive observation (Hein, 1998) and they raise the intellectual bar so to speak.

Tourists who visit museums see themselves and their culture reflected in such a way that they are encouraged to gain fresher perspectives, make new connections, understand in different ways and also learn more (Falk, 2004). Museums have moved on from being merely storehouses of knowledge and many and varied objects and now have a multifaceted and indeed outward looking role as hosts who invite tourists inside to be amazed, encounter and learn (Schauble, Leinhardt & Martin, 1997). Museums are perpetual participants in the shaping of modernity, and their role is dynamic in a global context as they expand into the

contemporary universal consciousness. Cities such as Johannesburg have a wide range of attractions such as Freedom Park, Gold Reef City and the Ditsong National Museum of Military History, the purpose of which is to promote tourism which has both a complex and multifaceted character. The support of local residents for these attractions is also critical for their sustainability, and also serves to boost the cultural liveliness of the city.

### **What does the term 'leisure' mean?**

Museums are closely associated with the leisure sector, principally in a number of research studies linked to the marketing of museums (Burton & Scott, 2003; Packer & Ballantyne, 2002; Witcomb, 2003). The prime motivations for tourists to visit museums are for leisure and entertainment (Packer, 2004). In an Australian Museum study on visitors, it was found that 71% of adults visited museums in the main for the entertainment value (Kelly, 2001).

Moore, Cushman and Simmons (1995), state that free time appears to be fundamental to the notion of leisure and that those who engage in a leisure activity are aware that they have both free time and opportunity available to do something different which they generally perceive to be mentally stimulating and rewarding.

Stebbins (2001) differentiated between what he terms 'casual' and 'serious' types of leisure with most leisure, including museum visits being of the former type and being conducted by your average tourist. This type is generally a short-lived but pleasurable experience. Historians or military analysts for example, who visit a military history museum do so due to as it conforms with their careers, knowledge and skills and challenges them, and these are the 'serious' type of leisure seekers, who comprise a much smaller group of visitors. Leiper (1990) on the other hand, maintains that tourists are not somehow "attracted" or "pulled" towards visiting a museum, but "are pushed ... by their own motivation towards the places and/or events where they expect their needs will be satisfied". Either way, museums want more visitors.

#### **Challenges facing museums**

There are numerous challenges facing museums today, including inter-alia, greater competition from a wider range of leisure options for tourists who are now more refined through the use of the internet (Lynch et al, 2000).

How museums maintain an ability to draw lessons of value to what is generally an extensive array of disciplinary interests for tourists is highly thought provoking. This is especially important as museums are now in global contention in the marketplace with many other leisure, learning and educational providers (Lynch et al., 2000). Museums clearly have limited resources and this requires them to operate with a greater commercial emphasis than was previously the case. Museums should not simply be suppliers of information but rather strive to provide utilizable knowledge and for tourists to investigate their own ideas and arrive at their own conclusions (Bradburne, 1998). Many museums are now of necessity

seeking greater stakeholder collaboration in their operations and seek to gain the support of corporations (Garnett, 2002). Apart from their heritage factor importance, for museums to remain relevant in 21st century society, they must be receptive to burning social and environmental issues such as societal justice, population growth and sustainability (Goulding, 2000).

It is increasingly important for museums to adapt their role and provide greater access to tourists for accurate and authoritative information (Cameron, 2006). Tourists visiting museums detest artificial exhibits and settings and value authenticity above all else. This poses a significant test to museums since it is not only important to tourists but they have come to expect authenticity. If museums fail to satisfy the needs and wants of their visitors, then they will simply visit other places in their leisure time. Most tourists and indeed the majority of all visitors to museums wish to know that any information they are given on exhibits is in fact based on careful research. They seek a true interpretation of the 'facts' that they are presented with. If tourists feel that what they are told or shown in a museum is in any way inaccurate, they will forever regard the museum as unauthentic. It is thus critical that tourists be imbued with a sense of trust by what is reflected in a museum as museums are the focal points of convergence for thinking, reflection, pleasure and knowledge (Arpin, 1992).

In the context of expansion of Johannesburg's portfolio of tourist attractions, it is imperative to attract miscellaneous, but nonetheless well-matched, markets and submarkets of visitors. As far as international tourists are concerned, the museum should be regarded as one of the essential sights to visit on a trip to Johannesburg. These are not the only important market however. The problem of accessibility and the relationship of conservation and heritage to the poor and marginalized constituencies of South Africa is an issue that the museum will have to try to address as a matter of urgency. Consequently this group is a potential market of importance and essentially comprises local visitors who have not yet visited the museum. Globally, there is an increasingly growing perception that admission to museums should be very cheap if not entirely free in order to encourage local visitors to attend (Rentschler et al. 2004). While this thinking should be encouraged, tourists from abroad could pay a higher foreign visitor fee as is the case in many countries. In addition there should be free admission for senior citizens, students and disabled people (Rentschler et al, 2007). A important question to consider is the status of 'leisure' tourism to the Museum.

### **An Effective Marketing Plan for the Museum**

Museum marketing is distinctive as the roles of Museums are to educate their visitors and become self-sustaining institutions by increasing their revenue through increased numbers of visitors. As a result of these roles careful planning is required in merging the mission and vision with the available market. An effective marketing plan is imperative to success as it is via this plan that a museum can increase its visitor base and boost revenues which will enable

it to realize its vision and mission. Planning is thus critical to a museum's marketing strategy. If a museum is marketed in a haphazard manner which is devoid of a considered plan, ideally based on a feasibility study, resources will simply be squandered. The annual marketing plan should target the primary tourist segments while it prioritizes its resources.

A primary concern of the marketing plan developers for the Ditsong National Museum of Military History, should be analyzing the type of experience the museum offers tourists. This should include a detailed description of the activities the tourists can enjoy while visiting the museum. There was a noticeable lack of any booklets, DVDs, and other vital marketing material at the front-desk of the museum. An effective marketing plan for the Ditsong (South African) National Military History Museum is lacking. Such a plan should encompass five main steps including:

1. A Situation Analysis the initial step in the strategic marketing plan. The context in which the museum finds itself in the marketplace is important to the future orientation.
2. Establishing Market Opportunities
3. Setting Marketing Objectives
4. Strategy and Programme Development
5. Implementation, Monitoring, Evaluation of the Marketing Plan

If there is a marketing plan why is it apparently not operational or functional as it should be? Has the museum conducted any analysis that attempts to answer questions such as: Why do visitors come to this museum? Who makes the decision to come to the museum? Do visitors decide to visit the museum spontaneously or is it a planned carefully worked out visit? There also needs to be an analysis of how societal values influence visitor attendance. For example, do certain population groups not visit the museum as it is regarded as an apartheid era glorifying institution? Why do school groups not visit as much as they should? How does the museum promote itself? Does funding or lack thereof hamper the growth of the museum? Is the state making enough tourism grants available to the museum which is part of the Ditsong museums?

Although the museum welcomes all visitors and looks forward to an increase in numbers, the vital fact of having sufficient amenities and the requisite number of staff to provide the necessary security and cleanliness, must be considered before any meaningful marketing drive is undertaken. There is the question of working within capacity. The museum could do with far more funding which appears to be a major challenge and is does not reside under the appropriate 'umbrella' organisation as such.

Does the museum have any competition and which other attractions are targeting potential visitors? Is it possible to collaborate with other tourism draw-card institutions? Once the museum knows the answers to such questions, it will be in a position to make important

marketing decisions and promote itself in a meaningful way. Technology and especially the internet now plays a vital role in increasing attendance to any museum. The Website of the museum is now under the Ditsong umbrella, but in order for it to be effective, it should be a stand-alone Website which will encourage thousands of 'hits' per week. These 'hits' can be translated into increasing real visitor numbers to the actual museum? Current marketing objectives clearly need to be analyzed. To what extent is the museum attempting to understand the motivations of its diverse visitors' and how does its marketing strategy reflect this? (Lepkowska-White & Powell, 2007).

### **Research study**

As international tourists are an important market for the Museum, increasing the number of these visitors should be a strategic objective. Consequently, a study of tourist origins and viewpoints on the Museum was undertaken to provide market information that the Museum could use in its future marketing strategy. The primary objective is to increase the number of tourists visiting the Museum.

There are currently two scales that have been developed which help the tourism industry to identify the motivational domains of the leisure tourist. These are the Leisure Motivation Scale (Beard & Ragheb, 1983) and the Subjective Leisure Scale (SLS) of Linger & Keman, (1983). The former includes four motivational domains that direct involvement in leisure. These include the intellectual domain, the social domain, the domain of challenge to achieve something and an escapism domain.

The Subjective Leisure Scale (SLS) on the other hand, comprises 26 items which differentiate between six main domains, namely, intrinsic satisfaction, perceived freedom, arousal, mastery, involvement and spontaneity. In preceding studies the SLS has established outstanding levels of reliability and validity. In this research 30 questions were posed.

Cronbach's alpha is a measure of internal consistency and a coefficient of reliability that was used in assessing how closely related the set of items (questions posed) were as a group. It is generally considered to be a conservative and safe estimate of the reliability of a test or survey. Cronbach's alpha may be written as a function of the number of test items and the average inter-correlation among the items used. However, it is important to remember that reliability is in itself not a characteristic inherent in the test, but it is rather an estimate of the consistency of the set of items which were administered to the international tourists at specific times under particular conditions for the specific purpose of this research. The Cronbach's alphas for the constructs of SLS as used in this research, ranged between .87 and .93. The average Cronbach alpha for a

set of scores thus turned out to be .90, and may be interpreted as meaning that the test was 90% reliable, and by extension, that was only 10% unreliable.



## Research Design

A quantitative data collection method was integrated into the case study of the Ditsong National Museum of Military History. Yin (2002) has explained that this type of approach is appropriate when the research conducted focuses on current situations and does not need control over behavioural events, and especially where the structure of the research question is based on how or why something occurs.

The research involved three threads of data collection techniques:

- Desk research to draw together existing information on tourism profiles to Gauteng, patterns of tourist behaviour and trends.
- An onsite exit survey/questionnaire of 580 visitors to the museum, of which 227 were international tourists visiting the Museum was conducted in order to gather information on visitor profiles, reasons for their visit, visitor experience and responses to what else they would have liked to have seen or experienced at the Museum.
- Discussion with three tour operators on their knowledge of the Museum and their marketing thereof.

This study reports on a number of areas of the questionnaire, namely:

- What are the trends in military history tourism?
- What is the profile of international tourists who visit the Museum?
- What motivates international tourists to visit the Museum?
- Which other sites were visited by them in Johannesburg?
- What visitor experiences do they seek?
- What are their sources of information?
- What trends are likely to occur in tourism to Gauteng Province over the next 5 years?

Additionally, three tour operators were asked:

- What levels of awareness of the Museum exist amongst them and their intermediaries?

The exit survey was conducted from November to December 2010 revealed that around 42% of all visitors' to the Ditsong National Museum of Military History were international tourists, with the following general characteristics:

- Country of residence:
  - 25% UK

- 17% Germany
  - 11 % France
  - 4% Holland
  - 4% Italy
  - 8% other Europe
  - 7% Asia
  - 5% North America
  - 21% other
- Visited due to proximity to hotel
- Visited due to proximity to the Johannesburg Zoological Gardens
- Visited as a result of tourist guidebook
- Visited due to interest in military history and heritage studies
- Visited due to local family/business partner driven initiative
- Visited due to tour guide recommendation
- Other sites visited by these tourists in or in close proximity to Johannesburg:
  - 29% Freedom Park and Soweto
  - 11% Johannesburg Art Gallery
  - 17% Walter Sisulu Botanical Garden
  - 34% Gold Reef City
  - 26% Johannesburg Zoological gardens
  - 5% The Constitutional Court
  - 4% The Sharpeville Museum in Vanderbijlpark
  - 23% The Lion Park
  - 14% The Crocodile Farm

### **Questionnaire Development**

Data was collected using a questionnaire administered in face-to-face interviews over the period of two weeks during November and December 2010, as randomly selected tourists left the Museum. It had to be ascertained on contact, if they were local or international tourists. Once this was established, the questionnaire was administered. Respondents were given standardised instructions on how to complete the questionnaire and an explanation was given on what was expected of them. The content validity of the questionnaire, or its

appropriateness of questions, were tested for correctness, lucidity and relevance in a preliminary investigation. The 30 questions that were included were considered to be relevant to the research problem and the survey was quite simple in design. Clear instructions were provided and simple, clear and unambiguous language was used. A rationale was given for any item whose purpose was not immediately clear and there were consistency checks and some items were designed to assess the same or similar characteristics. The specific characteristics of the respondents was measured and not the individuals themselves.

Questions on the relevant areas as well as leisure motivations with regard to tourists visiting the Ditsong National Museum of Military History were included in the interview using the Subjective Leisure Scale of Unger and Kernan (1983).

The 30 questions included in the SLS were:

- The main criterion for me visiting the museum is the intrinsic satisfaction I obtain when I learn something new.
- I was invited to visit the museum by a local family member/friend.
- I was taken to the museum by a business associate.
- I visited due to my curiosity of how good an African museum could be.
- I escape a mundane existence by experiencing something different.
- I made a spontaneous decision to visit the museum.
- I visited as I had nothing else planned for the day.
- I have visited/will visit other tourist sites in and around Johannesburg.
- I am a professional in whose field of work history/military studies/heritage plays a large part.
- I visit museums for the thrill of the experience.
- I visited the museum to see how different cultures articulate their understanding of global events.
- I visited due to what I have read about the museum in a travel guide/guidebook.
- I visited due to the tour operator's/tour guide recommendations or advice.
- I visited due to the proximity of my hotel to the museum.
- I visited due to the proximity of the museum to the Johannesburg Zoological Gardens
- I visited due to my interest in military history and heritage studies
- I visited due to local family/business partner driven initiative

- I visited the museum because of specific rare exhibits such as the Messerschmitt 262 or the one-man German submarine.
- I visited the museum because other museums/art galleries were inaccessible at the time.
- I investigated what the museum had to offer on the internet before I arrived in South Africa?
- I investigated what the museum had to offer after I arrived in South Africa?
- I would say the museum has a good marketing strategy in place.
- I would say that the museum has a welcoming atmosphere.
- I would say the food stall is adequate for refreshments.
- The staff including guides seemed to be well trained, friendly and knowledgeable.
- My visit to the museum was an authentic experience that had an emotional impact on me as I 'relived' important moments in history.
- What I have read about crime in South Africa made me wary about visiting the museum.
- Would you visit the museum again?
- Would you recommend the museum to others in your country of origin?
- I have visited or will visit other attractions in Johannesburg and surrounds? (they were asked to list which attractions alongside on the rating scale)

A 5-point Likert scale was used to measure the extent to which respondents disagreed/agreed with the SLS statements (Unger & Kernan, 1983). These statements included in the rating scale were used so as to simplify and more easily quantify the attitudes and behaviour of the international tourists surveyed. Statements included 'strongly agree, agree, neutral, disagree, strongly disagree'. A value of 1 represented 'strongly disagree' and 5 represented 'strongly agree'. Since the respondents each selected an appropriate response on the scale of 1 to 5 points, the scores were added up for each individual based on their reaction and assessed and their attitude on the issues could thus be determined as stated by Huysamen (1994).

Generally, studies which used the SLS displayed high levels of validity and reliability and it was expected that the same instrument would be able to produce the same data at a later stage under similar conditions such as for example by means of a test-retest procedure. Respondents could also write comments alongside each point on the rating scale if they so wished.

Based on Aizen's Theory of Planned Behaviour (1985) and Fishbein's Theory of Reasoned Action (1980), it was considered suitable to use behavioural intentions as a 'ballpark' figure of visitation to the museum. Ajzen stated that all intentions are merely indicators of how hard people are willing to try, and of how much of an effort they are planning to exert, in order to perform a certain behaviour' (Ajzen & Driver, 1992). In leisure activities such as visits to museums, intentions are strongly correlated with reported behaviour. Consequently, ones attitude towards leisure activities can be differentiated on the basis of whether they are emotional, or descriptive or instrumental (Ajzen & Driver, 1992). In this study then, behavioural intentions were used to measure respondents' likelihood of visiting the museum again.

## **Sample**

A convenience sampling (accidental sampling) methodology was operationalized through a sampling approach from tourists who had just visited the museum. The data was collected between November and December 2010. The resulting sample size of people approached was 580 of which only 227 were international tourists, which was considered to be appropriate given the aim of the study. This sampling typology is suitable for less demanding research problems as it provides the researcher with the information needed for the purpose of the study.

## **Data Analysis**

The sample (n = 227) was initially segmented, based on respondents' behavioural intentions in relation to their visit to the museum. Such a sample size is considered to be representative of the population, and the results achieved give a true reflection of the characteristics of the international tourist population. Data filtering took place in which only the data critical to the research remained. The role of the data towards the elucidation of the research problem as well as the relationship of the data towards the research topic, were carefully considered. The target population was only international tourists visiting the museum. Filtering of data continued until only critical data remained which was analysed in depth. During this process, the interpretation and integration of viewpoints of the respondents came to the fore and thus new knowledge was created by the researcher.

## **Results**

This research provides insights for the Ditsong National Museum of Military History with regard to what international tourists are seeking when they visit local tourist attractions and what motivates them to visit. The information can thus be used to develop more constructive experiences for international tourists for this important sector of the tourism market. Like other destinations such as Durban and Cape Town, Johannesburg is gradually experiencing some cumulative effects of increased levels of global tourism since the successful hosting of the FIFA 2010 World Cup. The Museum has a great deal of competition in Johannesburg and

surrounds. International visitors who are interested in history and military heritage sites visited the Museum. The majority of international tourists visiting the Museum were either business or short-stay tourists. Most of them also visited other venues of interest with nature and wild-life related sites absorbing most of their attention.

By drawing conclusions from the collection of data, the researcher was able to extrapolate about tourist motivations and expectations. The Subjective Leisure Scale (SLS) was used to explore whether there were any differences across the age groups in terms of their leisure motivations. It was clear that intrinsic satisfaction was the main motivator for tourism visits but the marketing of the museum was very poor. Local government needs to support the future development of the museum. In this study, it is argued that international tourists are a very important market to pursue for the museum and so marketing initiatives must be revamped as a matter of urgency if the museum is to attract more visitors from abroad. Service quality excellence is non-negotiable and word of mouth is important in developing goodwill and business for the museum (White & Schneider, 2000). To take full advantage of this market, it is important to understand why international tourists visit the museum. By gathering information on this theme, it is likely that new marketing and management strategies for the museum will be developed to better accommodate the needs of international tourists.

British, German and French international tourists were the main visitors from abroad. They represented 53% of the sample, and 38% of these were most likely to revisit the museum in the future. Only 17% of those surveyed had been advised to visit the museum by tour operators or guides. Approximately 89% of the sample indicated that had no prior knowledge of the museum before arriving in Johannesburg. The sample indicated that they would or had already visited other attractions including mainly Gold Reef City, Freedom Park and Soweto, the Zoological Gardens and the Lion Park. Results indicated a higher propensity to visit some heritage sites (34% Gold Reef City), while other heritage sites had minimal intended or actual visits (5% The Constitutional Court and a paltry 4%, the Sharpeville Museum in Vanderbijlpark- the latter is in critical need of extensive marketing given that it is a very historic site in the history of South Africa). Nature based attractions', in particular the Johannesburg Zoological Gardens (26%), the Lion Park (23%), the Walter Sisulu Botanical Garden (17%) and the Crocodile Farm (14%) also attracted international tourists. The Johannesburg Art Gallery attracted on 11% of the respondents in the sample. The survey indicated a strong propensity of international tourists to visit at least 2 sites in Johannesburg and surrounds. Most visitors in the sample visited due to spontaneity and interest in heritage studies/history. 98% of the respondents indicated that they had enjoyed their experience which was immersive and authentic. 95% found staff to be friendly and guides to be knowledgeable. 87 % of respondents found the food stall to be inadequate for a museum of such standing and one respondent wrote the word 'pathetic' alongside the relevant item on the rating scale (number 24).

Surprisingly, given its central position in Johannesburg, the results indicated that the museum appears to be a rather difficult attraction to access. Approximately 90% the respondents wanted to experience the unique South Africa, and were seeking mainly satisfying experiences from which they could learn. Only 12% had read any general descriptions on the museum in tourist guide books and 7% had the museum recommended to them by friends and family, or 'heard it was interesting' and should visit by businesses associates. Certain exhibits, amongst which was the ME 262 World War II, aircraft developed by Germany, was advanced as the main reason for 4% of the visits.

### **Three tour operators' perspectives**

Face to face open-ended semi-structured interviews were conducted with representatives of three Johannesburg tourism operators in order to get clarification on their knowledge of the museum and their promotion thereof if any at all. Two expressed the opinion that although they are aware of the museum and what it offers, South Africa is not the first country most tourists have visited. Consequently, the museum is essentially competing with many similar overseas attractions, especially in North America and Europe, for example the Smithsonian in the United States and the Imperial war Museum in England. Knowledgeable tourists thus believe they have 'seen it all'.

Most tourists do not plan in advance what they will see at there destination and thus rely on information they receive for example at the airport or referrals from friends and business associates. Most visitors to South Africa Tourism also want to spend limited time seeing nature-linked tourism sites. Tourists are also increasingly looking for authentic experiences that impact on them emotionally and so they prefer live safari-type encounters, but this does not necessarily mean that heritage sites are less important to them. The tourists also rely on tour guide advice. Tour operators admitted that they could do more to promote the museum and one stated that he would be happy to support initiatives to encourage more international tourist visits if only they (the museum) approach him to discuss such an initiative. Most tourists seek a unique nature visit and so visit the Lion Park etc to fulfill this desire. Many also seek an opportunity to visit cultural sites although these are limited in number in Gauteng. For most international tourists on a travel itinerary, Johannesburg is seen as a transit point or a shopping destination rather than as place with meaningful tourism sites. Generally, the tourism operators interviewed had relatively low knowledge of what was on offer at the Ditsong National Museum of Military History. It was not surprising therefore that international tourist visits were when low compared to similar museums abroad.

### **Limitations of the study**

The descriptions of the attitudes and opinions of the respondents (international tourists) visiting the museum were constructed on the spot and they did not have enough time to carefully consider the questions posed. In addition, some of them may have intentionally

misrepresented the facts so as not to 'offend' the researcher. The researcher thus could have obtained limited and possibly distorted information (Dowson & McNerney, 2001).

### **Recommendations for further research**

Given the case study nature of this research, the results are only applicable to the Ditsong National Museum of Military History with its excellent range of exhibits. The results are useful for the museum and the marketers of tourist destinations and attractions in Johannesburg to consider when developing their strategies which are generally aimed at meeting the needs of international travellers with regard to their leisure motivations.

Research with a greater quantitative focus to ascertain diverse market segments' preferences for certain amenities as well as a drive to further determine the reaction of international tourists to dissimilar fundamentals of the marketing strategy is also advocated for future studies. Further research could also be conducted on how competing attractions may choose to market their 'type' of attraction collaboratively. The nature-based attractions could intensify collaboration with the museum for a multi-venue pass for international tourists sold by tour operators in their country of origin or at the airports in Gauteng. From a marketing perspective, however, it is evident that the museum considers expanding its marketing initiatives. Research could also be conducted in this area.

### **Recommendations for enhanced experiences and increased visits**

Although the exhibits and related information are presented to visitors, it should be done in a more imaginative way. The museum should consider installing interactive video gallery which will allow visitors to search databases and learn about the many sacrifices of all nations affected by war. Chronological timelines for wards could be placed on wall charts to assist visitors to contextualize the exhibits they are seeing. Although there are a few television screens showing DVDs of various military campaigns from World War I onwards, these should be made viewer friendly with some simple benches placed at strategic positions to make viewing easier.

The museum should essentially become more of a learning laboratory where visitors both local and international, students and researchers can use the exhibits to assess the role of South Africa in global conflict. Museums must build relationships and strive to become 'communities of practice' (Kelly et al, 2006)

The average visitor spends approximately two hours at the museum. What should be encouraged is that the museum should present questionnaires to visitors which encourage them to consider the consequences of war and its many negative impacts on our fragile planet. The museum could also, where possible, hire veterans from armed conflict to serve as guides as this will allow visitors to become au fait with experiences of war from those who were actually involved. Guest lecturers on military themes could be held once a month and vigorously advertised in the local press. Globally, museums with a military history slant



favour marketing strategies involving dedicated websites (Schuler & Janell, 2002). They also utilize newspapers, magazines as well as a number of community activities to increase attendance. Coach operators could be handed freely available leaflets to promote visits by international tourists and tour operators could help a great deal in this regard. Tourists who book their holidays through a tour operators are far more likely than independent travellers to make the decision to the museum before leaving home and so tour brochures would be important for those on package tours. Tour buses could also, for example, be met by Zulu dancers in traditional impi (warrior) garb. This in itself would set a warm and inviting tone for the rest of the visit.

The museum receives welcome additional income from its Conference and Function Centres and these centres supply in excess of R500 000 to the income portion of the annual budget, and also serve as an excellent tool for marketing the museum to individuals who visit the museum for work - related functions or seminars and are able to take time to tour the premises. However more advertising in the media of such premises and their availability would be advisable as not many people are aware of these facilities in really special surrounds. Additionally, special events such as the launching of a new exhibit, which may be advertised in the media, may draw those who may not otherwise visit. Special offers could also be made for cheaper entry at specific times. The media should be fed with press releases on all issues of interest. This is the most cost effective element in marketing the museum. It is after all free media coverage and in this regard the museum should pursue the building up of good relationships with news editors, feature editors, journalists, photographers and cameramen employed by the local media including those who are employed on a freelance basis. The website of the museum should be a unique one, while still maintaining a separate Ditsong website. This is probably the most important marketing tool to employ.

The reception area of any museum sets the tone for the rest of the museum and generally is an indication of things to come, so to speak. At the museum, the front desk is stark and uninviting. Apart from charging admission fees it should be selling guide books and providing useful information on the museum for tourists. In terms of food and drink provision, the current set-up is sub standard and it would be worthwhile to tender for reputable coffee shops or restaurant chains to establish an operation on the museum site at reasonable rentals. The same applies to reputable bookshops that could offer and sell a wide range of militaria and historically oriented publications. The existing shop is a good initiative but this concept must be expanded.

The Offerings on entry could also be improved by the provision and sale of a carefully compiled tourist guidebook which elaborates on the major exhibits on view. Vigorous marketing initiatives using tour operators and even airline companies publications, are

critical to increased international tourist visits. If a museum is not marketable it cannot survive (Colton, 2000). It is recommended that far more work be undertaken in this regard as there is a market just waiting to be informed of what is on offer.

Many museums abroad find that television advertising is very effective, but a very expensive way of reaching a large target market. Piggybacking with multinational corporations that appreciate the value of corporate social responsibility and such initiatives, such as MTN for example, could alleviate such a deficiency. There may also be local radio stations with an international audience such as 702 that could be useful in raising awareness and who would also be seen to be 'leading South Africa'.

## **Conclusion**

Historically, Museums have been and continue to be, leisure and tourist destinations but the contemporary challenge is for them to remain relevant and be regarded as a must-view tourist destination in an environment in which there are many competing tourism sites (Scott & Burton, 2000). There is no doubt that international tourists value museums' as places for active personal learning through the observation of interesting and educational exhibits and also as outlets for physical relaxation and escapism (Slater, 2007).

Museums despite the fact that they are needed in society (Carr, 1999), are recognizing that they are competing for the international tourists share of leisure time and entertainment with many other tourism related operations and new avenues must be sought to make them more interesting (Freedman, 2000). The challenge for the Ditsong National Museum of Military History is to connect with potential visitors from abroad. To do this it should realize that a profitable future lies in its urgent implementation of effective marketing and vigorous public relations efforts, which begin with ascertaining what visitors want. This should be followed by promoting what the museum has to offer and exhibiting its many and unique attractions in new and exciting ways so as to satisfy international tourist needs and wants for meaningful leisure experiences.

The findings of this research have a number of practical implications for those involved in the management and marketing of the Ditsong National Museum of Military History. The international tourists visiting the museum, who responded to the survey, were not only guided by the potential attractiveness of the museum, but while looking to spend their valued leisure time in a free environment, simultaneously challenged the operators of the museum through what were generally sincere and useful responses which should hopefully benefit the museum and all its stakeholders and enhance the offering so as to be world-class.

As stated earlier, the museum resides under the umbrella of an organisation called – Ditsong: Museums of South Africa. This organisation is under the 'ownership' and control of the Department of Arts and Culture – and there is no doubt that this is indeed a strange place for a military museum to reside. The museum consequently competes continually with other

cultural museums for funding. There has been a drastic cut in core function personnel over the last ten years and, as a result, many of the curators are of necessity multi – tasked. Advertising the museum is in a sense, thus unwise, if there is insufficient staff to handle the current workload. It is recommended that the museum not reside under the current umbrella organisation, but rather under another, and that additional funding and staff be made available as soon as possible.

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## ENTREPRENEURSHIP AND HIGHER EDUCATION IN SOUTH AFRICA

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### Abstract

In the last ten years, entrepreneurship has assumed an increasingly important role in the South African economy as well as around the globe. The creation of new business activities has become a major driver in the economy and these greatly affect economic growth, job creation and general prosperity and, to an extent, enhance the national competitiveness of the nation in the global business arena.

This paper strives to answer some important questions relating to entrepreneurship. First and foremost, why is entrepreneurship necessary and who, precisely, are entrepreneurs and where may they be found? What can government do to promote entrepreneurship and what is it that Higher Education can do to develop a greater entrepreneurial awareness in South Africa given that there is ambivalence as to the degree to which entrepreneurship can be taught? Are South African universities able to develop cross-functional thinkers who are innovative and have entrepreneurial skills that are needed in the local economy? To what extent do the local universities encourage entrepreneurship by making use of innovative programme designs and are there specialist post-graduate programmes in entrepreneurship or is it simply regarded as an area business students must be aware of with no explicit academic entrepreneurship bias? The answers to these questions and their implications for the nation are discussed in this paper.

### Why is entrepreneurship necessary?

In a world where people live in fear of being made redundant and where corporations “right-size”, “downsize” or “retrench” employees, whichever term you prefer to use, entrepreneurship is seen as a viable option, albeit with risks attached. Entrepreneurship is thus regarded as a “dynamic process of vision, change, and creation. It requires an application of energy and passion towards the implementation of new ideas and creative solutions. Essential ingredients include the willingness to take calculated risks...” (Kuratko : 2003).

South Africa is faced with a multitude of challenges including the great need for a higher economic growth-rate. There is a growing need to transform innovations and new creations or products or services into something more meaningful. This transformation will create employment. Many employees are forced into becoming more flexible functionally and opt to become self-employed in areas where they feel they have relevant skills and /or training and

education. The promotion of entrepreneurial thinking and action will in essence, to very large extent create employment, which is much sought after and desired for masses of unemployed South Africans. Generally speaking, entrepreneurship will be a driver for economic growth and its benefits in the South African scenario will be huge, particularly when there is a negative business climate as in a recession. It also facilitates global economic development and increases the skills of employees. Human capital and personal development are able to grow. This is very important given that large businesses cannot conceivably hope to even absorb 5% of the surplus of unemployed people. Entrepreneurship will also create a fresh competitiveness in markets as entrepreneurs are individuals who identify opportunities and use these to their own benefit (Maas & Fox : 1997). The country is obliged by external economic forces to become far more competitive whilst the changing face of the workforce and types of work, means that the skills necessary for socio-economic growth need to be re-assessed (King & McGrath : 2002).

### **Who are entrepreneurs?**

Schumpeter (1934) regarded entrepreneurs as individuals who are radical market innovators. He saw them as instigators of “creative destruction” through the process of innovation. He believed that all industries are at some point in time appropriately replaced by others. This replacement process he termed as “destruction” making way for “creation”. Hence the term “creative destruction”. This process is ongoing and new entrepreneurial enterprises are being founded daily in the United States of America (Census : 2000). South Africa as a growing economy is also subject to this phenomenon. Who are these entrepreneurs?

Entrepreneurs are generally confident individuals who show promise in creativity and innovation and have the know-how obtained from either Higher Education institutions, from family networks or have simply gone out there and researched for themselves, often learning by a painful trial-and-error approach. The education of an entrepreneur will greatly influence his/her perception of entrepreneurship. They have the ability to transform a simple idea into a workable reality. They tend to network very well and think conceptually. They basically see an opportunity in the market and exploit that opportunity by gathering resources and taking measured and carefully managed risks. Entrepreneurs are always results orientated and seek to add value by satisfying the needs of their market. Many of them are challenged by their education. The growing interest in entrepreneurship is leading to more and more universities offering entrepreneurship as a course of study.

### **Where do we find entrepreneurs?**

Many entrepreneurs have been driven by necessity into entrepreneurial ventures. A large number of businesses in various sectors of the economy, such as marginal mining enterprises, have over the last few years tended to layoff middle-management and workers and this has led to unemployment figures escalating. People have thus been forced in a sense, to start other

ventures such as small businesses. Others have been more fortunate and have been employed by companies where there is a need for people who are able to think cross-functionally.

Many South Africa high school students have now begun to see entrepreneurship as a potential career choice and this is also the case in the United States of America (Bardach : 1997). In fact, the demand has been so great that many American Universities have established entrepreneurship centres (Katz : 2000). In South Africa, entrepreneurs are found in the business world and the community at large, in both the public and private sectors as well as in the formal and informal sectors. There are also many entrepreneurs in the Arts and Science.

### **What can government do to promote entrepreneurship?**

The government must begin to vigorously develop a spirit of enterprise in which entrepreneurial ventures are acceptable and worthy of support. In this regard, individuals should be helped more to take calculated risks. Creativity, learning and innovative thought through education should also be vigorously promoted. Schumpeterian entrepreneurs (individuals who learn to become entrepreneurs) should be nurtured whilst Kirznerian entrepreneurs (those who are naturally entrepreneurially orientated), should be supported more. The “network paradigm” as it has been defined by Cooke and Morgan (1993), is a major way in which innovation possibilities can be capitalized on. The necessary resources such as finance and infrastructure should to an extent be made available by the government. Organs should exist at Universities in which “selection panels” have a greater vision in identifying people with a natural aptitude for creative and innovative business development. The individual entrepreneur should be able to make use of his/her family networks as well as governmentally assisted social networks.

### **What can Higher Education do to help?**

Higher Education institutions are regarded as the custodians of knowledge in society and play a very significant role in developing a nation. This is why entrepreneurship education should not merely be a niche activity. This realization has dawned on Higher Education institutions and has resulted in a noticeable increase in entrepreneurship programmes since about 1998. The process is ongoing and it is a matter of time before there is a relatively fixed entrepreneurship culture in South Africa, which will challenge academics and students alike. Many new challenges are facing universities as they seek to develop and establish growing entrepreneurship programmes. First and foremost will be the promotion of the very great potential for innovative start-up business ideas. An effective investment in national higher education initiatives concerning entrepreneurship, which will to an extent meet the needs of the population, will underpin the international standing of South Africa’s higher education institutions. Only by recognizing the great value and importance of entrepreneurship, and by expanding education about it, can South Africa hope to obtain a pre-eminent position in the

world of education and become truly competitive economically. In many societies in Africa, education has always played a very important role alongside culture in forming an individual (Micere : 1999). The cultural mindset concerning entrepreneurship in any region needs to be taken into account and the aspects which may either promote or go against entrepreneurship as a career option should be carefully analyzed. In this regard, the “spatial and cultural proximity” between those that produce knowledge and those who use knowledge is particularly salient (Koschitzky : 2001). The South African education curriculum at school level as well as in Higher Education system needs to be transformed so as to make entrepreneurship one of the most important subjects that should be taught. A difficulty could be that to achieve a measure of parity for students from disadvantaged backgrounds, access may become limited to other students. This implies that higher education would have to be further expanded. There is a problem however, in that there are no acceptable paradigms or suitable theories as to what entrepreneurship education should encompass (Norton, Kaplan & Hofer : 1999). This is a major challenge for South African universities to overcome by meaningful research initiatives on their part. By this I mean that Higher Education institutes should link research more closely to the market.

Entrepreneurs should be in a position to identify national and international trends and be able to isolate and identify entrepreneurial opportunities that have potential growth and should then be able to take advantage of these opportunities. Entrepreneurship courses should carefully separate business skills from entrepreneurial skills. Business strategies and business plans whilst important elements do not really improve a person’s entrepreneurial skills. Dana (1993) expresses the opinion, that entrepreneurship education should train students in knowledge and skill acquisition that would enable them to bring an idea, process or invention from conception to full business potential. Whilst practical experience is essential there must be harmony in education. By this I mean that the practical components requiring innovation and creativity, new idea-generation and practical action, and the academic knowledge components, need to be carefully counter-balanced so as to make the study meaningful.

A strong knowledge base for entrepreneurship should be created via research and the findings of such research must be disseminated. Students must be in an educational environment in which entrepreneurial ideas are generated and tested. The results should then be made known. The personal growth of students should be facilitated and their critical faculties should be developed as far as possible. Given the very wide range of personalities, the characters of students should be built so as to make their learning more significant. Ideally, students should be inspired to learn for themselves in an environment which promotes the idea of lifelong learning and an ethos of personal research should pervade every higher education institution and be part of the mindset of each and every student. Entrepreneurship courses at Universities can make a very significant contribution in promoting meaningful



entrepreneurship, as they could allay the fears of failure of potential entrepreneurs by educating the students about pitfalls and risks to avoid when embarking on a new business venture. Students will thus have a fuller understanding of entrepreneurship as a phenomenon and surely become more competent stakeholders in entrepreneurship at whatever level; investor or employee, manager or entrepreneur (Maranville : 1992). Young adults should be made capable and be taught to become self-reliant rather than expect to be fended for in an economy which is limited in capability and which has approximately a 24% unemployment rate. In a nutshell, as entrepreneurship is a philosophy which can help the South African economy to grow, it should be supported as a total system (Timmons : 1999).

Another major challenge facing entrepreneurship education in Higher Education institutions, is an academic faculty body, which has entrepreneurial ability and the necessary qualifications to make the subject intelligible and meaningful to students. There are clearly shortages in suitably qualified academic staff to teach entrepreneurship. While some faculties have a glut of PhD academics who cannot find suitable employment, entrepreneurship has too few suitable academics (Pfannestiel ; 1998).

In many parts of the world, South Africa being no exception, entrepreneurship is battling to find academic legitimacy. Entrepreneurship should be a separate stand-alone subject and not be viewed as simply part of Business Management or part of an interdisciplinary field. It is also good and well to have guest speakers and guest lecturers, as these tend to offer a measure of interaction with entrepreneurial business people, but this is not really enough. Academic staff able to alter the mindsets of students and who do have the ability to effectively teach basic business skills and develop creative thinking in their students by giving them practical assignments, whether individual or group, should be the priority. Course content should focus on the skills and knowledge an entrepreneur would need to be successful (Benson : 1989). What is paramount is that potential entrepreneurs see themselves as self-reliant, aware, creative, analytical and knowledgeable individuals who are able to successfully become self-employed and make a meaningful contribution to the society in which they live. They require an entrepreneurial perspective (Kuratko : 2003). This perspective should ideally be developed at high school levels where more business related subjects should be added to existing curricula, perhaps being made compulsory to an extent.

Higher Education institutions create an environmental awareness of entrepreneurship and its many facets. This learning should be life-long learning and is necessary to sustain individuals in society in this new century where business is changing (Drucker : 1995). It is also invaluable to the promotion of the philosophy. Higher Education institutions need to ask the question as to what the appropriate relationship between education and the ever-changing workplace is and what it is precisely that employers are seeking in terms of skills and capabilities in young people entering the world of work?

Universities could be more supportive of entrepreneurs, as is the case at the University of Johannesburg, which involves students in gaining practical experience in direct selling and practical sales management. Students completing the National Diplomas in Marketing, Retail Business, Sport Management, Small Business Management and the Certificates in Marketing and Sales as well as the Foundation Programme, have the opportunity to gain two years of practical sales and one year of practical sales management experience. Once they complete their studies some students may find it difficult to obtain full-time employment. By participating in the above project in which they do practical sales for any of the Direct Selling Association (DSA) companies, they are able to generate income for themselves and have opportunities for personal and entrepreneurial development. This opportunity granted through the partnership with the DSA gives students a competitive advantage. Students who successfully complete the respective modules could reflect on their CVs that they have two years sales experience as well as one year experience in managing a sales team. On a macro level, this project contributes towards alleviating unemployment and instilling an entrepreneurial spirit which our country so desperately requires (Govender : 2005). Universities should also be more analytical and reflective of entrepreneurship and its huge potential to impact positively on the economy of the entire southern African subcontinent. They have great potential to influence the decision of an individual for or against a career as an entrepreneur. This is particularly important for young unemployed individuals who are either graduates or non-graduates, women and the unemployed in any particular society. Places of learning should be the catalysts of entrepreneurial motivation and should drive it forward as a viable alternative to working for someone else. Teaching should be facilitated to maximize the potential of individual students and to encourage a sense of curiosity and motivation in them. Above all, Universities should be seen as places where there is a teamwork mentality between students and academics with respect to things entrepreneurial. New patterns of work organization are appearing in the workplace and team-based work is increasing, with fewer levels of management and supervision, multi-tasking if not multi-skilling, and a greater need for effective communication skills (Probert : 1999). Learning groups could be established which would go a long way to sustain a climate of learning. In these groups of students, they would inspire each other and assist each other, with the guidance of academic staff, to succeed with a business venture.

## **Conclusion**

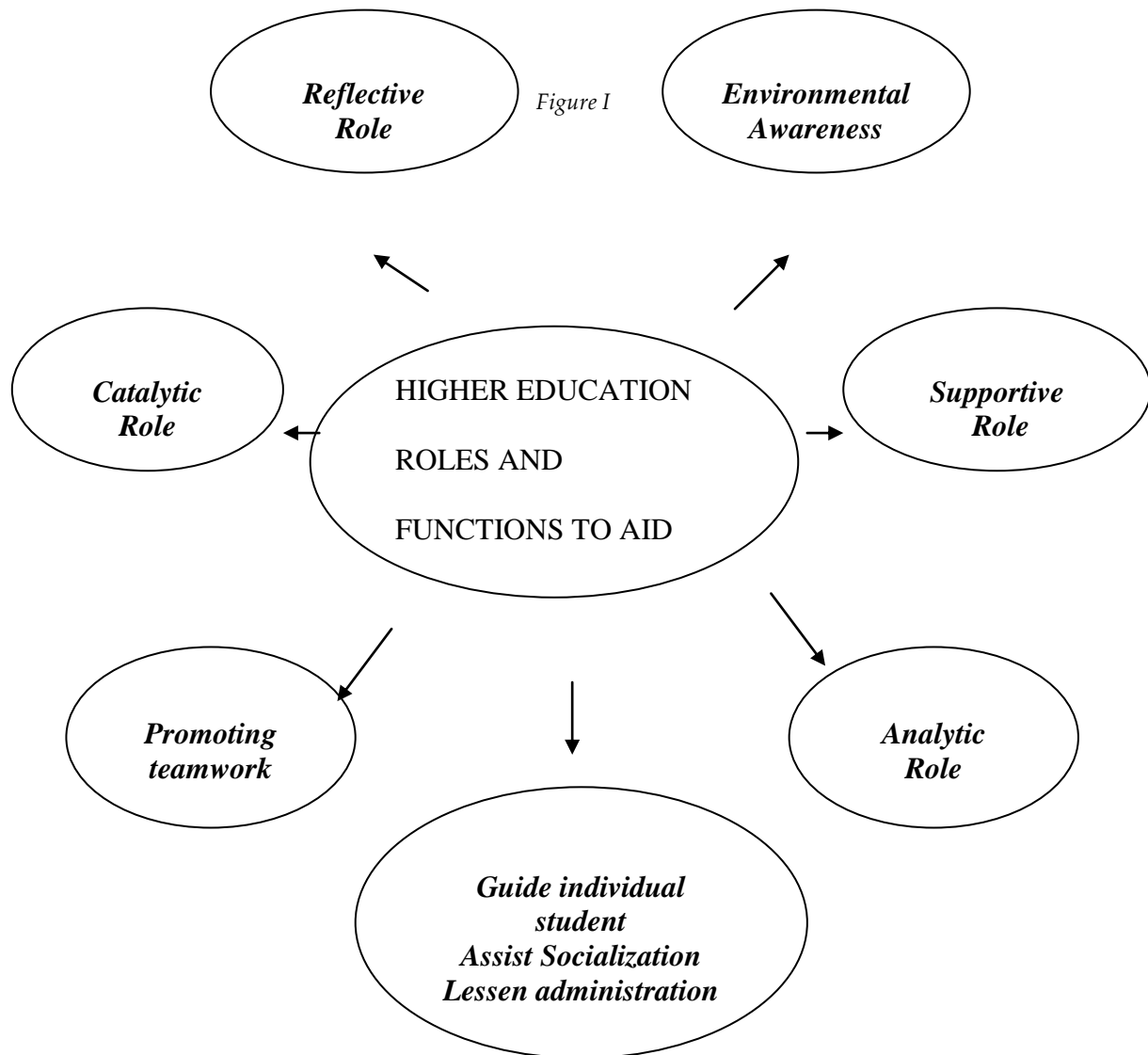
Entrepreneurship gives students a new way of looking at the world, irrespective of whether or not they opt to develop their own enterprises. New business start-up activity is probably one of the most important social activities for countries around the world. The rise of new business significantly affects economies and creates jobs and generally makes society more prosperous. Entrepreneurship is now a mainstream in many countries around the world. The young entrepreneur faces many challenges in attempting to launch and grow potentially good

businesses. About 11 % of entrepreneurs attempting to create high growth businesses, known as “opportunity entrepreneurs” expect to provide 20 or more jobs over a period of 60 months as opposed to 2% of entrepreneurs who are “entrepreneurs by necessity” (Zacharakis *et al* : 2001). This type of mentality is common globally, therefore, a vision of what entrepreneurship is all about will have very important implications on the economy as a whole. It should be fostered in light of job creation and the alleviation of poverty amongst the masses. Entrepreneurship provides individuals with career options and has great potential to aid society to become self-sustaining. It is a means of socio-economic upliftment for the downtrodden in society and should be vigorously promoted at school and higher education levels.

Students embarking on an entrepreneurial career path should have greater access to government financial support throughout their study. Private sector investment initiatives in entrepreneurial education should also be bolstered and in this regard, the government should provide incentives to the private sector enterprises which support quality entrepreneurial programmes. Business could, for example, assist universities to develop digital libraries which would make entrepreneurship initiatives worldwide accessible to virtually all entrepreneurship students. This would also enable students to contact specialists in the field and they could maintain electronic links. Each entrepreneurial student could interact with vast numbers of people around the world, quickly and simply and relatively inexpensively. The vision of the future can be drastically altered for entrepreneurship students by the use of the Internet. Higher Education institutions must become lively communities of intellectuals once again, as in the Renaissance, in which both academic faculty and students can collaborate more and discover together, understand and meaningfully utilize knowledge. The use of the Internet can never however, replace the personal interaction between students and academics.

This can also assist young unemployed graduates to gain a sense of worth in work. Students can be self-motivated and even self-learn with appropriate guidance and facilitation, where they are able to discover and self-actualize to an extent. Entrepreneurship education should continue to receive increased attention and should be more vigorously researched. Only by utilizing entrepreneurship will South Africa be able to cope with the challenges of this century. Universities cannot any longer sell the notion of preparing students for a “lifelong career”. The education revolution has arrived (Norman & Spohrer : 1996) and for successful entrepreneurship, top-notch education is paramount. Higher Education institutions should be providing extra entrepreneurial capacity and this should be especially aimed at high-potential student entrepreneurs (Driver *et al* : 2001), as it is these individuals who will ultimately succeed more and be able to employ others, thus alleviating the huge levels of unemployment in society. Opportunities must be created or seized and vigorously pursued (Timmons : 1999). Students must be taught to identify opportunities in the marketplace and their potential risks and should also be assisted to innovate and create something different in establishing a new venture.

Management skills must also be taught including planing, organizing, leading and controlling (Nieman & Bennett : 2002). The private sector could help them to obtain capital and resources and develop projects such as that of the DSA to reward them for their labours.



*A model for entrepreneurial activity support from Higher Education*

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## SERBIA BRAND IDENTITY: PERSPECTIVES OF RESIDENTS AND DIASPORA

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### Abstract

The main aims of this research paper are to identify, compare and contrast different perspectives of Serbian residents and Diaspora regarding Serbia brand identity. Multiple surveying techniques consisting of on-the-field and on-line surveys were applied. 900 responses were collected and results were analyzed using principal component analysis. Findings demonstrated that certain differences and similarities in the Serbia brand image perceptions between Serbian residents and Diaspora exist. First difference is reflected in the number of brand identity elements identified by each of the 2 examined groups. Diaspora identified 4 brand identity elements which are marked as mild nostalgia, business and pleasure destination, great cuisine and negative media bias; whilst residents identified 6 elements: people, obsolescence, negative media bias, cultural uniqueness, tourist destination and national treasure. Second difference, reflected in the mere content of the brand elements, is mainly determined by the fact that Diaspora's perception is mainly influenced by the nostalgia, whilst residents' by national pride. Except identified differences, certain convergences in the perception of two examined publics are evident. Both groups hold the view that Serbia suffers from negative media bias but still stays a recommendable tourist destination and a place to be.

**Keywords:** country brand identity, residents, Diaspora, Serbia

### Introduction

After Yugoslavia fell apart, 6 newly formed countries (Serbia, Montenegro, Croatia, Bosnia and Herzegovina, Slovenia, FYROM) had tasks to create their new brand identities. Despite all the challenges, this opened numerous opportunities for international brand experts and marketing scholars to get involved and give contribution in the terms of destination branding and strategic brand identity development. Konecnik et al. (2010) argue that managing destination brands focusing on only one stakeholder is myopic. Contrast to this, our study examines destination brand perception through the spectacles of two interrelated but different audiences: Serbian residents (internal audience) and Serbian Diaspora (external audience). The country of Serbia appeared as a fertile research context for brand destination image type of study based on the following arguments. First, in 2003 after dissolution of Serbia and

Montenegro state union, Serbia became 'new to the market' country and a destination beckoning for a serious branding approach. Second, Serbia is endowed with Diaspora almost equal to the size of its own population. It is estimated that approximately 6 million Serbs live abroad, comparing to the 7,5 million Serbian citizens living in Serbia (Statistical office of the republic of Serbia, 2010; Ministry of Religion and Diaspora of the Republic of Serbia, 2011). Third, Serbia is economically dependent from Diaspora, which represents a significant source of foreign income. In 2010, Diaspora forwarded to Serbia 3,1 billion EUR, or 5% of Serbian GDP (Mikavica, 2011). Therefore, there is a strong economic rational to provide a better understanding of Diaspora's perception of their homeland identity.

This having said, Serbia, with all its properties, represents an interesting and suitable context for a comparative (Diaspora-Residents) brand perception research with possible contribution to both theory and practice.

## **Literature review**

First literature stream relevant for this study is general literature on destination branding, destination brand identity and destination image. The interest of scholars and practitioner for the issues surrounding these topics is steadily growing in the recent years (Qu et. al. 2011; Roy and Banerjee, 2007; Tasci and Kozak, 2006). In the period 1998-2007, 74 destination branding publications by 102 authors were identified (Pike, 2009). Mainstream studies on brand strategy development at the national level mostly explore attitudes of external stakeholders, usually focusing on the multiple stakeholder groups. For example, Anholt (2005) explores consumer perspective on America's brand image from the viewpoint of ten different countries. Morgan et al. (2003) examine influence of public and private sector stakeholders on brand image of New Zealand. Ekinci and Baloglu (2007) explore visitors' opinion about brand personality of Turkey.

Second relevant literature stream has particular focus on destination image of ex-Yugoslav republics. A respectable number of studies outlined rebranding necessity of former Yugoslavian republics that appeared as new states on the global scene burdened with their post-conflict media image. The increased interest was followed by the number of publications. For example, Hall (2002) examined Serbia brand identity and found Serbia as the meeting place of cultures, religions and languages. Furthermore, he found Serbia as multiethnic country where all the ethnicities have one thing in common - their homes are wide open to the friends. In the case of Bosnia, Duborija and Milvic (2008) recognized local people as the key element for building a distinctive brand image of Bosnia. In the case of Croatia, Martinovic (2002) analyzed poor international destination brand recognition. Martinovic (2002) suggested Croatia to focus on geo-economic position, natural resources, human resources, tradition and social and cultural activities in positioning their destination brand. Konecnik and Go (2007) describe endeavours of Slovenia to position their small country on the fierce international destination market using

slogan "I feel Slovenia". None of the identified studies explored their Diaspora's perception of home country.

Third literature stream is studying importance of local people for a destination brand identity. In the case of Portugal (Freire, 2007), friendliness of local people was found to be important for brand building process in Portugal. In the case of Stoke-on-Trent (UK), Phillips and Schofield (2007) found that perception of residents is an important component of the place brand identity. Previous studies on Serbia by Hall (2002) and Popesku et al. (2010) explored brand identity of Serbia, focusing exclusively on internal stakeholders.

Fourth and final relevant literature stream for this study is literature on Diaspora and their importance for home country branding. For example, in the case of Caribbeans, Conway and Benjamin (2010) have identified multiple roles of Diaspora: development through remittances, contribution to disaster relief, investments savings in home country, doing business in home country, giving professional advices to local communities, etc. In the case of Samoa, a Pacific Island country, it was found that citizens and Diaspora have significant impact on Samoa's branding success and development of tourism industry (Scheyvens, 2007). Newland and Taylor (2010) found a strong association between nostalgia and returning visits of Diaspora to the home country. Furthermore, Newland and Taylor (2010) concluded that nostalgia helps Diaspora to maintain a sense of identity and community while living abroad. Morgan et al. (2002) argue that nostalgia as a feeling is the most important element of marketing communication strategy toward Diaspora. Diaspora, as an important stakeholder for brand image of a country, on internal plan, can be active, both as tourist visitors and as entrepreneurs contributing to the homeland's economical and industrial development. On the external plan, Diaspora can play a vital role in representing their home country as good ambassadors.

Building on the actual literature and identified literature gap our research has and having in mind immense economic importance of Diaspora for Serbia as a country, it would be important to examine and compare their perceptions with the perceptions of residents. The proposed research question can be framed as following: *What are the differences and similarities between Serbian residents and Diaspora in relation to the elements of Serbian destination brand identity?*

## Methodology

The questionnaire consisted of relatively large number of attitudinal questions on a number of frequent stereotype attitudes shared in the discourse of everyday communication, media, history and collective conscious of Serbs. This might appear as a radical and risky approach in the research design, but in the cases when researchers do not have previous study to refer to, or the phenomena of study is new, a start from the scratch seems inevitable. Attitudinal statements were collected within a period of 12 months from national media (TV and newspapers) and 10 focus groups. 4 different researchers were independently coding frequent issues regards



perception of Serbia and the lists were then compared and convergences identified. Further inspiration for the questionnaire design was found in the work of Ristiano (2005) who provided theoretical framework consisting of generic elements of a country's brand identity. Thus, our initial questionnaire consisted of 7 clusters of questions: demography, brand culture, brand personality, brand character, brand symbols, brand name, and brand slogan related questions. We undertook pilot testing to test the questions and make sure that questions are appropriate and relevant. The questionnaire was pilot tested on a group of 160 examinees. Final list of issues consisted of 38 most frequent attitudinal statements on the image of Serbia and a number of socio-demographic questions. In the phase of confirmatory research, PCA was used in order to distinguish significant from insignificant brand image elements. To measure attitudes, 5-item Likert scale was used with *Strongly Disagree* - weight of 1, and *Strongly Agree* - weight of 5, as the scale anchors. The original questionnaire had a question labelled "residence" where optional answers were: permanently in Serbia, occasionally and permanent elsewhere. This question was used to capture if our examinees were member of Diaspora or residents. Serbs that occasionally live in Serbia were identified as Diaspora, as well.

Surveying lasted for three weeks in April 2010. People were surveyed on-line and on the field. In order to avoid response bias through the on-line survey, on the field only people older than 40 years were interviewed. In order to secure responses from Diaspora, one group of surveyors was placed on the Belgrade airport. After expiration of the surveying period, on-line survey was closed. Results were coded and inserted in the SPSS 17.0 software, which was used for statistical analysis. Following good practice of Palant (2005) and Malhotra (2007), prior to the data analysis, error screening and data cleaning was undertaken. After insuring that there are no missing values or values of the variables that fall outside defined ranges, it was preceded to the data analysis. Following statistical tools were used: (1) **Descriptive statistics** tools were used to capture average values on the examined issues. These tools were very helpful to extrapolate demographic profile of participants and their general impressions. (2) **Factor analysis**. Exploratory and confirmatory factor analyses were used. The aim of this tool was to reveal underlying structure (i.e. Serbia brand identity) and determine how many reliable and interpretable brand elements can be found within both of the examined groups.

## Findings

In total 900 people were surveyed, from which 740 residents and 160 Diaspora. Both of the groups, in the terms of size, were suitable for principal component analysis. According to the recommendation by Tabachnik and Fidell (2007) and Stevens (1996), it is comforting to have at least 300 cases or 150 cases, in the case when solutions have several high loading market variables (above .80). These conditions are met in both of our target groups (refer to the Table 1 and Table 2 for further details).

As this study aimed to determine and discuss differences and similarities between Serbian residents and Diaspora regarding elements of Serbian destination brand identity, first step was to split dataset into two groups – residents and Diaspora and conduct separate analyses. Second step was to determine brand identity elements for each of the two groups and test their explanatory power. Final step was to compare results and give critical evaluation of the similarities and difference and their implications for theory and practice.

### **Serbia brand Identity: Residents' perspective**

The surveyed residents (N=740) were in average 30.36 years old (std. dev. 9.969, median 27, mode 25, range 15 to 81 years). Prior to the performing of principal components analysis (PCA), the suitability of data for factor analysis was assessed. PCA was repeated 3 times with exclusion of attitudinal statements with communalities lower than .5. Finally, 27 attitudinal statements have left. Inspection of the correlation matrix revealed that all of the coefficients were equal to or higher than .3. This confirmed that dataset is suitable for the factor analysis. The Kaiser-Meyer-Olkin value was .882, exceeding minimal required value of .6 (Kaiser 1970, 1974) whilst Bartlett's Test of Sphericity reached statistical significance of .00, supporting factorability of the correlation matrix. Initial PCA was performed used Oblimin rotation technique which suggested 8 factors/components. In order to determine optimal number of factors, parallel analysis (MonteKarlo simulation) was used and eigenvalues were compared with the eigenvalues given by the PCA (Pallant, 2005). Parallel analysis showed 6 components with eigenvalues exceeding the corresponding criterion values for a randomly generated data matrix of the same size (27 variables x 740 responses). Thus, we found that optimal factor number was 6. We facilitated another PCA and forced procedure to suggest 6 factors. The 6 component solution explained a total of 55.51% of the total variance of Serbia as destination brand. To aid in the interpretation of identified components, Oblimin rotation was performed. The 6 brand identity elements emerged (for the detail findings of PCA please refer to Table 1.):

- (C1) **People** – 25.54% of total variance explained. It was found that people are the most significant brand identity element. Despite the life in a country burdened with problems, Serbian people enjoy and celebrate life with the sounds of Serbian folk music. They are talented for sports, curious and good looking.
- (C2) **Obsolescence** – 8.75% of total variance explained. Serbia was found as a country that falls behind modern world and current trends. Serbia was also described as mainly rural, under-developed and non-European country.
- (C3) **Negative media bias** – 7.01% of total variance explained. Negative media bias seems as the outcome of long years of conflict in the region and role of Serbian people in these misfortunate events. Serbia and Serbs were usually presented in foreign media as “bad guys” and initiators of civil war in Yugoslavia. Despite the fact that

Balkan conflicts are more than a decade behind, Serbian media picture is still considered to be negatively biased and not authentically presented in the domestic in foreign media.

- (C4) **Recommendable tourist destination** – 4.99% of total variance explained. Serbia was found to be hospitable country, with great cuisine and glorious history, recommendable to every foreign visitor. This is also a point of self-reference as respondents identify themselves with the role of a good host which is a part of Serbian cultural matrix.
- (C5) **Rich national treasury** – 4.72% of total variance explained. Serbia is perceived as rich in archeological sites, monuments, monasteries and natural beauties. Even though aware of national treasury, it would be interesting to examine how many of these places are in the reality visited by Serbian residents.
- (C6) **Cultural uniqueness** – 4.5% of total variance explained. Serbia is described as a country with distinctive culture, where tradition, countryside and church play vital roles in the everyday life of Serbian people.

**Table 1:** Serbia brand image perceived by Serbian residents - rotated component matrix for PCA with Oblimin rotation for 6 factor solution

Attitudinal statement	Pattern / Structure coefficients						Comm.
	C1	C2	C3	C4	C5	C6	
Serbs love folk music	.671	-.020	.051	.178	-.141	.161	.487
Serbia is always burdened with problems	.650	-.217	.073	.197	-.143	-.025	.466
Serbs love to know everything	.647	.009	-.112	.234	-.260	-.003	.431
Celebrations play vital role in the lives of Serbians	.698	-.030	-.232	.408	-.387	.183	.573
Serbs are talented for sports	.600	.239	-.254	.523	-.443	.159	.529
Serbs are beautiful nation	.491	.260	-.266	.531	-.446	.282	.510
The image of Serbia in media is full of contradictions	.419	-.086	.033	.216	-.264	-.226	.283
Serbia is mainly urban	.039	.756	-.015	.123	-.207	.110	.585
Serbia is modern and developed	-.148	.714	-.031	.011	-.121	.357	.588
Serbia is mainly agricultural and rural	.157	-.496	-.038	.203	-.141	.364	.294
Serbia is European country	-.027	.518	-.020	.163	-.081	.196	.671
The image of Serbia in media is positive	-.060	.074	.787	-.010	.079	.045	.497
The media image of Serbia is better than reality	.135	-.074	.755	-.107	.083	-.221	.658
Serbia is as presented by the foreign media	-.189	-.195	.615	-.424	.222	.124	.656
Serbia is as presented by the domestic media	-.125	.131	.502	-.180	-.015	.462	.531
I would recommend every foreigner to visit Serbia	.150	.148	-.123	.778	-.444	.086	.501
Serbia is country of hospitality	.276	.183	-.165	.796	-.386	.162	.651
Serbia has great national cuisine	.349	.053	-.163	.782	-.319	.145	.646
In Serbia people spend more than they have	.410	-.162	-.129	.686	-.218	-.017	.623
Serbia is a country of glorified history	.133	.198	-.186	.643	-.530	.339	.562
Serbia is rich in archaeological sights	.175	.086	-.074	.318	-.862	.088	.565
Serbia is rich in monuments	.220	.145	-.129	.342	-.833	.206	.762
Serbia is rich in nature beauties	.464	.109	-.201	.516	-.753	.168	.698
Serbia is rich in monasteries	.573	.056	-.173	.435	-.727	.173	.657
In Serbia, tradition is specially nurtured	.146	.278	-.014	.272	-.219	.682	.671
Serbs have unique and distinctive culture	.258	.308	-.141	.412	-.545	.474	.497
Church plays vital role in lives of Serbian people	.234	.121	-.105	.196	-.293	.640	.474
	C1	C2	C3	C4	C5	C6	Total
% of variance explained	25.54	8.5	7.01	4.99	4.72	4.5	55.51
$\alpha$	0.887	0.759	0.723	0.719	0.71	0.69	
Mean	4.09	2.43	2.44	4.19	4.04	3.39	
$\sigma$	.59	.75	.71	.75	.78	.66	

**Serbia brand Identity: Diaspora perspective**

In total 160 Serbs from Diaspora participated in the survey. Examined Diaspora (N=160) was in average 31.84 years old (std. dev. 9.005, median 30, mode 29, range 17 to 61 years). Prior to the performance of principal components analysis (PCA), the suitability of data for factor analysis was assessed. All of the 38 attitudinal statements had communalities higher than recommended value of .5. PCA was then fully performed. Inspection of the correlation matrix revealed that all of the coefficients were equal to or higher than .3. The Kaiser-Meyer-Okin value was .758, exceeding recommended value of .5, whilst Bartlett's Test of sphericity reached statistical significance of .00, thus supporting factorability of the correlation matrix. Initial PCA was performed using Oblimin rotation technique which suggested existence of 4 factors. In order to determine optimal number of factors, parallel analysis (MonteKarlo simulation) was used and projected eigenvalues were compared with the eigenvalues given by the PCA (Pallant, 2005). Parallel analysis showed 4 components with eigenvalues exceeding the corresponding criterion values for a randomly generated data matrix of the same size (38 variables x 141 responses). Thus, we found that optimal factor number was 4. We facilitated another PCA (Kaiser-Meyer-Okin value was .877 and Bartlett's Test of sphericity reached statistical significance of .00) that was performed using Oblimin rotation technique and forced procedure to suggest 4 factors and reduced the number of attitudinal statements from 38 to 14 due to unsatisfactory communalities. Next PCA, showed that one out of fourteen attitudinal statements had communalities less than .5 and was excluded from further analysis. The final number of elements (attitudinal statements) was 13.

The PCA revealed 4 component of Serbia brand identity among Diaspora (for full details please refer to Table 2.). This solution explained a total of 69.52% of the total variance of Serbia as Brand construct:

- (C1) **Nostalgia** - 22.58% of total variance explained. This is the strongest brand identity element for Diaspora. As the proverb says "There is no place like home" it should not be surprising that Serbs from Diaspora feel homesick and nostalgic. This is a strong emotional entanglement that keeps Diaspora always close to the "fire".
- (C2) **Business and pleasure destination** – 21.18% of total variance explained. Diaspora usually sees Serbia either through business or pleasure. As explained in introduction, Serbia is dependent on money coming from Diaspora and most Serbs from Diaspora have significantly better standard of living than majority in Serbia. Many of Diaspora Serbs invest their capital in Serbia and expand their business there. On the other hand, part of the Diaspora Serbs visits Serbia only for the leisure purposes and reunion with their family and cousins.

- (C3) **Negative media bias** – 11.14% of total variance explained. Negative media bias reveals that Serbia and Serbs are usually presented in inappropriate manner in almost every foreign country. This also interesting as it reveals inertia of foreign media and deeply rooted prejudice of Serbs as bad guys stemming from the civil war in Yugoslavia.
- (C4) **Great cuisine** – 14.16% of total variance explained. Serbs are fond of Serbian cuisine and this is also close with the phenomenon of nostalgia. Food takes the central place in Serbian culture and staying hungry is one of the worst fears of an average Serb. Opposite to Serbian residents, Serbian traditional food is not so available and accessible to Serbian Diaspora and this might be the reason why Serbs living abroad daydream about proper Serbian dish made just as “grandma does”.

Table 2: Serbia brand image perceived by Serbian Diaspora - Rotated Component Matrix for PCA with Oblimin rotation for 4 factor solution.

Attitudinal statement item	Pattern/structure coefficients				Comm.
	C1	C2	C3	C4	
Serbia is mainly urban	.770	.020	.015	.085	.601
Serbs have unique and distinctive culture	.720	.201	.091	.279	.644
When mentioning Serbia, I only have nice associations	.706	.425	-.107	.124	.706
Serbs are nicely up brought	.666	.419	-.068	-.114	.637
Serbia is a country of glorified history.	.622	.423	-.083	.308	.668
Serbia is country of hospitality.	.162	.850	.027	.122	.764
Serbia is country in which one should invest.	.299	.772	-.035	.142	.707
Serbia is country I would recommend to every foreign visitor.	.174	.733	.074	.368	.709
Serbia is country with high quality products	.426	.602	.212	.204	.631
The image of Serbia in media is better than reality	-.216	-.094	.857	.062	.794
The image of Serbia in media is positive	.173	.186	.846	-.083	.788
Serbia can be proud with its national cuisine	.041	.483	.052	.731	.757
Serbia is country of great cuisine.	.502	.157	-.107	.684	.772
	C1	C2	C3	C4	Total
% of variance explained	22.58	21.18	11.14	14.16	69.52
$\alpha$	.837	.861	.580	.639	
Mean	3.4	3.97	2.48	4.21	
$\sigma$	.88	.99	.90	.96	

### Residents and Diaspora: Divergences and Convergences in brand perceptions

The first major difference, in the perception of Serbia brand identity by Serbian residents and Diaspora, was found in the number of elements identified within both of the groups. Serbian residents outlined six elements, out of which the most positively associated elements of Serbian Brand identity are: People, Negative Media Bias, Obsolesce, and Tourism destination. On the other side, Serbian Diaspora perceived only four elements of Serbia brand identity: Mild nostalgia, Business and pleasure destination, Negative Media Bias, and Great Cuisine.

Comparing the results of Serbian residents and Diaspora, it is possible to conclude that both audiences recognize Serbia as a recommendable tourism destination for business and pleasure. Also, Serbian residents had a more detailed approach when analyzed Serbian brand identity features. This can be related to a range of “first hand” information and experiences that are accessible to them.

Second difference can be found in the core emotions that drive both audiences. Serbian Diaspora is often driven by the emotion of nostalgia (longing for home) and it reflects on perceived elements of Serbia brand identity. Serbian residents rated people as the most important element of Serbia brand identity. Serbian sportsmen, scientists and young talented people make often Serbian public proud, as they are the main source of good news for Serbia.

Finally, both audiences agreed that media bias is negatively associated with Serbia has a negative influence on the destination image and international positioning of Serbia as a destination brand. But still both Serbian Diaspora and Residents hold the view that Serbia is a recommendable destination for tourism, business and pleasure. (See Exhibit 1. for graphical description of differences and similarities of Serbian Diaspora and Residents).

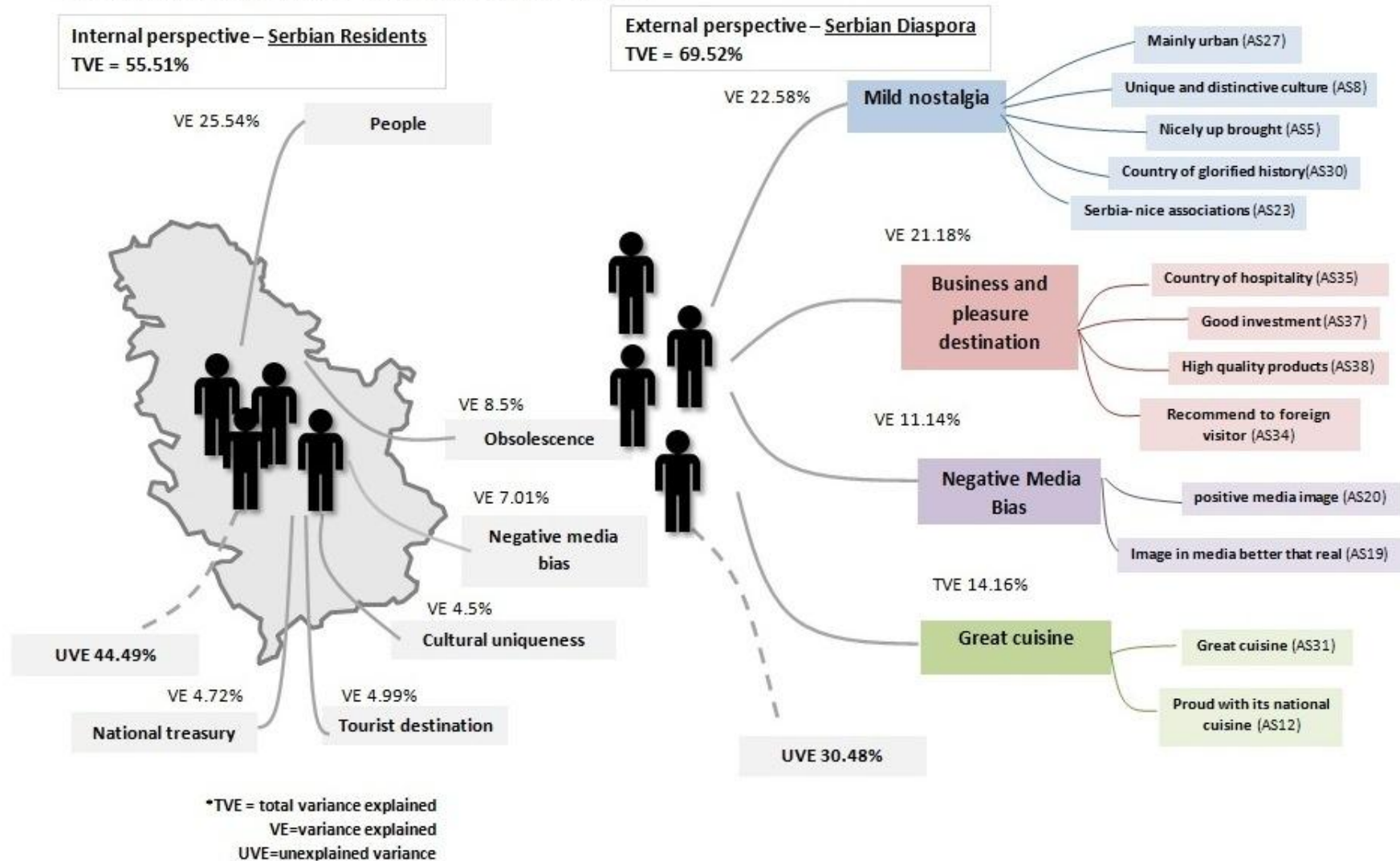
## Conclusion

Referring to the research question stated at the beginning of the paper and according to our findings, significant differences and similarities between Serbian Diaspora and Serbian residents exist. Serbian Diaspora identified 4 elements of Serbia brand identity: **mild nostalgia, business and pleasure destination, negative media bias** and **great cuisine**. Residents were more detailed and identified 6 broad brand identity elements: **people, obsolescence, negative media bias, cultural uniqueness, tourist destination** and **national treasure**. Furthermore, both audiences are driven by different emotions that are strongly affecting their perception of Serbia as a brand - Diaspora by nostalgia and residents by national pride. Diaspora and residents highlighted that negative media bias that follows Serbia as a country has a strong impact on external perception and positioning Serbia as a brand. Lastly, despite all negative associations that surround Serbia, both audiences match opinion that Serbia is still recommendable tourist destination and a great place to visit.

There are several limitations of this research study that need to be highlighted. Primarily, small sample size of Diaspora, as well as period spent living abroad that was not taken in consideration for this research can be seen as significant limitation of this study.

Having in mind the fact that Serbian Diaspora has a great impact on Serbian economical and social development; future research should be specifically targeted for countries where majority of Serbian Diaspora live. Further research should also focus on recognizing core values of Serbian brand identity from residents and Diaspora perspective in order to create a unique destination branding strategy for development and differentiation of Serbian brand identity from its competitors at the Balkans and Mediterranean region.



**Exhibit 1:** Different perspective - elements of Serbia Brand identity

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## NEGOTIATIONS BETWEEN GERMANY AND LATIN AMERICA: A CROSS CULTURAL CUALITATIVE STUDY

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### Abstract

This is a summary of research about the inter-cultural negotiation processes followed in Germany and Latin America, highlighting similarities and differences. Results are based on research carried out with managers on Latin American and German negotiations cultural values. The study includes 110 interviews using a semi-structured questionnaire on a concrete negotiating experience in one of these cultures. The author offers suggestions on how to negotiate more effectively in the German and Latin American cultures. The purpose of the paper is to build theory using a qualitative, comparative and grounded theory approach to cross-cultural negotiations.

This paper includes five sections. The first part presents the research. The second continues by summarizing results on the sequence of negotiation processes in the Latin American culture. The third section contrasts by presenting characteristics of negotiating processes followed in German culture. The fourth part analyzes the similarities and differences found using a quantitative Globe study with managers on German and Latin American cultural values. Finally, the fifth section presents several conclusions and recommendations for people from these cultures who will be negotiating with the other.

A negotiation culture is understood as the set of values, beliefs, behaviors, customs, expectations, process and rationales shared by people from a region or collectivity and used when they try to make an agreement to do a common project or to solve differences or conflicts of interest.

**Keywords:** negotiation cultures, cross-cultural management, qualitative/quantitative comparisons.

### THE STUDY

#### Objectives

- To describe the sequence of negotiation behaviors in Latin America and Germany.
- To understand the differences and similarities between Latin American and German negotiation cultures.
- To predict and highlight negotiation misunderstandings and problems associated with cultural patterns in these two regions.

- To offer guidelines and advice for people about to engage in negotiations with the other culture.

In summary, the purpose of this paper is to build theory based on practical experiences.

### **Methodology**

Qualitative research on intercultural negotiations is anthropological (describing and understanding the phenomenon from the participants' perspective) and sociological (symbolic interactions describing and interpreting the negotiating process to understand the participants' behaviors). Likewise, it requires studying the culture from the outside (what is said by those who are negotiating in the culture) and inside (the internal perspective) (Dorfman, 1996; Morris et al, 1999). As what usually happens with qualitative methodologies, the analytical process has been primarily one of induction and comparison, meant to develop an explanation on one culture's way of negotiating with the other one (Glaser & Strauss, 1967).

The process began with research questions rather than hypotheses: how do Latin Americans negotiate with Germans (and Germans with Latin Americans), why do they negotiate that way, what characteristic processes do they use, and what recommendations can be made to them and to those negotiating with them? The research questions were very concrete, limiting the theoretical field to negotiating practices.

Research questionnaires were targeted for one specific negotiation experienced by the respondents. To avoid stereotyping, the questionnaire focused on only one experience. Interviewees were asked, through open questions, to narrate their experience with the other culture, from pre-negotiation through the negotiation sequence. It also included a question about experiences that were radically different from the ones narrated, in order to assess whether they had described an isolated incident from their general experience. Finally, they were asked to describe what they had liked the most from that particular experience (and what they had not liked), what amazed them, the similarities or differences they thought existed concerning participants in the negotiation, the other party's negotiating behaviors and the advice they would give a friend or colleague who had to negotiate in that country. See the questionnaire in Appendix 1.

This paper is based on a data analysis using the constant comparative method on 110 interviews about a concrete negotiation experience in the other culture (Germans in Latin America, and vice versa). Data analysis consisted of semantic coding/classification of interview statements based on 20 predetermined dimensions adapted from Weiss & Stripp's (1985) framework: content analysis of open-ended questionnaire data.

I used two successive "samples." The first was a thesis written by Ovalle (2000) based on 86 interviews (with 36 Germans and 50 Latin Americans). The second was a thesis written by another student who had not read the first one; he used 24 interviews conducted while he

was living in Hannover (Germany) for eight months during the World's Fair in 2000 (Martínez, 2001). The second thesis reached similar conclusions, validating the first. This paper integrates the results from both research projects.

Another way I validated the data was to incorporate responses from groups of Latin American managers with experience working in Germany, and vice versa; they have reviewed and validated the information presented. A final source of validity is the comparison I made to results from other studies about these managerial cultures, including a qualitative study of intercultural negotiations between Colombians and the Dutch and quantitative measurements from the Globe study.

I achieved inter-rater reliability by training my students to select and classify sentences from the interviews. This revision had face validity because the answers were mostly straightforward behavioral descriptions, without much interpretation or inferences. We continued independently selecting/coding the information until achieving a complete fit; this took five interviews for one student and three for the other one.

## **THE CULTURAL SCRIPT OF NEGOTIATIONS IN LATIN AMERICA**

Not much research on negotiation processes in the Latin American culture exists. Ogliastri's research (1992; 1997; 2000) shows that there are several similar negotiation patterns that are followed throughout different countries in Latin America. He concludes that even though not all Latin Americans negotiate the same way, it is possible to identify traditional patterns or guidelines that have been established and are widely used in negotiations: a negotiation culture. This paper confirms such general conclusions, but points to specific behaviors and sequences of events in experiences with German counterparts.

2-1. In Latin American culture negotiators are supposed to get to know the other side personally before starting business. Culturally, personal relationships are very important in business, and it is a plus to be friendly, soft and warm. Meetings are often relaxed, with few time pressures. Negotiators are expected to use their instinct and first impressions to evaluate whether they trust you and your company. Negotiations become a very interpersonal process. Latin American culture avoids conflict and open confrontation, preferring to use close, personal relationships to soften the experience.

2-2. In Latin American culture negotiations are not usually prepared for in great detail. Additionally, negotiators often hesitate to share information or data about the problem because they believe the other party will use it against them.

2-3. In Latin American culture there is a belief and assumption that there are winners and losers in negotiations: one side wins at the expense of the other in a "zero sum" situation, in which the problem is basically solved by distributing benefits. Bargaining and haggling are standard negotiation tools. The process often starts by making exaggerated offers and demands, aimed at framing and positioning for subsequent negotiation moves.

2-4. Latin American negotiations emphasize persuasion. Negotiations often begin with hospitality: people in a good mood, telling jokes, being friendly and warm, or trying to find personal similarities. Negotiators try to be quite eloquent (convincing you with their reasoning, moving you emotionally) and turn to power as a last resort (using loud voices and disinterest to intimidate).

2-5. In this culture people express emotions quite openly. In Latin America it is believed that a genuine and authentic person is one who openly shows what he or she is feeling. In some parts of the region, people can be more hostile, but in the majority, it is customary to conceal this aggression and show more affection. Some negotiators control their emotions and are more aware of how to use them to have an impact on others. Generally, though, the emotional side of Latin American culture shows less concern for rationality; there is much more romanticism, as demonstrated by Pascal's quote: "The heart has reasons that reason cannot know."

2-6. In Latin American culture negotiators analyze all points on the table at the same time, as a "package" or negotiation block, instead of using a more traditional technique of going down the agenda, agreeing on a point and moving to the next. This package method corresponds to the most advanced negotiation theories, since it creates more mutual value through the exchange of concessions. However, many people from outside the region find it disorienting and chaotic.

2-7. Many sub-cultures in Latin America play on language ambiguities. A "Yes" may in fact mean "maybe" or even "No," if the negotiation party does not "read" the underlying context in which things are said (subtle signals on how people speak or body language). In these settings, literal translations can be completely incorrect. These sub-cultures tend to exist in areas away from the coasts (for example, Bogota, San José de Costa Rica, La Paz and Quito).

2-8. Latin American culture is full of uncertainty, which makes people very flexible and able to manage new or unforeseen situations; therefore, negotiators in Latin America should be prepared for a wide margin of error around any commitment made. This means that agreements can change and the legal "Act of God" (*casus fortuitous*) in contracts is, in fact, relative.

2-9. Even though business is often a short-term deal in Latin America, people consider the personal relationships they develop while negotiating to be long-term. Therefore, they try to maintain good personal relationships with the other side even if no business agreement is reached.

## **A COMPARISON WITH THE GERMAN NEGOTIATING CULTURE.**

Several studies have analyzed German culture and negotiation processes (Flippo, 1996, Glouchevitz, 1997, Kenna & Lacey, 1985). The main difference between those studies and this paper is that I offer a more concrete and precise perspective without implying universalism

or that the results only reflect interactions with the Latin American culture. In addition, I am focusing solely on negotiation cultures and cross-cultural processes.

I have collected 218 written experiences of negotiations between Germans and Latin Americans. However, in this section I am using only the 110 included by the two bi-cultural students in their theses about German negotiating patterns written under my supervision (Ovalle, 2000; Martínez, 2001). Based on these studies, I developed four main conclusions about how negotiations are different in the German culture.

3-1. In Germany, negotiators are expected to study all the business details before beginning the negotiation and define the objectives they wish to achieve. These objectives may be optimistic, but are not irrational. German culture places emphasis on achieving sustainable results in the long-term. In contrast, negotiations in Latin America often are started without thorough preparation, and there is a short-term focus.

3-2. In German negotiating culture opening demands are presented objectively with the reasons and data behind them. This pragmatic approach allows for an upfront presentation of objective data, a confrontation, of sorts, using facts without arrogance or personal attacks. In cultures that place emphasis on bargaining, like in Latin America, negotiators tend to make exaggerated requests to see how the other party reacts and push the limit to an extreme so that an agreement in the middle can be reached. These are two very different ways of negotiating.

3-3. Another difference is that German culture expects an ordered negotiation process, in which one negotiation point is discussed at length until it is resolved. Negotiators avoid moving on to the second point until the first is finished. Most people process items using a “point-by-point” negotiation style, in a methodic and orderly manner. This is very different from “package” negotiation, like in Latin America (and Japan), where negotiators discuss everything at the same time and “nothing is agreed upon until everything is agreed upon.” Negotiating in a block or package is hard to do for “monochronic” (one thing at a time) and orderly cultures that prefer to finalize one item before beginning the next. Although it is important for negotiators to be organized, in negotiation, the inability to discuss several items at the same time is an obstacle to more comprehensive solutions.

3-4. Personal relationships during negotiation also differ. In Latin American culture people can be emotional, personal and warm, even in business negotiations. In contrast, the German culture places an emphasis on rationality, being objective, hiding emotions and not mixing personal and business topics. An intellectual confrontation about data is considered unemotional, and it clashes with the Latin Americans’ preferred style.

The following section presents cultural differences found in recent studies that can help us understand these negotiation patterns better.



## ANALYZING THE DIFFERENCES

Several studies have shown that Latin American- and German-speaking countries belong to two different cultural regions in the world (Schwartz, 2008; Chokkar et al, 2007; House et al, 2004; Inglehart and Carballo, 1997; Ronen S., Shenkar, O, 1985). Each region has its own set of values and practices (Ogliastri et al, 1999; Szabo et al, 2002). Table 1 presents a summary comparison between these two different cultures, focusing on East and West Germany (Brodbeck and Freese, 2007) and Latin America (Ogliastri et al, 1999). Identifying these differences helps us to understand negotiation patterns better and how misunderstandings may occur. For most of these variables, the Table presents current cultural practices as well as those values or preferences that managers have, which have been identified in research on general cultural traits. This Table has been prepared exclusively to facilitate understanding on the abovementioned differences in negotiation patterns between Latin American and German cultures; there are seven key differences between behavior and values between these two negotiating cultures.

Table 1: Cultural similarities and differences between Germany and Latom America

VARIABLES	Germany: current culture/practices	Germany: desired or preferred culture	Latin America: current culture/practices	Latin America: desired or preferred culture
1- Uncertainty avoidance	High (A)	Low (C)	Low (C)	High (A)
2- Family and group collectivism	Low (C)	Low (C)	High (A)	High (A)
3- Assertiveness	High (A)	Low (C)	Average (B)	Average (B)
4- Orientation toward performance	High (A)	Average (B)	Low (C)	High (A)
5- Future orientation	High, long-term outlook (A)	Low, focus on present (C)	Low, focus on present, short-term outlook (C)	High, future outlook (A)
6- Time	Monochronic		Polychronic	
7- Importance of communication context	Low		High	

Source: Elaborated by the author based on data from GLOBE (Brodbeck and Freese, 2007, Ogliastri et al, 1999) and Van Hoof et al (2005).

Note: The letter A represents results with a standard deviation higher than the overall average in the Globe study.

The letter B represents results with a standard deviation just above or below the overall average. The letter C represents results with a standard deviation lower than the average. Globe interviewed 17,000 middle managers in 61 countries. The first column represents the “as is” (current common practices) situation in the home countries of the interviewed managers; the second indicates what they think the situation “should be” (preferred values).

For example, managers from Germany described their culture as “highly inclined to avoid uncertainty” (A), but wanted them to have a “low inclination to avoid uncertainty” (C).

4-1. According to the Globe Study on middle managers (Chokkar et al, 2007), German and Latin American cultures are completely different in terms of trying to avoid uncertainty, though there is a trend for convergence between the two. German managers try to avoid unforeseen events at any cost; they want to minimize uncertainty, so they carefully prepare for the negotiation and leave nothing to chance. They take little risk. At the same time, they would prefer for business relationships to have a little less structure than what their culture normally expects so the process can be more flexible. On the other hand, Latin American managers live with uncertainty and would like much more security and institutionalism. These trends are positive for both parties' negotiation processes because they may be able to meet half-way.

4-2. German culture is individualistic, both in family life and institutionally or socially, and this trend is not likely to change. Latin American culture is the opposite, in which people value collectiveness in families and groups, cohesion, and loyalty. They value group benefits and achievements over individual ones. The two cultures are clearly different, both in terms of practices and preferred ideals.

4-3. German culture accepts assertive, aggressive and confrontational communications, and uses direct and serious language. New negotiation theory suggests a "soft on the person, hard on the problem" approach; however, being "soft" or "hard" is culturally-relative. In the Latin American culture, on the other hand, people are raised to be softer in personal relationships and in the middle in terms of assertiveness. Problems with interpersonal business relationships reflect these differences in values: an effective way to solve a problem for some, being "hard on the problem," can be interpreted as being "hard on the person," since relationships are not always seen as separate. Fortunately, German managers would prefer less aggressive interactions, and Latin American managers would prefer more direct and assertive ones, so it is possible that they could negotiate together somewhere in the middle.

4-4. Something similar is seen in performance orientation, which is declining in German culture, but increasing in Latin America. This convergence will facilitate the negotiation process so that the negotiators focus more on results than personal relationships.

4-5. In terms of time, Germans would prefer to not think so far in the future as they do now. The opposite is true for Latin Americans, who would prefer to move from a present, short-term perspective to a more long-term one.

4-6. Another topic related to time that has been studied by Edward Hall (1966, 1998) has to do with the process: German culture is monochronic, meaning people prefer to do one thing at a time and do it well. In negotiations this means that they analyze and agree on issues point-by-point. This process is not as appropriate according to new negotiation theory because it causes them to miss opportunities to exchange priorities and trade off concessions, which result in mutual value creation. The apparently disordered and confusing process of discussing several points at a time, exploring concessions of one point for another, requires a

polychronic mentality (doing several things at once), which is more common in Latin Americans culture.

4-7. Finally, one other cultural difference is the importance placed on communication context (Hall, op. cit.). Cultures with little communication context speak clearly in univocal tones, avoiding ambiguity and misunderstandings. Other cultures, like the Latin American or Japanese ones, have much greater communication context, in which the message is relayed not only through the words used, but also by the way they are said, the tone of voice, gestures, non-verbal communication and body language. Like the Dutch (Van Hoof et al 2005), Germans operate with little or low communication context. This makes negotiations done with literal translations difficult and results in misunderstandings.

## SUMMARY AND ADVICE

The four main differences between the Latin American and German negotiating cultures include the following topics: prior preparation to reduce uncertainty, the use of bargaining or objective technical standards, the process of negotiating packages and the type of interpersonal treatment expected by each side.

Latin Americans could learn from the German culture how to prepare better and improvise less, not open negotiations with exaggerated and unfounded demands and use objective standards. They should remember that an attack on a problem does not equal a personal attack. It must be clear that Germans separate their personal and professional lives, and Latin Americans should not get upset by their distance since it is something normal in German culture. By learning about German culture and values before the negotiation, Latin Americans will be able to understand them better, feel less frustrated and make the necessary adjustments.

On the other hand, German negotiators could learn from the “package” negotiation technique used in Latin America, to make concessions on different points, instead of trying to solve everything in order, point-by-point. Likewise, they should accept that Latin American culture is less aggressive and direct and that they might see the Germans as being arrogant and confrontational, which would not be productive in the negotiation. In order to incorporate Latin American values and culture, Germans would have to be more flexible and less impatient, developing warmer relationships. Sometimes these types of experiences make us more aware about our own cultures and understand that “normal” is culturally-relative.

This cultural analysis reviewed traditional practices and lessons learned in families, schools and organizations in society. We have highlighted general values and preferences, some of which are different from traditional ones, in these regions. However, generalizations at the cultural and individual levels are different. Individuals are distinct and unique. It should be highlighted that our data shows dissatisfaction with current cultural trends: things that Germans and Latin Americans would like to change. In particular, it seems that there is a

certain convergence between the two in several key areas. In today's global world, it is imperative that negotiators be able to understand very different cultures in order to be effective in the negotiation process, as well as enrich their own understanding.

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**APPENDIX 1**

*Questionnaire No. 1*  
*Formal International Negotiation*

Name of respondent \_\_\_\_\_ Nationality (culture) \_\_\_\_\_

Country/culture the respondent negotiated with: \_\_\_\_\_

Company/Organization \_\_\_\_\_ Date of the negotiation \_\_\_\_\_

Name of the interviewer \_\_\_\_\_ Date of the interview \_\_\_\_\_

Recall your negotiation experiences in other countries. Think of a former experience that has been particularly significant.

- Specifically, think of one concrete formal negotiation (purchase or sale, conflict resolution, discussions to reach an agreement, etc.) where you participated and that involved people or entities from two countries.
- What were the previous issues (interests) leading up to this negotiation? (What would have happened to each party if no agreement was reached; what were their alternatives? BATNA) What were the main options for each party?
- How did you and they prepare for this negotiation? What were the pre-negotiations, how did they approach you?
- How did you decide who was going to negotiate, what would be on the agenda and where would the negotiation take place?
- How did the negotiation begin? (Was it a haggling/bargaining process with an excessive opening demand?) Who opened the negotiation? How did each of the parties go about their openings? Were criteria and or objective criteria sought or established, or was it a mere bargaining of positions?
- What were the main events in the process? How did you get to the most important points?
- How was the deal closed? Was it a good deal? (satisfactory to both parties, took a long time, etc.)

- What about this experience called your attention the most? What did you like the most? What did you like the least? Do you think people from the other country are similar to you? (in what respect?) Different from you (in what respect?) What are they like?
- Do you think this was a typical experience? Have you had experiences that differ much from this one? (with people from the same country or culture)
- What advice would you give someone (a colleague or a friend) going to this other country to negotiate?
- In brief, how do people from that country usually negotiate? What is the difference between that culture and yours that you experienced in the negotiation you just recounted?
- If you had to do this negotiation again: would you change your behavior? What would you do differently and why?

## GREEN ECONOMY: THE CASE OF SUSTAINABLE BUILDING CLUSTER IN GREECE

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### **Abstract**

The aim of the present original for the Greek standards research, was to reach the necessary conclusions in order to detect the critical mass of the professionals who really wish, either to get actively involved or to support the establishment of a sustainable building cluster, which will contribute in green economy.

For the present research, which was made in mid of 2010, the methodology followed was this of editing, gathering and processing, of questionnaires specially constructed for the purpose of the study. The questionnaires were addressed to businesses and organizations that are directly or indirectly involved to the establishment of the sustainable building cluster. The data were processed and analyzed using SPSSWIN ver 17.0 and the relative statistical tests of Frequencies, Descriptives and Crosstabs, independence tests between all variables using X2 criterion, correlation analysis and analysis of variance (t-test), and content validity tests of the variables used in the questionnaires were also made.

Greek enterprises estimate that the wave of “green buildings” is coming to Greece. Most of them are forecasting that in the next 5 years this will be institutionally established and they are getting prepared for this.

The targets set from the most Greek enterprises, in order to support the sustainable building cluster and to be supported by it, are mainly focused on the development of new innovative products, on the improvement of the quality of the products that they produce, on their conformation to environmental legislation and on the improvement of their business' image/fame, on the reduction of pollutants and wastes and on the reduction of production cost.

For the development of sustainable building in Greece, the factors that have been found to play the most significant role and on which attention should be paid by Greek cluster's enterprises, seem to be: the economic situation of the country, the appointment of advantages and benefits for the users of new “products” of sustainable building, the implementation of appropriate and effective ways of publicity, promotion and advertisement of sustainable building, and the support of the investment from financing programs.



Clusters are gaining continuously growing significance and they can play a fundamental role towards the direction of “green economy”, and the improvement of innovative and entrepreneurial landscape of a country in the basis of cooperation and synergy creation of Greek construction companies and related organizations, in order to overcome the consequences of the national and global economic crisis and secure a further development.

This research is the first one in Greece, trying to investigate the critical factors that are incorporated and shape the meaning of sustainable building in Greece, in the light of economic crisis, but also investigating the challenges that arise for green economy and development.

**Keywords:** green economy, clusters, sustainable building, environment, entrepreneurship, sustainable development, innovation

## **Introduction – Aim of the Study**

### **Sustainability towards a green economy and entrepreneurship**

The update of European strategy, as it was expressed through the review of Lisbon strategy with “Europe 2020” strategy, is aiming to the exit from the economic crisis and the preparation of the E.U. economy for the next decade (Rizzuto, 2011; European Commission, 2010; European Policy Center, 2010; Erixon, 2010; Frazer et al., 2010). Among others, priority will be given on: a) connection between innovation with R&D, b) the efficient use of E.U. resources, in order to attain a low carbon emissions economy and c) the promotion of entrepreneurship and the development of new skills for the creation of millions of new jobs across Europe.

In the framework of this strategy and following the Kyoto Protocol, European Union is obligated to reduce its greenhouse gas emissions per 20% till 2020 in relation to the levels of 1990. The environmental policy of all the nations that have signed the Kyoto Protocol, in which Greece is also participating, is mainly determined by actions which have to do with the reduction of human activities' contribution in climate change, and with the conformation of the countries to the commitments and the targets of the protocol, based on the National Programs of greenhouse gas emissions reduction (Saikku et al., 2008; Narayan et al., 2007; Carraro, 2000; Oberthur and Ott, 1999; Grubb et al., 1999).

The actions related to the confrontation of climate change, have to incorporate a change of the existing developing model, towards the direction of a sustainable, green economy of low or zero, if possible, carbon emissions with the use of modern technology. Besides the focusing on environmental protection, when considered a singularity, sustainable development is the result of the growing awareness of the global links between mounting environmental problems, socio-economic issues having to do with poverty and inequality and concerns about a healthy future for humanity. It strongly links environmental and socio-economic

issues (Hoppwood et al., 2005). The development of this model has to be based on, and supported by the horizontal coordination of mitigation and reconciliation policies in the sectors of energy, industry, agricultural production and many others such as the sector of constructions and building (Blakely and Leigh, 2009; Haughton and Hunter, 2003; Russo, 2003; Adams, 2001; Breheny and Batey, 1992). The cost of emissions reduction and adaptation in climate change, may seem relatively high in the beginning, but is much lower in comparison to the cost that we will have to pay because of any inaction. (Van Vuuren et al., 2006; Nordhaus, 2001; Manne and Richels, 1999).

Regarding Greece in specific, according to a recent report evaluating the cost of climate change (Bank of Greece, 2011), the most unfortunate scenario from the aspect of the tension of human climate change, corresponds to the absence of any action for the reduction of the human gas emissions that causes this change and it was characterized, according to the report, as the Scenario of No Action. In this case it is estimated that the Greek GDP will suffer a reduction, in annual base, of 2% in 2050 and of 6% in 2100. The total accumulated cost of the No Action Scenario for Greek economy, concerning the period till 2100, expressed as a reduction of the base year GDP, is up to €701 billions (in fixed prices of 2008). According to the best scenario called the Adaptation Scenario, the Greek GDP will show a reduction of 2,3% and 3,7% during the years 2050 and 2100, correspondingly, and the adaption cost it is estimated up to €67 billions. However, the adaptation measures are not able to erase the total of the losses because of climate change, they just reduce them.

The tendency in most developed countries has to do with the turn of people towards the achievement of a better life quality, the sustainable management of natural resources showing respect to the environment. Thus, the interest of the market nowadays points to the development of a continuously growing “green development”, “green economy”, “green entrepreneurship”, “green building”, especially for the small and SME's, but also to the improvement of citizens' quality of life (Allen and Malin, 2008; Berchicci, 2008; Henderson, 2007; Bansal, 2005; Brown, 2003; Milani, 2000; Pedler et al., 1996; Pearce and Atkinson, 1993).

The key of green development and economy lies to the principal of sustainability and sustainable management. At this point, we have to mention that the meaning of sustainability has been originally developed by Carlowitz in 1713 (according to Speidel, 1972) and has started being implemented by the end of the 18th century. At a next stage it has constituted the conceptual principal of the reasonable environmental management globally. Sustainable development, concerns development in such a way that satisfies the needs of today's generations, without decreasing the capability for the satisfaction of the needs of future generations (Bell and Morse, 2008; WCED, 1987; Stamou, 1985).

The Sustainable building (Radlin and Falk, 2009; Bunz et al., 2006; Russo, 2003; Anink et al., 1996) concerns the design, construction and operation of buildings and landscapes that incorporate energy efficiency, water saving, minimization of wastes, the prevention of

pollution, the efficiency of the resources of the materials that are used and the quality of life in buildings, during all the different phases of a building's life. Per definition, sustainable development, leads to "living cities" that respond to residential and environmental needs, not only through resources and energy saving, but also through the capability to support more productive, stable and innovative economies in urban areas (Haughton and Hunter, 2003).

Greece, incorporating these policies to its residential development, legislates in favor of a more environmental friendly building and house activity. The energy demand of the house sector in Greece, is expected to show a relatively small increase during the next years, mainly because of the relatively small increase of population and of the introduction of more efficient energy technologies (National Program of greenhouse gas emissions reduction – Governmental Paper A'-58/5-3, 2003). The average annual increase of energy consumption in the sector during 2000 - 2020 is expected to reach 1%. Energy activity is improving with an average annual rate of 1.9% (National Program of greenhouse gas emissions reduction – Governmental Paper A'-58/5-3, 2003).

After the previous analysis, the question that rises as a challenge for Greece is: Can sustainability and entrepreneurship in building and construction sectors constitute a common platform of policies and business strategies approach, for a greener economy?

The answer has already been given through the already implemented policies, in the framework of NSSF 2007 – 2013 (National Strategic Statement Framework) and the Sector Programs "Environment – Sustainable Development" and "Entrepreneurship and Competitiveness". The main development object concerns the protection, improvement and sustainable management of natural environment, in order to comprise the background for the improvement of citizens' quality of life as well as to contribute to the improvement of competitiveness of Greek economy. At the same time, the improvement of the Greek business and production system's competitiveness and extroversion is being aimed, with significant emphasis being given on innovation through the promotion of the National Research, Development and Innovation System, on the products' quality improvement and on the promotion of business clustering.

### **The role of clustering**

At the same time, more positive results are being observed, concerning firms of many economic sectors, which are collaborating and participating into a cluster and thus this participation is recognized as a valuable tool for economic development (European Cluster Observatory, 2010; National Observatory of SME's, 2009; European Commission, 2005, 2006 and 2007; Cortright, 2006; Robinson, 2002; Rosenfeld, 1997; Malmberg *et al.*, 1996). The growing focusing on clusters and innovation systems, reflects the importance of specific initiatives at a regional level, that will become the driving force of innovation capabilities and

of business competitiveness (Trigkas, 2010; Makios *et al.*, 2006; Gordon and McCann, 2005; Pittaway *et al.*, 2004; Prastakos *et al.*, 2003).

Porter (1990), describes the cluster idea in the light of the “*diamond of competitive advantage*” which reflects the meaning of a cluster and how the position of an enterprise into it affects its strategy and productivity. The four elements of this diamond incorporate factors dealing with the enterprises resources, demand factors, related and supporting industries and enterprises and finally, the business strategy, its structure and its competition.

According to the Hellenic Organization of SME's and Craftsmanship and the National Observatory of SME's (2009) as clusters are defined “*groups of competitive enterprises, usually established in neighboring regions, which interact aiming to economies of scale (common procurement, logistics, storage etc.), to resources access (capital markets, development and transfer of knowledge, specialized personnel), to direct and accurate information and in general to initiatives undertaking regarding the reduction of production cost, and the improvement of business - participants operation and competitiveness*”. In these clusters, besides the enterprises – participants (known as body enterprises), supporting enterprises and organizations are also participating, such as industries' associations and professional chambers, technological institutions, research centers and universities, governmental organizations, financing organizations, network brokers etc. which offer services of a horizontal character towards the cluster participants.

A cluster is formed by the participating enterprises, but also constitutes an separate operational entity, institutionalized or not. Each successful cluster, implements more effective activities that either the enterprises – participants were promoting individually, or were not promoting at all till now. These activities aim to the participants' enhancement, as well as to their external business environment enhancement, from which the cluster takes resources and capabilities (National Observatory of SME's, 2006).

Clusters are mainly composed by enterprises that are operating in the same economic sector (*horizontal clusters*) or into different sectors of production process, meaning that they belong to the same logistics (*vertical clusters*). Those enterprises are called either “enterprises-participants” or “body enterprises”. Clusters are located to a specific geographic region, since the neighboring facilitates communication, inter transportations but also business interacting (Shields, 2003). But if business transactions are not affected by geographic distance, clusters may be developed in wider geographic regions. Thus, clusters exist at local, regional, national an international level. Clusters may also be developed in an urban and agricultural environment.

*Industrial clusters* constitute a total of enterprises and related financial organizations which are located close to each other (Cortright, 2006; Shields, 2003). These neighbouring enterprises often enjoy advantages regarding their production, because of this specific neighbouring (Cortright, 2006).

The importance of clusters is underlined also by O.E.C.D. (2002) through the investigation of the way in which business clusters help innovative activity of enterprises through knowledge flows, new ideas and information inside the cluster, under the framework of a wider innovation system. Cooperation with innovation organizations, in the framework of such a system, gives competitive advantages to the enterprises since the cooperative organizations have the capability to provide specialized know how towards the enterprises, specialized personnel, financing opportunities and R&D for the production of new products (Trigkas, 2010; Drucker, 1985). For that reason, we can state that innovation systems are constituted by: a) the enterprises of a cluster along with the supportive units, b) innovation organizations, c) interactions between all the above.

The key for success of such an innovation system is the way that the above mentioned organizations and enterprises are interacting in such a network (Pittaway *et al.*, 2004) as well as individual elements such as, the applied policy, the existing legislation, infrastructures, the capability for market financing and development (Woolthuis *et al.*, 2005).

Also, firms that are already exporting their products, are more supportive to the establishment of a cluster, while the absence of new products development, the low promotion of products, the weakness of exporting and the tendency of focusing only on low prices of products as the only competitive advantage, are the most important problems in decision making regarding the creation of a cluster (Papadopoulos *et al.*, 2008).

A related study that was conducted in Greece concerning the establishment of a cluster for small enterprises has shown that, the main objective of businessmen participating into a cluster, is the growth of competitiveness through the implementation of new innovative activities for the promotion and development of new products, while their priorities concerning decision making in investing, are the improvement of quality, of productivity and the development of marketing (Karagouni *et al.*, 2009).

The European Community directions for the coherence policy of 2007-2013, have as a target the improvement of knowledge and innovation in the basis of economic development (GSRT, 2007). Concerning the growth and the improvement of investments for research and technological development, one of the priorities that have been set, is the enhancement of cooperation between enterprises and between enterprises and public institutions of research/higher education, supporting the establishment of regional and inter regional clusters of excellence (GSRT, 2007; National Observatory of SME's, 2006).

According to a recent report of the European Clusters Observatory (2010), clusters constitute a fundamental part of the European economic reality but also of the policy for innovation and entrepreneurship, as mentioned. The benefits of clustering concern the achievement of economies of scale and scope, reduction of transactions cost, increase of interactions and cooperation between the enterprises based on confidence relationships, reduction of costs because of specialized occupation, business services, products and raw

materials, public investments for the satisfaction of specific sectors' needs, creation of markets for the satisfaction of specific products' needs. Furthermore, clusters are recognized as the driving force for innovation through knowledge flows between its members both because of their geographic closeness as well as through the creation of new knowledge.

### **Perspectives of a sustainable building cluster in Greece**

According to the above, sustainable building cluster rises as a new form of economic activity, having as a core the private green entrepreneurship, in cooperation with universities, research centers, organizations etc. aiming to the development of cooperation and in extension the maximization of environmental protection, the improvement of business environment, but also as a new opportunity for competitive advantage and implementation of national strategic policy for a green economy. This new tendency and reality should be used by the Greek enterprises (producers, suppliers, scholars, constructors), but also by the citizens who wish to participate into a sustainable building network, in order to modernize the way of doing business and gain themselves significant and multiple benefits that will rise from this specific action.

In the construction and related activities sector, a significant number of clusters across Europe is operating, which shows the potentials of the sector. If we include also, the number of clusters concerning further elements of construction – building sectors (wood, metal, aluminum, electric materials, real estate etc.), it is obvious that at a European level there is a significant perspective of clustering development (European Commission, 2007).

In Greece, according to the report of European Cluster Observatory (2010), there is great specialization in the construction sector, where a significant number of employees are being occupied, with the rest of the sectors to follow. Regarding the regions where this accumulation exists, Attica stands in the first position with Northern and Central Greece, Aegean islands and Crete following (European cluster observatory, 2010). In Greece, very few cooperative structures are operating comparatively to the rest European countries.

### **The construction sector in Greece**

The construction sector in Greece consists one of the most dynamic sectors of economic activity having a total Gross Added Value in current prices for 2009 up to €9.581millions (Greek Statistic Service, 2010). In a GDP percentage, it is up to 4% for the same year. Counting in the data concerning related sectors of economic activity (ICAP, 2009 and 2008), which are in a direct or indirect relation to building sector, such as manufacturing industries, real estate, financing sector etc. it is obvious that the constructions and related sectors hold a significant percentage of total national GDP and occupation.

The data concerning the basic financial figures in the construction sector of Greece (Greek Statistic Service, 2010), show the clear upward tendency of the sector for the period 2000 – 2007. Thus, during 2007, in Greece 108.829 firms were operating in total, occupying 304.589

employees, which is a very significant number. The percentage change for the specific period is up to 35,5% concerning the number of firms, 42,4% for turnovers from constructive activities and up to 65,1% for the turnovers from building activities. It is considered that in general, the course of the numbers is positive, at least until the period before the financial crisis of 2008.

Nevertheless, the above positive ambience in the construction sector was inverted by the recent economic crisis. The positive course of the sector was inverted from 2006 and hereafter while a dramatic decline occurs since 2008, whereon the effects of the crisis start to become visible in Greece too. The negative effects of the crisis that the Greek construction and building sector experiences can be understood better, considering the figures of the decade 2000 – 2009. For this period, the percentage change of the number of buildings was -22,1%, of number of floors -26,8%, of volume -29% and of their surface -29,7%, while their value has changed 74% showing a positive sign, which shows the great increase of the estate value, beside the reduction of demand.

The situation seems to get worse in a dramatic way during 2010, after the recent financial measures in Greek economy. During the period of May 2009 – April 2010, the total building activity index (private and public), has shown a decline of 12,1 % concerning the number of building licenses, of 22,0% concerning surface and of 26,0% in volume, in relation to the corresponding period of May 2008 – April 2009. During the same period of May 2009 – April 2010, private building activity index shows a decrease of 12,2% in total concerning the number of issued building licenses, of 22,5% concerning surface and of 27% in volume, compared to the corresponding period of May 2008 – April 2009.

The above mentioned data, underline the imperative need that exists in the sector concerning the enhancement of production activity, the boosting of demand and competitiveness of the Greek constructive enterprises, in order to be able to successfully overcome the difficult economic circumstances, reversing the present negative ambience and boosting economic development of the sector and of the country in general.

The aim of the present original for Greece research, was the extraction of the necessary conclusions in order to study, at a first stage, the demand of “green buildings” and then to detect the critical mass of professionals who really wish, either to get actively involved or to support the establishment of the sustainable building cluster, as well as to indicate the importance of individual factors and obstacles considering the cluster’s operation and to investigate, in what way this could contribute towards green economy in Greece.

## **Methodology**

The research was based on the collection of primary data from statistical databases, which were processed, analyzed and their results were presented, regarding the quantitative data of the mentioned cluster, such as the construction sector, building activity etc.

The implementation of a specialized research followed, concerning clusters and sustainable building in Greek market. For the data collection of this original research, as a method, the one of editing, collecting and processing of specially constructed for the purposes of the study questionnaires was used, according to the basic principles of marketing research, responsibility, transparency, validity, perception and connection to strategy (Gordon and Langmaid, 1988; Tull and Hawkins, 1990; Doyle, 1998; Aaker *et al.*, 2004; Papadopoulos *et al.*, 2010).

The questions that were used, were aiming to originally study the factors of demand, knowledge, willingness and philosophy of the involved stakeholders (scholars, manufacturing industries, suppliers, constructors, research centers, universities, institutes, organizations) concerning the establishment of the sustainable building cluster.

The potential participants of the cluster, who constituted the study's population, were categorized in 5 major groups. The 1<sup>st</sup> group contained the materials production industries such as: wood, steel, concrete, gravel, glass, asphalt, plastics, petrochemicals etc. In the 2<sup>nd</sup> group belong the frames manufacturers, furniture, plumbing, electrical, sanitary, floors, solar collectors' manufacturers etc. The 3<sup>rd</sup> group contained the dealers and suppliers of timber, steel, aluminum, concrete and other raw materials. The 4<sup>th</sup> group was composed by civil engineers, architectures, decorators, constructors – contractors, real estate corporations, brokers etc. Finally, the 5<sup>th</sup> group contained organizations that belong to the category of the cluster supporters, which are the government and innovation supporting organizations, organizations that legislate, promote and educate and more specifically Universities and Technological Educational Institutes, Research Centers, Chambers, Developing Agencies, Public Organizations, Consultants etc. Two different questionnaires were created, with many common questions, the one of which was addressed to the enterprises and the other one to the organizations.

The questionnaire was pilot addressed to 5 enterprises and experts with experience in clusters. From this pre sampling these questions that needed to be rephrased were detected, and thus the quality of the questionnaire was improved, taking its final form (Dillman, 2000). The time period of questionnaires collection was August 2010. Finally, 33 enterprises and organizations responded, and thus the research sample is considered adequate (>30) for the extraction of reliable conclusions.

The data were edited, processed and analyzed through the specialized statistic package SPSSWIN ver 17.0 and all the relative statistical tests were made such as frequencies, descriptive and crosstabs, independence tests between all variables using the X<sup>2</sup> criterion, correlation analysis and analysis of variance (t-test), as well as questionnaires' content validity and credibility (Norusis, 2007; Howitt and Cramer, 2003).



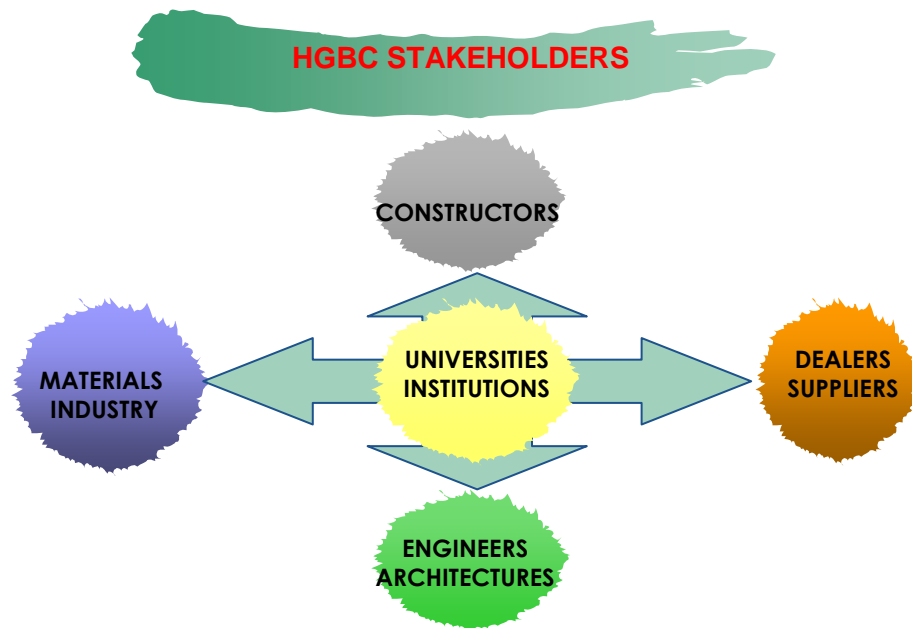


Figure 1: Groups of enterprises and organizations of the study

## Results

### Evaluation of the sustainable building demand in Greece under the framework of green economy

The organizations and enterprises participating to the relative market study that has been conducted, believe in total that the construction of single “green buildings” (buildings that have the minimum possible energy consumption and use environmental friendly materials) could create a general positive “tendency for sustainable building” in Greece too.

Only some variations exist, concerning the time that the above mentioned “movement” will be developed in a significant level in Greece too, with the existence of an sufficient number of “green” buildings. The majority of the organizations and enterprises of the research (53,6%) believe that “green” buildings will be able to be established in Greece in the next 5-10 years. The most optimistic (29,8%) forecast that this “movement” will be established in the next few years (1-5).

The findings concerning the increase or not of the demand for sustainable building internationally during the last years, is that an increase has been observed in a moderate and satisfactory rate. The factors which have been observed to be altered concerning the demand for sustainable building, as well as their alteration rate, are shown in Table 1. These that have been altered in a moderate level are the enhancement of the media’s role, the enhancement of the role of environmental training and the financing of related activities.

The Pearson correlation analysis concerning the alterations of the demand factors for sustainable building has shown that:

- The more this kind of activities is financed, the more the number of certified professionals, the number of certifying projects and acquisition of experience and

know how from the industry in subjects of sustainable building is increasing (Pearson correlation coefficient = 0.604, 0.721, 0.562, 0.475 respectively at a significance level of 0.01, 2-tailed)

- The more the number of certifying projects in subjects of sustainable building increases, the bigger the number of certified professionals, the number of certified buildings and the acquisition of experience and know how from the industry will also be, (Pearson correlation coefficient = 0.818, 0.796, 0.635 respectively at a significance level of 0.01, 2-tailed) and
- The more the movement of “green buildings” is getting stronger, the more several business opportunities are being developed, corporation schemes are being enhanced along with environmental training and the role of the media is also getting bigger (Pearson correlation coefficient = 0.564, 0.649, 0.547, 0.548 respectively at a significance level of 0.01, 2-tailed).

Table 1: Alteration rate of sustainable building demand during the last years (ranking 1-7, with 1 = not at all, 4 moderate and 7 in a very high rate)

FACTORS	Mean	Std	t-test
Enhancement of the media's role	4,07	1.44	15.5
Enhancement of the role of environmental training	4,04	1.46	13.3
Financing of activities	3,90	1.78	11.2
Acquisition of experience and know hoe by the industry in sustainable building subjects	3,73	1.55	13.2
Development of entrepreneurial opportunities in Greece and abroad	3,63	1.54	12.9
Enhancement of the “sustainable building” movement	3,60	1.61	12.2
Number of certified professionals in sustainable building subjects	3,47	1.48	12.8
Development of corporation schemes in sustainable building subjects	3,41	1.48	12.5
Number of certification projects in sustainable building subjects	3,32	1.47	12.0
Acquisition of experience and know how by the consumers in sustainable building subjects	3,03	1.45	11.5
Number of certified sustainable buildings	2,76	1.60	9.3

In a percentage of 93,3% it is considered that sustainable building will increase the construction price of buildings in relation to the conventional building, in an average percentage of 12,5% approximately. More specifically, this percentage of increase is estimated up to 5-10% from the majority of those questioned (46.4%).

Since it is forecasted that sustainable building will increase the construction of buildings price in relation to the conventional ones, it is of great importance to investigate the percentage of increase that Greek consumers are willing to pay in order to gain the benefits (direct and indirect) from a construction that will be created under the principals of

sustainability. This percentage is estimated up to 7% approximately by those questioned in the research. The majority (82.8%) considers that this percentage can not overcome in any case 10% (Figure 2).

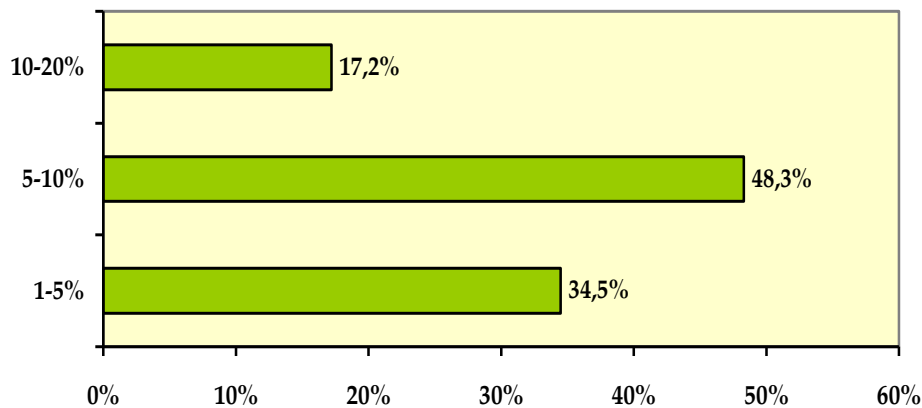


Figure 2: Percentage % that is estimated that the consumers are willing to pay extra in order to buy or construct sustainable buildings

The benefits that the users of buildings that have been built according to the principals of sustainable building seem to enjoy, are at least the following:

- Greater energy efficiency in a percentage of 20-50% (from the 66.7% of those questioned), or 44.7% in average.
- Greater water saving in a percentage of 10-20% (from the 43.3% of those questioned), or 28.6% in average.
- Minimization of wastes in a percentage of 20-50% (from the 33.3% of those questioned), or 32.0% in average.
- Better prevention of pollution in a percentage of 20-50% (from the 39.3% of those questioned), or 50.3% in average.
- Better efficiency of resources, concerning the materials used in a percentage of 20-50% (from the 46.7% of those questioned), or 37.4% in average.
- Better quality of life in a percentage of 50-75% (from the 43.3% of those questioned), or 51.3% in average.

Approximately 5,000 are the enterprises that constitute the industry of sustainable building that can be developed in Greece in the next years. The main characteristics of this industry which seem to affect in a greater, average and smaller rate the development of sustainable building, have mainly to do with:

- The prices of the environmental friendly materials
- The customers and the prevalent public opinion
- The import of new products with environmental characteristics

- The environmental legislation that affects the sectors dealing with building activity
- The existing demand for products with environmental characteristics

For the development of sustainable building in the Greek market, the elements which seem to play a very significant role and should be carefully attended by the Greek firms of the cluster, are: a) the economic situation of the country, b) the appointment of advantages and benefits for the users of “new” products of sustainable building, c) the implementation of appropriate and effective promotion and publicity methods for sustainable building and d) a set of other elements mentioned in the following Figure 3 which worth to be taken seriously into consideration, by the decision makers that will take the related decisions about the creation and operation of the sustainable building cluster.

The Pearson correlation analysis concerning the alterations of the factors affecting the development of sustainable building in Greek market, has shown that:

- The greater the economic crisis of the country is, the more significant is the institution and the implementation of a legislation framework, for the development of sustainable building and the allowance of motivations and investment support from financing programs (Pearson correlation coefficient = 0.677 and 0.428 respectively at a significance level of 0.01, 2-tailed)
- The support of investment from financing programs should be accompanied with the institution and implementation of the legislation framework concerning subjects of sustainable building (Pearson correlation coefficient = 0.533 at a significance level of 0.01, 2-tailed),
- The bigger the competition between enterprises for sustainable building is, the more significant is the factor of market studies implementation (Pearson correlation coefficient = 0.617 at a significance level of 0.01, 2-tailed),
- The bigger the investment for sustainable building is, the bigger the entrepreneurial venture is (Pearson correlation coefficient = 0.552 at a significance level of 0.01, 2-tailed),
- The more accurate the cost accounting of sustainable building is, the better and more significant as a factor will the pricing of the “product” be (Pearson correlation coefficient = 0.664 at a significance level of 0.01, 2-tailed) and
- The better the business organization is, the more significant the implementation of market studies concerning sustainable building is, as well as, the more appropriate the information of salesmen for the comparative advantages and the specific characteristics of sustainable building is (Pearson correlation coefficient = 0.588 and 0.671 respectively at a significance level of 0.01, 2-tailed).

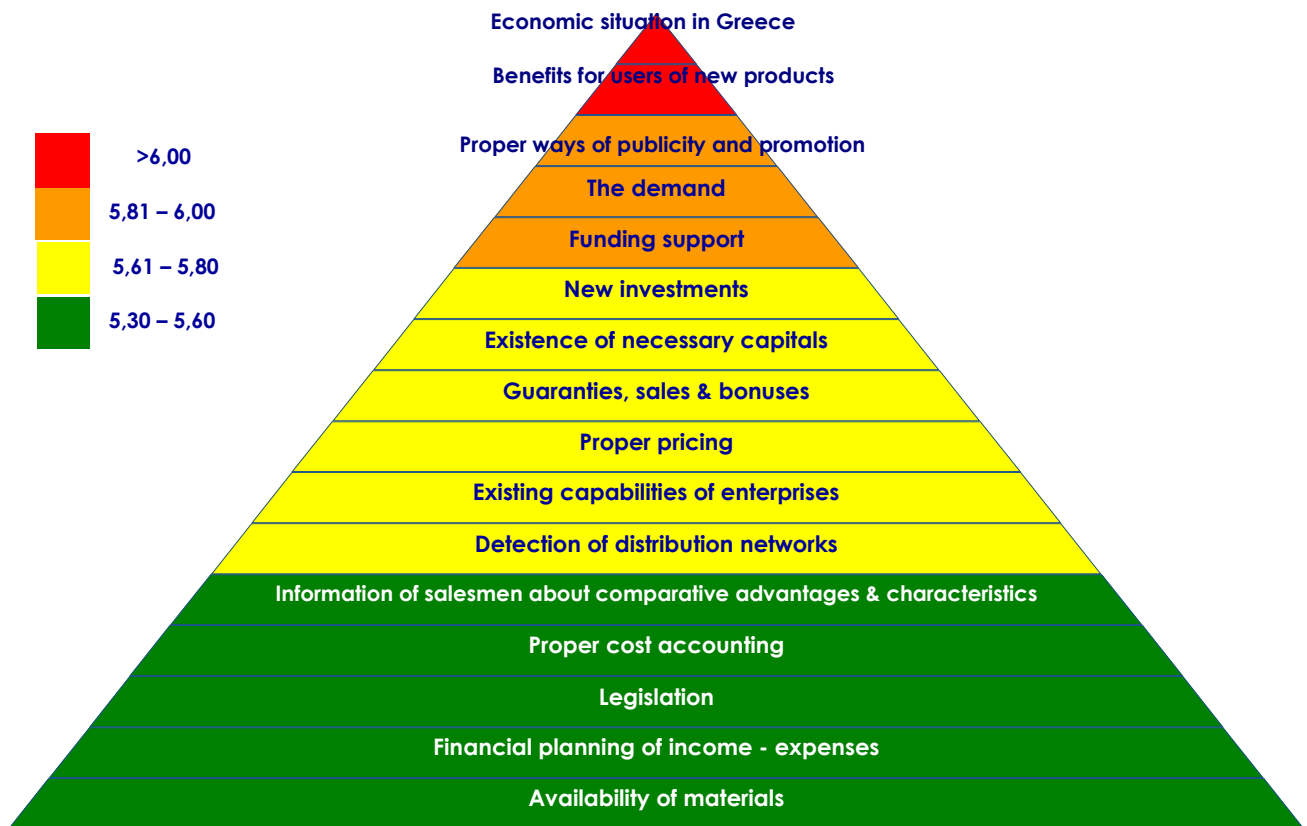


Fig. 3: Significance of sustainable building development factors in Greek market (7 the most significant)

Unfortunately, Greek enterprises are operating in an environment which creates many serious obstacles for their entrepreneurial activity. The most significant of them, that the present study has shown, seem to be in declining ranking: bureaucracy during the establishment as well as during the operation of enterprises, the intensely observed in nowadays economic uncertainty, the corruption of the system especially concerning public services as well as the operation of the banking system for the granting of the needed working capital for the enterprises, their financing, as well as the level of interests rates (Table 2).

Especially the factor of economic uncertainty, seems to be significantly statistically correlated to the implementation or not of exports by the enterprises which are going to participate in the sustainable building cluster, according to  $X^2$  test (Pearson  $X^2 = 3.027$ , Cramer's  $V = 0.323$  for a significance level greater than 90% Approx. Sig= 0.099). This means that the enterprises that export, are directed towards this activity when there is economic instability in their headquarters' country.

Also, enterprises which were established before 2000 consider the absence of information from related organizations, as a very significant obstacle for the development of their entrepreneurial activity. On the contrary, the existence of per chance political instability, doesn't constitute an obstacle for exports. Finally, corruption constitutes a more significant obstacle for the smaller enterprises (that occupy less than 10 employees).

Also, enterprises which were established before 2000 consider the absence of information by related organizations, as a very significant obstacle for the development of their entrepreneurial activity. On the contrary, it doesn't constitute an obstacle for exports the existence of per chance political instability. Finally, corruption constitutes a more significant obstacle concerning smaller enterprises (that occupy less than 10 employees).

*Table 2: Main obstacles in developing entrepreneurial activity of the Greek enterprises which could participate in the sustainable building cluster, until today*

FACTORS	AFFECTION RATE
<i>Bureaucracy</i>	62,1%
<i>Economic instability</i>	51,7%
<i>Corruption</i>	50,0%
<i>Operation of the banking system</i>	41,4%
<i>Institutional framework of business and labor legislation</i>	34,5%
<i>Absence of market</i>	17,2%
<i>Competitiveness arrangements</i>	13,8%
<i>Political instability</i>	10,3%
<i>Absence of information organizations</i>	10,3%
<i>Transparency</i>	6,9%

Seeking financing sources for economic enhancement and support for environmental activities of the sustainable building cluster enterprises, it seems that Greek enterprises are focusing mainly on European Union which supports and co finances them (Figure 4). Financing by the firm's own sources seem to stand relatively high in the list of financing sources. This means that the study's enterprises don't hesitate, and some of them have proven it until today, to use part of equity capitals, for the financing of environmental activities, boosting this way their social accountability.

In order to find connections among financing sources for economic enhancement of environmental activities of the study's enterprises, the Pearson correlation criterion was implemented. The analysis has shown that in order to receive financing from the European Union, financing from the central government of the country should respectively exist (Pearson correlation coefficient = 0.729 at a significance level of 0.01, 2-tailed). Of course the existence of the above mentioned financing is negatively correlated to the individual financing of enterprises (Pearson correlation coefficient = -0.417, at significance level of 0.05 level (2-tailed).

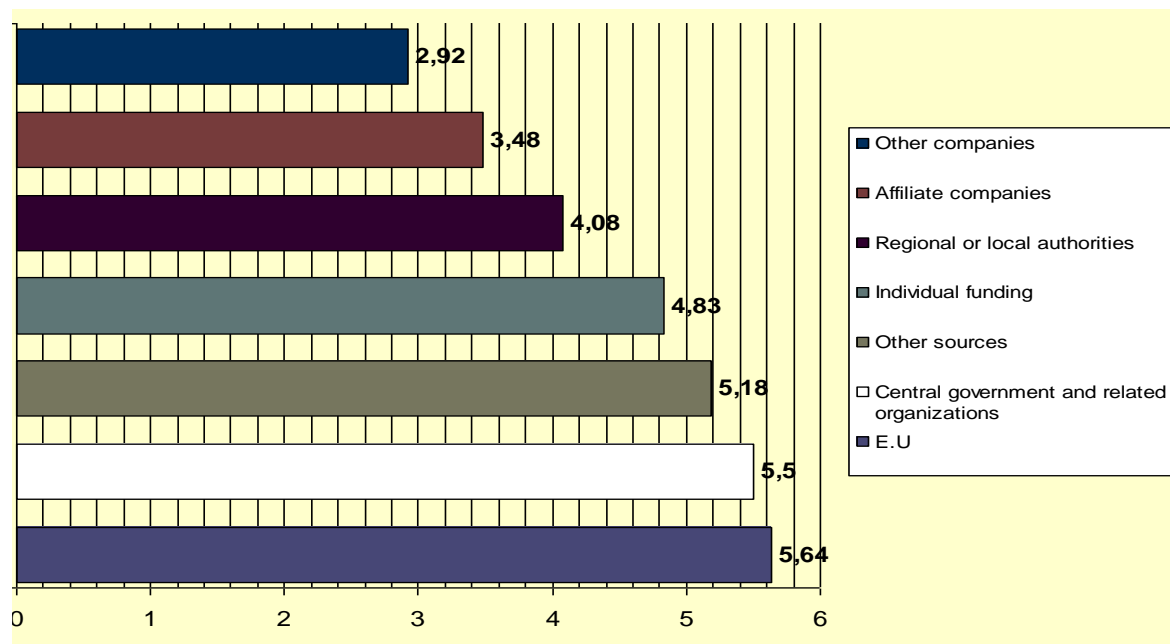


Fig. 4: Funding sources of Greek enterprises that could participate in HGBC for their environmental activities and evaluation of their significance (7 the most important factor)

Regarding the development of a specific policy for the effective implementation of sustainable building for the enterprises themselves, the factors that seem to play a fundamental role are: the adoption of innovation strategies and culture (mean 5.82 with max 7.0), the leadership and management of new ideas (5.75), technology and information systems (5.75) and the development of new co operations with foreign firms (5.52). A minor role, but at an important level, seem to play the easy access to new markets (5.41), the engineering corporations (5.39), research institutes and the rest academic institutions (5.38), specialized personnel and certified staff (5.29), as well as construction companies (5.00). In a small rate, appears the role of external business consultants (3.70).

Good leadership and appropriate management of new ideas for the development of sustainable building seems to be significantly statistically correlated to the choice of specialized personnel in their firm (Pearson correlation coefficient = 0.597) and to the adoption of innovation strategies and culture (Pearson correlation coefficient = 0.557. Correlation is significant at the 0.01 level (2-tailed). Furthermore, the adoption of innovation strategies and culture is positively correlated to specialized personnel of the sustainable building cluster enterprises (Pearson correlation coefficient = 0.647 at significance level of 0.01).

On the contrary, the main obstacle for the development of a specific policy regarding sustainable building seem to be the absence of appropriate financing sources (mean = 5.79, max = 7), at least until today (Figure 5). In high ranking stands also the factors of: a) the very high cost of the alterations needed, and should be made by the enterprises themselves (mean = 4.93), b) the absence of customers response in new products and services (4.82), since until today no kind of a significant promotion towards the public opinion about sustainable building subjects has been implemented, c) the very long period of the necessary investment's return on capital (4.81), d) the absence of know how and innovation flow organizations, in the building sector (4.79) and e) the existing weaknesses of the Greek legislation framework (4.75).

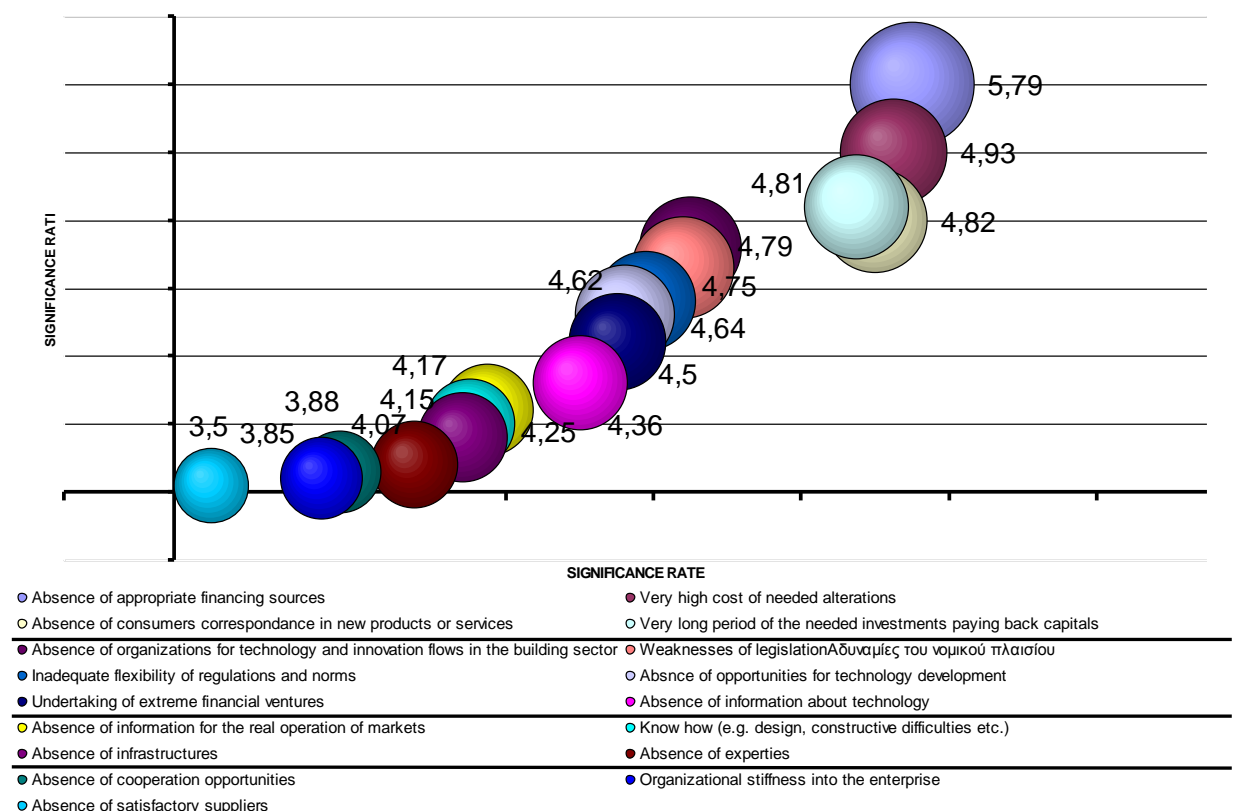


Figure 5: Significance of obstacles for the development of a policy for sustainable building, of the Greek enterprises that could participate in the sustainable building cluster (ranking 1-7, with 1 = not significant, 4 moderate and 7 very significant)

A very important parameter for the establishment of the sustainable building cluster is the intension and the willingness of the enterprises and related stakeholders to develop co operations between them. The present research has shown that the total (100%) of the participants develop such co operations, which is very encouraging for the cluster's first establishment.

From the up to date activity of the research participants, it seems (Figure 6) that the most important co operations are those with customers (mean=5.25, max=7.0), with construction



companies (5.09) and with engineering companies (4.92). Good seem to be also the co operations with governmental or private non profit research institutes (4.55), with R&D enterprises (4.45), as well as with Universities and TEI (4.45). In a moderate rate until today, co operations are being developed with other enterprises of the same sector (3.91), as well as with their competitors (3.67). Through the participation of the enterprises and organizations in the sustainable building cluster, co operation between them will be necessarily developed and their benefits will be multiplied.

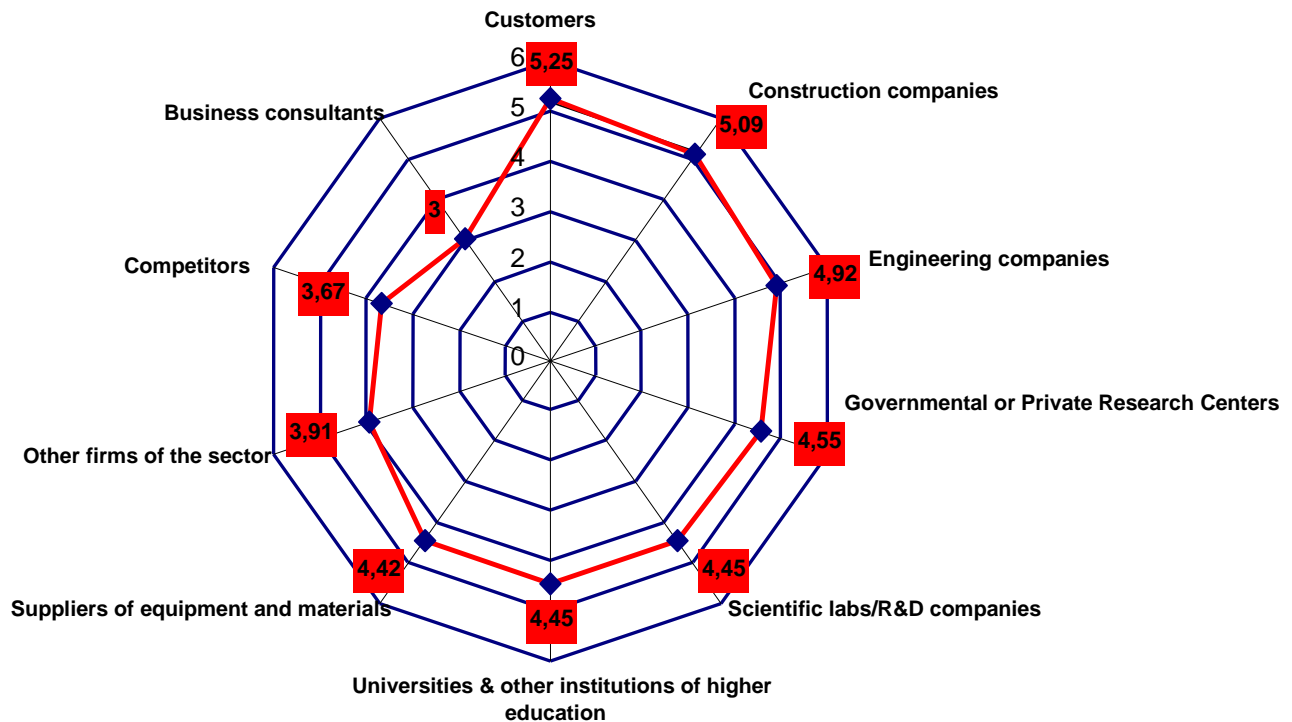


Figure 6: Co operation degree with several organizations of firms that could participate in the sustainable building cluster (ranking 1- 7, where 1= any, 4 = moderate, 7 = very much)

Seeking the short-term, mid-term and long-term demand and development of sustainable building in Greek market, it is estimated that the population percentage that will respond to the institution of sustainable building will be: in short-term (1-2 years) 4.7%, in mid-term (5 years) 11.3% and in long-term 27.6% per weighted mean. The greater percentage (41.4%) of those questioned estimates that in short-term 3-5% of Greek households will response , 44.8% estimates that there will be a response in 5 years from 5-10% of them, while in 10 years there is a great optimism that the response will reach the percentage of 10-20% in average from 27.6% of them (Figure 7).

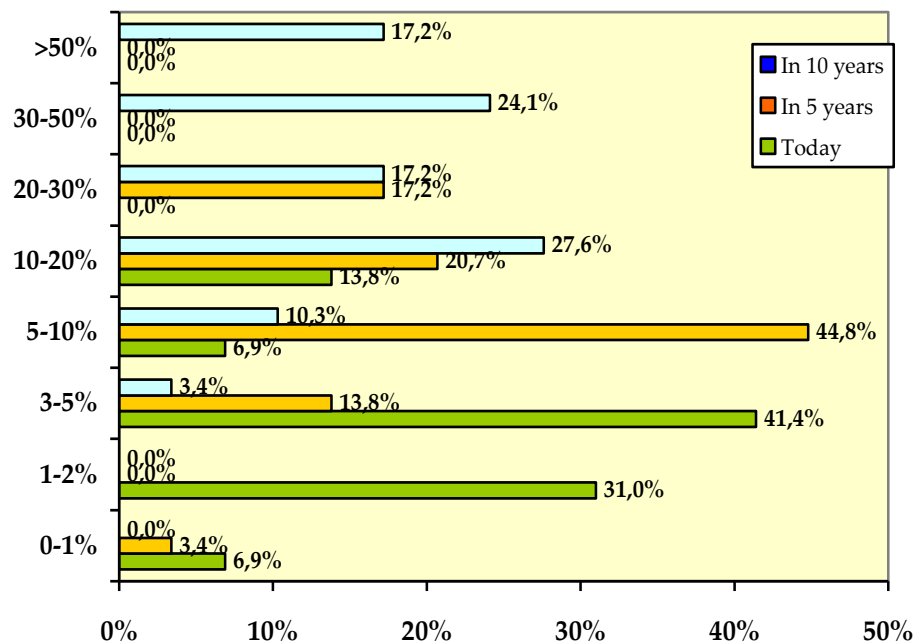


Figure 7: Percentage % that the enterprises which are going to participate in the sustainable building cluster, consider that the Greek population will correspond to the institution of sustainable building today, in the next 5 and 10 years.

Households which are estimated to respond directly to the institution of sustainable building, are in a percentage of 75.9% those of higher income and only in a percentage of 20.7% the smaller and lower income households. This is logical, because in times of economic crisis someone wants to ensure his survival first, and then to get interested for the environment (internal and external) in which he spends his life. By the end of the economic crisis, which is estimated in the next 3-5 years, sustainable building will expand to all income classes. Therefore, the economic crisis does not constitute an restraining factor for the development of sustainable building, at least in a mid and long-term period, since based on the previous result of the present study, the market – target has been determined.

## Conclusions - Proposals

The building sector which includes many other sectors and subsectors holds a very high and dynamic position in Greek economy. Its problems are well known, because of the global financial crisis, but also because of the Greek economic crisis. The increase of competitiveness and environmental protection constitute basic priorities for the European Union as well as for Greece. Best practices around the world should be used in maximum. The idea that the society should live in an environment that is designed and operates incorporating energy efficiency, water saving, waste minimization, pollution prevention, increase of the efficiency of the sources in the materials that are used, but also ensuring a better quality of life inside buildings based on the principals of “green economy”, has already grown. Sustainable building with its multiple benefits for the enterprises, the stakeholders, the cooperating

organizations and the consumers that have been pointed by the analysis, constitute a direct necessity and the significance is taken for granted.

Greek enterprises estimate that the tendency for “green’ buildings is coming in Greece too. The majority of them estimate that in the next 5 years this institution will be established and they are getting prepared for this. The market study has shown that the percentage of Greek population which will respond to the institution of sustainable building in short-term period (1-2 years) is estimated at 4.7%, in mid-term (5 years) at 11.3% and in long-term (10 years) at 27.6%. But, in order this movement to be successful, the cooperation between many enterprises dealing with building is required, in the form of a cluster, enjoying all the benefits that come from that. The present research has proven the maturity of the enterprises and the directness of their participation in such a movement.

Despite any increase on buildings' construction price according to the principals of sustainable building, their implementation is worthy, if we consider the environmental and economic benefits for the users during the whole period of the building's life, as well as the consumers' intension to pay in average an amount of +7%, in relation to the conventional construction.

For the development of sustainable building in Greece too, the factors that have been detected to play the most significant role and should be especially attended by the Greek enterprises of the cluster, seem to be: the economic situation of the country, the appointment of advantages and benefits for the users of “new” products of sustainable building, the implementation of appropriate and effective promotion and publicity methods of sustainable building and the support of investment from financing programs.

Further research could be conducted in a much bigger sample of Greek enterprises and organizations that will participate in the sustainable building cluster and will contribute to the development of the Greek green economy.

The appointment of appropriate strategies that the cluster's enterprises will implement, in order to pass the message of “sustainable building” to the Greek consumers, should be the main point for the continuation of this research and the connection of its results to the present study.

Furthermore, the present research could be conducted at an international level in countries such as: Cyprus, Italy, France, Germany, Bulgaria etc. in order to have comparable data concerning the situation and the ways of effective implementation of green economy through the promotion and publicity of the green buildings movement.

Best practices and case studies could also be investigated and appointed, in order to constitute guides for the survival and development of the sustainable building cluster enterprises. Through this kind of research we will be able to detect several key points of sustainable building and successful business activity in the frameworks of the cluster such as,

financing capabilities and viability of a cluster, staff training in subjects of sustainable building as well as of citizens, protection of the household income through money saving, and development of new entrepreneurial opportunities.

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**THE INTERMEDIATE COMMUNITY: A BEHAVIORAL / BARGAINING  
APPROACH FOR CONFLICT RESOLUTION AT THE LOCAL LEVEL/ BAYESIAN  
ANALYSIS**

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**Abstract**

The paper explores the Nash' equilibrium point and the "Non Cooperative Games Theory" for extension of bargaining solution analyses, applied in the local development field.

Social trust and social cohesion conditions (sensitization process) within the Community develop the necessity of building social capital at a local level. That presupposes that the local community builds up a "new local standard," based on local people's sensitized instant reflection behaviour. By its turn, sensitized behaviour must be considered in the frame of any "bargain", between two, taking place inside the Community. "Instrumental rationality" has been proved to be the main obstacle toward the socio-sensitized behaviour in the bargain process. Hence, a scientific dialogue in the socio-philosophical level has been developed on how "instrumental rationality" should co-exist with the "sensitized behaviour" at local levels leading to a "society of citizens."

Nash' "bargaining solution" is based on binomial probabilities ( $p$ ,  $1-p$ ) distribution, corresponding 1-1 with those utility functions "prices" (disagreement fear factor). In its extension, which may be the paper's contribution in this academic dialogue, the author hypothesizes that the Intermediate Community (the "C" factor) produces a new behavioural type that converges the interests of both sides at a local level. By converting a

binomial distribution ( $p$ ,  $1-p$ ) into a trinomial distribution, ( $p_1$ ,  $p_2$ ,  $1-p_1-p_2$ ) combined with 3 utility function "prices", the dynamic behavioural sensitization process may converge into the integrated local development limit-end.

Thus, the resulted behaviour leads into the absolute cooperation, which steps on the same rules of globalization. The paper, then, argues that this resulted behaviour reflects the end point of the local development process.

**Introduction- the purpose**

The purpose of this paper is threefold. First, to point out the interaction between local development, as a part of social capital building in local areas and the games theory, especially, the Nash "non Cooperative Game Theory" including the bargaining problem and

focusing on conflict interests within local community, second, to formulate a quick overview on Nash equilibria in the frame of a bargain, as well as Harsanyi's Nash refinement, i.e. games with incomplete information, played by bayesian players (or condition probabilities distributions), highlighting the welfare economics vs normative economics and third, to create a base for alternative local development approach, coming from the above mentioned synthesis, so called the "win-win-win papakonstantinidis model"

### **Local Development/Welfare Economics and the Bargain**

Over past decades, the concept of local development, as well, as the "equivalent" social capital at the local level seemed to be out of the scientific dialogue, for the reason that Regional Development Science, coming from the decade of 50's (Walter Isard, 1956) was the dominant approach of the peripheries economics. Local development, mainly based on social capital building and social networks, has developed in the recent literature. Having its origins in Latin America, current interest in the concept of social capital in the field of national development stems from the limitations of an exclusively economic approach toward the achievement of the basic developmental goals: sustained growth, equity, and democracy (Alejandro Portes, Patricia Landolt, 2000). The record of application of neoliberal adjustment policies in less developed nations is decidedly mixed, even when evaluated by strict economic criteria. It was the dominant reason that a scientific dialogue open, on Normative and Welfare Economics

In the first half of the twentieth century, most leading economists [(Pigou, 1928), (Kaldor, 1939), Samuelson, 1985) etc] devoted a significant part of their research effort to normative issues, notably the definition of criteria for the evaluation (Samuelson, 1977) of public policies. The situation is very different nowadays. "Economists do not devote a great deal of time to investigating the values on which their analyses are based. Welfare economics is not a subject which every present-day student of economics is expected to study", writes (Atkinson, 2001) who regrets "the strange disappearance of welfare economics". Social capital and social cohesion at the local level with respect to physical, architectural and cultural environment, (Wilkinson K, 1991) may be proved to be the key-point for the local development process. At the same time, local people have to continuously negotiate (bargain) each-other expected to derive individual profit from this bargain. So it is necessary, costs and benefits of these negotiations be measured (Gannon A, 1991)

### **Interaction between bargain and behavior (behavioral approach)**

Dewey and Bentley, 1949 wrote that (John Dewey, Arthur Bentley, 1949): "A behavior is always to be taken transactionally: i.e., never as of the organism alone, any more than of the environment alone, but always as of the organic-environmental situation, with organisms and environmental objects taken as equally its aspect".

In this frame, is there any correlation between bargain and behavior in the bargain and during the bargain?



In his excellent book under the title “Behavioral Game Theory: Experiments in Strategic Interaction” (Colin F. Camerer, 2003) defines the behavioral games theory: “Behavioral game theory is about what players actually do. It expands analytical theory by adding emotion, mistakes, limited foresight, doubts about how smart others are, and learning to analytical game theory. Behavioral game theory is one branch of behavioral economics, an approach to economics which uses psychological regularity to suggest ways to weaken rationality assumptions and extend theory. Interaction bargain-behavior is the main assumption in this paper Bargainers behavior, is shaped by many factors, but instrumental rationality may be the dominant criterion. At any case, recent literature provides us with the relation between knowledge and behavior So, an overview is attempt (Papakonstantinidis L.A: (2005)”, as to find the relation between “knowledge transfer and knowledge creation”, in the frame of the “Modern Innovation Theory- M.I.T” (M.M Fischer, 2006 Nonaka and others) Behavior thus may resulted from this knowledge types’ synthesis, as the table

*Table: Knowledge Creation/ Information/ Types of Behavior*  
*Papakonstantinidis, 2003*

<i>Type of Knowledge-1</i>	<i>Type of Knowledge-2</i>	<i>Synthesis</i>	<i>Resulted Behavior</i>
<i>tacit</i>	<i>tacit</i>	<i>Sympathetic</i>	<i>Socialization</i>
<i>tacit</i>	<i>codified</i>	<i>Conceptual</i>	<i>Externalization</i>
<i>codified</i>	<i>tacit</i>	<i>Procedural</i>	<i>Internalization</i>
<i>codified</i>	<i>codified</i>	<i>Systemic</i>	<i>Networking</i>
<i>sympathetic</i>	<i>systemic</i>	<i>Conceptual</i>	<i>Sensitization</i>
<i>systemic</i>	<i>systemic</i>	<i>Procedural</i>	<i>Strategic</i>

The different examples of knowledge types synthesis and the resulted 1-1 behavior leads us to understand the bargain-behavior assumption, based on information given. From the other hand, bargainers information may be the dominant result of this cross-related knowledge types.

Despite Nash “complete bargainers information” Harsanyi distinguishes between complete and incomplete information, that each player has from the others bargaining behavior

Thus, the hypothesis of bargain-behavior interaction is very important in building the suggested “Intermediate Community” model: Following the Harsanyi’s Bayesian Theorem original game can be replaced by a game “where nature first conducts a lottery in accordance with the basic probability distribution” (Harsanyi (1966-revised 1967). Suggested model is mainly based on this point: In my mind, the suggested in the paper “Intermediate Community” and its “win-win-win papakonstantinidis” methodological tool is fully aligned

with the “Harsanyi’s transformation”, with a difference: original bargain between 2 can be replaced by a game, where intermediate community first conducts a lottery in accordance with the basic probability distribution. In addition, “Intermediate Community” (the “C” factor) should be seen as the result of a “new” suggested bargaining behavior, coming from sensitization process locally Papakonstantinidis L.A:2005) In this frame, Intermediate Community is given in terms of a continuous sensitization process, tending to sensitization itself, inside the community

### **Assumptions**

- The main hypothesis is that development (especially, local development) may be sighted as the output of the bargaining trends.
- Social interactions regularly lead to mutually beneficial transactions that are sometimes puzzling
- Bargaining is strongly correlated with bargainers behavior (as above mentioned)
- We could imagine the intra-community relations as a continuous bargain between 2- It is rather a dynamic “winning strategies instant reflections” game, based on competitive interaction relations
- All players have complete information about the game being played.- J. F. Nah, “instrumental rationality”, 1950
- Sensitization is a kind of “information”, making the given information complete – Papakonstantinidis, 2002)
- Each player has a subjective probability distribution over the alternative possibilities – (Harsanyi, 1967),
- If a type is associated with several states but cannot distinguish between the states, it assigns a probability distribution over the set of types. If a type is associated with only one state, then that type believes with certainty that it is in that state (Ben Danford, 2009) .
- The main assumption(Papakonstantinidis, 2004): Introducing the “Intermediate Community”, as the third bargainer in a bargain between 2 ,a new state is resulted thus converting a binomial probabilities distribution (Nash win-win equilibrium) into trinomial probabilities distribution, so that each of the three(including the community) to win [win-win-win]
- The assumption that local development is based on a continuous “sensitization process”, trending to the limit end of the process (Papakonstantinidis, 2004), through the bargain: There is an interaction between people’s (involved in each of the bargains) behavior and the bargain itself. A dynamic evolution characterizes the

interaction which will pass in next generations by the memes (Richard Dawkins 1976)

- The limit of this continuous process may be proved to be the absolute players' sensitization, leading to the absolute cooperation, which is the best strategy for all the involved players in the bargain (under the Harsanyi's condition of a perfect players information)

### **A quick overview on Nash equilibria in the frame of a bargain**

In Social Sciences, we have to define a Rule such as to meet the majority needs, without neglecting the minority needs: In math terms, we have to define a differential equation in a model, setting the "Nature", "State" in the centre and then finding losses and benefits resulted by deviation from this function-rule. This analysis provides us with knowledge in real as well as in non real situation (Papastathis, 2004). The bargain is highlighted as a "game", Decisions are concerned as "instant reflection winning strategies". Payoffs are weighting by individual probabilities distributions, by taking into consideration that each player has a complete information about the other player's information conducted their bargaining behavior (Common Knowledge of Rationality- C.K.R, Varoufakis Y, 2001).

### **The bargain – Nash (Nash J. F . (1951)**

During the decade of 40's John von Neumann and Oscar Morgenstern had developed the "zero sum two players game" theory based on "maximin-minimax" strategic decision, as the reaction to a given winning strategy, coming from the other player: Maximizing the minimum profits and/or minimizing the maximum losses. This was a full competitive idea (win-loose) useful only for the war decision making but not for piece period.

Despite the maximin-minimax Neumann approach (Neumann von J., Oscar Morgenstern, 1944) John Forbs Nash proposed in 1951 ("Non Cooperative Game Theory"-Annals of Mathematic, 1951) a "solution" to the problem of how rational players would play, to win - now called Nash equilibrium. According to Nash, a priori coalitions must be excluded, as they do not generate "pure individual strategies". In the opposite, a game (bargain) based on "instant reflection strategies" may be accepted as it generates pure individual strategies

According to the Bargaining Problem in its math expression "An  $n$  -person game is a set of  $n$  players or positions, each with an associate finite set of pure strategies and corresponding to each player  $i$  a payoff function  $\pi_i$  which maps the set of all  $n$ -tuples of pure strategies into the real numbers" (Kuhn- Nassar, 2000)

Following the literature (Kuhn W.H -Nasar S, 2001), Nash's idea, based on the idea of equilibrium in a physical system, was that players would adjust their strategies until no player could benefit from changing. All players are then choosing strategies that are best (utility-maximizing) responses to all the other players' strategies (Colin F. Camerer, 2003). Nash equilibrium is a solution concept of a game involving two or more players, in which

each player is assumed to know the equilibrium strategies of the other players, and no player has anything to gain by changing only his own strategy unilaterally. If each player has chosen a strategy and no player can benefit by changing his or her strategy while the other players keep their unchanged, then the current set of strategy choices and the corresponding payoffs constitute a Nash equilibrium (win- win situation) A game may have multiple Nash equilibria or none at all (Aumann, Robert J. 1976). ( each strategy in a Nash equilibrium is a best response to all other strategies in that equilibrium(von Ahn, Luis, 2008)

Formal definition of Nash equilibrium (B. D. Bernheim, B. Peleg, M. D. Whinston , 1987),

Let  $(S, f)$  be a game with  $n$  players, where  $S_i$  is the strategy set for player  $i$ ,  $S = S_1 \times S_2 \times \dots \times S_n$  is the set of strategy profiles and  $f = (f_1(x), \dots, f_n(x))$  is the payoff function for  $x \in S$ . Let  $x_i$  be a strategy profile of player  $i$  and  $x_{-i}$  be a strategy profile of all players except for player  $i$ . When each player  $i \in \{1, \dots, n\}$  chooses strategy  $x_i$  resulting in strategy profile  $x = (x_1, \dots, x_n)$  then player  $i$  obtains payoff  $f_i(x)$ . Note that the payoff depends on the strategy profile chosen, i.e., on the strategy chosen by player  $i$  as well as the strategies chosen by all the other players. A strategy profile  $x^* \in S$  is a Nash equilibrium (NE) if no unilateral deviation in strategy by any single player is profitable for that player, that is

$$\forall i, x_i \in S_i, x_i \neq x_i^* : f_i(x_i^*, x_{-i}^*) \geq f_i(x_i, x_{-i}^*).$$

A game can have either a pure-strategy or a mixed Nash Equilibrium, (in the latter a pure strategy is chosen stochastically with a fixed frequency). Nash proved later that if we allow mixed strategies, then every game with a finite number of players in which each player can choose from finitely many pure strategies has, at least, one Nash equilibrium Later (1995) R. Aumann, 1999) and Brandenburger , show that, if players' payoffs are mutually known, their rationality is mutually known, their beliefs (or "conjectures") about other players' actions are commonly known and they have a common prior, then, for each player  $j$ , the conjectures of all the other players about  $j$ 's action agree and the  $n$ -tuple of such conjectures (one conjecture about each player) form a Nash equilibrium when viewed as a mixed strategy profile.

Besides, if the payoffs are commonly known to all bargainers, then the Common Knowledge of Rationality CKR), is the main Nash assumption. Harsanyi, suggested later (Harsanyi,1967) that "Complete information requires that every player knows the strategies and payoffs available to the other players but not necessarily the actions taken. Games of incomplete information can be reduced, however, to games of imperfect information by introducing "moves by nature"

Bargain may lead either in agreement or disagreement Utility expresses the constraint or the "fear factor"( Papakonstantinidis L.A, 2002,8/14) of disagreement for the negotiator who desires negotiations to be led in agreement more than the other one. Who needs more, negotiation to be led in an agreement expects more utility, but –probably he has to loose in terms of "shares", due to risk lack In the opposite, who is indifferent about "agreement" or

expects less utility /per unit, has- to win in “shares” under the dogma “the more risk, the more profit” Each of “negotiators” has, therefore to think twice (2-person anticipation) according to his & the other’s expectations so both to win, maximising the outcome of negotiation (win-win)

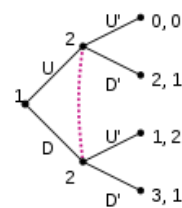
### John Harsanyi: From Incomplete to Imperfect information (sub-game)

John Harsanyi made a major contribution to welfare economics by two different interventions:

The first one is often called the “impartial observer argument”. An impartial observer should decide for society as if he had an equal chance of becoming anyone in the considered population. This is a risky situation in which the standard decision criterion is expected utility.

The second Harsanyi’s argument, worldwide as the “aggregation theorem”, is about a social planner who, facing risky prospects, maximizes expected social welfare and wants to respect individual preferences about prospects.

The key step in (Harsanyi’s,1955) Harsanyi’s argument, based on Bayesian, or conditional probabilities distribution was the claim “....that expected social welfare would be the weighted sum of expected individual utility functions, assuming that whenever all individuals are indifferent between any two probability distributions over social states, then so is society..” (Stanford Encyclopedia, 2001) Players have initial beliefs about the type of each player (where a belief is a probability distribution over the possible types for a player) and can update their beliefs according to Bayes’ Rule as play takes place in the game. In a Bayesian game, the incompleteness of information means that at least one player is unsure of the type (and so the payoff function) of another player (see below)



Harsanyi grappled with the analysis of “incomplete information’s” games, where the players are uncertain about games situation parameters (or even some of them, as payoff functions, or about the other players’ information about the game situation etc) Harsanyi’s approach for modeling a Bayesian game in such a way, allows games of incomplete information to become games of imperfect information

Games of “incomplete information” (between C- games and I-games) must not be confused with “games of imperfect information”, although they have been extensively discussed in the literature:

The first case concerns games where the players are uncertain about some important parameters of the game situation, such as the payoff functions, the strategies available to various players, the information other players have about the game, etc.

The second case concerns games in which the history of the game is not available to all players.

Besides, “complete information” requires that every player knows the strategies and payoffs available to the other players but not necessarily the actions taken. Games of incomplete information can be reduced, however, to games of imperfect information by introducing “moves by nature”

According to Harsanyi, each player has an objective probability distribution over the alternative possibilities: in this framework, probability distributions for each player is assumed to be mutually consistent or, they can be considered as conditional probability distributions derived from a certain “basic probability distribution” over the parameters, which are unknown to different players, even if it was assumed (by literature) that these probability distributions entertained by the different players are mutually “consistent”, in the sense that they can be regarded as conditional probability distributions derived from a certain “basic probability distribution” over the parameters unknown to the various players. However, the theory meets also those cases where the different players' subjective probability distributions fail to satisfy the above assumption (the condition of mutually consistency for the players' probability distributions). According to Harsanyi J. (Harsanyi, 1967), in cases where the consistency assumption holds, the original game can be replaced by a game where nature first conducts a lottery in accordance with the basic probability distribution, and the outcome of this lottery will decide which particular sub-game will be played. However, every player will know the “basic probability distribution” governing the lottery.

Following Harsanyi's concept, a Bayesian game can be modeled by introducing Nature as a player in a game. Nature assigns a random variable to each player which could take values of types for each player and associating probabilities, In this nature randomly chooses a type for each player according to the probability distribution across each player's type space). Finally, Harsanyi utilitarian theorem (Stanford Encyclopedia, 2001) states that the social welfare function is the weighted sum of individuals' utility functions if: (i) society maximizes expected social welfare; (ii) individuals maximize expected utility; (iii) society is indifferent between two probability distributions over social states whenever all individuals are.

**Formal definition (Harsanyi , 1967),**

The game is defined as:

$$G = \langle N, \Omega, \langle A_i, u_i, T_i, \tau_i, p_i, C_i \rangle_{i \in N} \rangle, \text{ where}$$

- $N$  is the set of players.
- $\Omega$  is the set of the states of the nature. For instance, in a card game, it can be any order of the cards.
- $A_i$  is the set of actions for player  $i$ . Let  $A = A_1 \times A_2 \times \dots \times A_N$ .
- $T_i$  is the types of player  $i$ , decided by the function  $\tau_i : \Omega \rightarrow T_i$ . So for each state of the nature, the game will have different types of players. The outcome of the players is what determines its type. Players with the same outcome belong to the same type.
- $C_i \subseteq A_i \times T_i$  defines the available actions for player  $i$  of some type in  $T_i$ .
- $u_i : \Omega \times A \rightarrow R_i$  is the payoff function for player  $i$

## Proposal

Starting from the Harsanyi's refinement concerning the Nash equilibrium, the objective of this paper was to formulate an argument on how it should be possible to provide appropriate tools for local development, taking into consideration the suggested "sensitization process" (behavioral analysis) and its interaction with the bargain and during the bargain. For this purpose, we have to suggest the "Intermediate Community" in a bargain between 2, but not as the result of transferring a game of incomplete information to a game of imperfect information. According to the paper's proposal, the "Intermediate Community" (Nature as a player in the Game which first conducts a lottery in accordance with the basic probability distribution) must be seen as conscious choice, taken by local people in the frame of sensitization process: Sensitized people should conduct their bargaining behavior in a "new" type of bargain, less competitive, more cooperative, even if adopting the "Non Cooperative" instant reflection winning strategies' concept for modeling a Bayesian game in such a way, allows competitive games of incomplete information to become more cooperative games of perfect information : sensitization, may be one of factors influenced this sep-by-step change at the local level (see the LEADER EU Initiative's application in Greece (Papakonstantinidis L.A, 2003), during the 1991-1994 period

The limit of the continuous sensitization process defines a new behavioral status, in the bargain between 2, which trends from pure competition to the absolute cooperation, which is the best of all instant reflection, individual winning strategies

The suggested "Intermediate Community model" (see at the triangle relation scheme below) or "win-win-win papakonstantinidis model" (as any of the 3 parts of the negotiation has to win from this) is the end/purpose of this paper's contribution

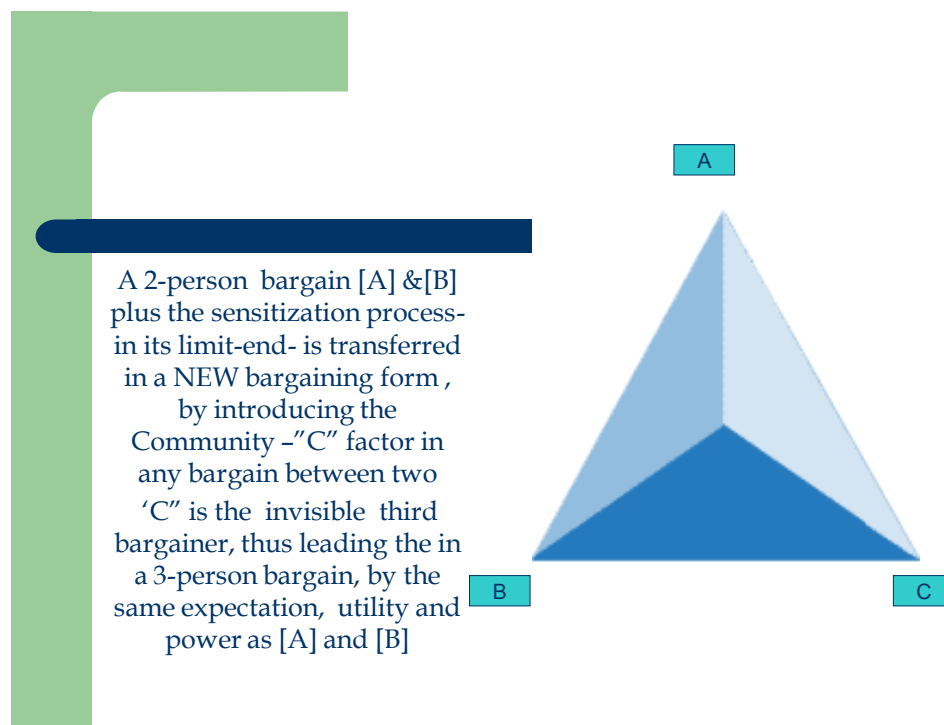
Especially,

- Introducing the “Intermediate Community” – (“C” factor) as the THIRD (invisible) part in a bargain between 2 provides us with a “sensitization measure” to go the local development on Bargaining belief, in that case, should be continuously strengthen, thus tending to the limit of a pure and absolute cooperation, especially in an Inequality Age, due to capital accumulation (Amin Samir, 1970)
- Defining the Intermediate Community in terms of a continuous sensitization process, at the local level with social and endogenous characteristics. These may be seen as the output of the continuous sensitization process AND perfect information (the sensitization)

$$\lim_{i \rightarrow \infty} P_i(\&) Q_i(\&) R_i(\&) = \max U_a U_b U_c$$

$$i \rightarrow \infty$$

$P_i(\&)$ ..strategy under the  $P_i$ ..probabilities distribution,  $U_a$ .. utility functions or, how to transform a “competition” into the absolute cooperation, taking into account the integrated information, coming from knowledge transfer AND the sensitization process in the community, thus maximizing bargainers utilities and the Community utility ( $U_c$ ) (Papakonstantinidis L.A, 2002)



Now, we have to reproduce the Harsanyi Bayesian game’s formal definition, with some difference which is the paper’s contribution: introducing the “Intermediate Community” as the 3rd imaginary part of the negotiation between 2, as well as weighting of certain variables



with coefficients, it should be possible to define the suggested “win-win-win papakonstantinidis model”

The (sensitized) game is defined as:

$$G^{**} = \langle N, \Omega^*, \langle A_i, u_i, \phi T_i, \tau_i, p_i, C_i \rangle_{i \in N} \rangle$$

- $N$  is the set of players.
- $\Omega^*$  is the set of the states of the “Intermediate Community”, depended on local people bargaining intra-community behavior
- $A_i$  is the set of actions for player  $i$ . Let  $A = A_1 \times A_2 \times \dots \times A_N$ .
- $T_i$  is the types of player  $i$ , decided by the function  $\tau_i : \Omega \rightarrow T_i$ . So for each state of the nature, the game will have different types of players. The outcome of the players is what determines its type. Players with the same outcome belong to the same type.
- $C_i \subseteq A_i \times T_i$  defines the available actions for player  $i$  of some type in  $T_i$ .
- $u_i : \Omega \times A \rightarrow R$  is the payoff function for player  $i$
- $\phi$  : the sensitization coefficient of  $T_i$  : Each state of the Community (Nature, Local Community, Physical Environment etc) must be (according to model definition) weighted by the “ $\phi$ ” appropriate sensitization coefficient of  $T_i$ , thus providing behavioral convergence towards community prevailing ethos (John Friedman, Clyde Weaver, 1979)

Finally,

- Nash equilibrium is based on binomial probabilities ( $p, 1-p$ ) distribution, corresponding 1-1 with those utility functions “prices” (disagreement fear factor). In its extension, the author hypothesizes that the Intermediate Community (the “ $C$ ” factor) produces a new behavioural type that converges the interests of both sides at a local level. By converting a binomial distribution ( $p, 1-p$ ) into a trinomial distribution, ( $p_1, p_2, 1-p_1-p_2$ ) combined with 3 utility function “prices”, the dynamic behavioural sensitization process may converge into the integrated local development limit-end.
- Paper focus on local level’s behavior by a rural, social and ecological development’s methodological tool, worldwide known as win-win-win papakonstantinidis model, taking into consideration the memes approach (Blackmore Susan, 1999) influenced biological and cultural “behavior” for the next generations (Dawkins Richard, 1976)

- Paper adopts the Bayesian Nash equilibrium (Harsanyi) which defines the strategy profile and beliefs specified for each player about the types of the other players that maximizes the expected payoff for each player given their beliefs about the other players' types and given the strategies played by the other players.
- Sensitization" may concerned as information, thus changed the 2parts imperfect information, into a complete information as Harsanyi conditional probabilities claims
- Each of players following his/her best individual instant reflection winning strategy, having perfect information, as well as initial beliefs about the type of each player where a belief is a probability distribution over the possible types for a player) can update his/her beliefs as play takes place in the game (according to Bayesian Rule)
- Introducing the "Community" as the "third" part in a bargain between 2, we can imagine a "new bargain type" in which the "Community" ( Nature, common values, ethic etc) is included
- That is reflected in bargainers behaviour, tending to the sensitization, in its limit-end (perfect sensitization, at the local level)

Coming from the above, the resulted behaviour leads into the absolute cooperation, which steps on the same rules of globalization. The paper, then, argues that this resulted behaviour reflects the end point of the local development process. That is the end of sensitization process.

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## **SOCIAL MEDIA: MARKETING PUBLIC RELATION'S NEW BEST FRIEND**

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### **Abstract**

The organizational long term success of promotional campaigns and the integration of marketing communications are affected by the effective use of information communication technologies, including the use of the Internet. Internet technology, as a source of communication, had become an important and exploring tool for marketers in the past. Today, the Internet implementation in the marketing process is inexpensive, delivers instant international reach, offers great real time feedback and reaches millions of people for whom the Web is the centre of virtually all communications.

Although the term word-of-mouth marketing hasn't really changed over the years, what has changed is the increased opportunities that companies have nowadays to foster it. Social media is a channel which is considered to be especially useful in enabling word-of-mouth between people, and especially because of its large number of users, word-of-mouth can now spread not only from one to one, but more like one to thousands, depending on how many 'friends' one has. This of course, may backfire since a dissatisfied customer may spread negative word-of-mouth to thousands of people, virtually overnight, with the company having little control over the content and dissemination of this.

With social media on such a rise, some may say that traditional marketing practises as we know them are phasing out. However, it may also be assumed that they are not necessarily phasing out, but are rather 'supported' by a stronger sibling – that of social media. The aim of this research is to identify and discuss the growing popularity of social media and explore its potential impact on marketing practises and especially Marketing Public Relations.

**Keywords:** marketing public relations, social media, promotion, consumer generated marketing

### **Social Media**

Social media is a natural extension in the communications world. The Chartered Institute of Public Relations (2010) define social media as the term commonly given to websites, online

tools and other interactive communication technologies which allow users to interact with each other in some way, either by sharing information, opinions, knowledge or interests. Social media are often defined in narrow terms (Tuten, 2008) and regarded as synonymous with social networks like Facebook and MySpace. Social media is often characterised as sites where participants can produce, publish, control, critique, rank and interact with online content (Tuten, 2008). Examples include: blogs and micro-blogs, video sharing, bookmarking applications, wikis, forums, and opinion sites as well as social networks (Giannini, 2010). What makes social media so popular is the fact that it enables consumers to interact and share information.

With the emergence of social media, companies are now going beyond simply maintaining a website for basic transactional purposes and traditional promotion. They are rather finding new ways to interact with customers, in search of a more long term relationship rather than a once-off sale relationship or one-way communication which most websites may be confined to. According to a research study by digital communications agency The Group, 56 per cent of FTSE 100 companies now run a corporate Twitter account and the proportion of FTSE 100 companies with a Facebook page has gone up from 25 percent to 38 percent ((Murphey, 2011).

In the last few years, a number of tools which are typically referred to as consumer-generated marketing or consumer-generated media (CGM) are regarded as the 'hottest' tools of MPR. This form of media describes a variety of new sources of online information that are created, initiated, circulated and used by consumers intent on educating each other about products, brands, services, personalities, and issues (Blackshaw and Nazzaro, 2004). CGM encompasses all the marketing messages and brand exchanges created by consumers themselves which subsequently result in creating word-of-mouth communication and a 'buzz' about the brand. The latest trend is for consumers around the globe to demonstrate a preference towards the use of social media in creating messages regarding brands and corporations as well as exchanging them through blogs, video sharing, forums, and social networks. Undoubtedly, social media is a powerful tool that can be used by companies in their integrated marketing communication campaigns since it enables them to interact in an informal and more personal way. Consumers expect brands and their companies to engage with their customers and their 'fans'. CGM offers many opportunities to marketers. Increasingly, what marketers are realising is that social media gives the power to consumers to move from spreading the word about brands from a one-to-one basis to a one-to-hundreds, or even one-to-thousands.

One of the fundamental objectives of marketing is to develop relationships with customers. The internet is no longer only to find information; it is there to enable companies to more effectively engage in relationship building. According to Gummesson (2008) relationship building is the interaction in networks of relationships. The internet can be used to create this network of relationships. Carter (2009) believes that one of the best ways to form

relationships and create influencer value is by going socially since now the market has evolved. The Web 2.0, or Marketing 2.0, is a powerful mix of new and traditional marketing tactics where it allows people to share, collaborate, participate and co-create forming relationships (Weber, 2007; Tomlinson, 2008; Carter, 2009).

The need for this creation of relationships has also brought about the rise of social networks (hereinafter SNs), one part of the social media platform. Social media networking is not really something entirely new – the foundation is quite old as a matter of fact. It dates back to primitive life when people started to live in groups because they had a need to belong. They lived together, worked together – much like what we have even today. It is a basic biological need to feel belongingness and this feeling can be enjoyed by forming groups. Today these groups are quite more advanced since we belong to a family group, a work group, even a sport group. This advancement has also seen the emergence of these ‘online’ groups. Much like the closeness we may feel within our ‘real groups’, we may also feel this closeness within our ‘virtual groups’.

People in groups share information because they trust one another; hence people who join social networks are thus considered to be quite open about sharing information because they too feel they are sharing with their close friends, their intimate group - although the word ‘intimate’ has now expanded to mean a few hundred ‘intimate’ friends for some people. Now, something shared by one of these few hundred friends is likely to be more believable by any form of message that comes from the outside world. You somehow *know* your friends, and you trust them – you may not *know* a company representative and thus surely cannot trust a stranger. Companies have come to realise the fact that basic word-of-mouth principles are even stronger in this online world.

SN is used to create awareness and ultimately relationship building. It is clear how the marketing mix, relationship building, the internet and SNs make a perfect combination when they mix together. Although some may disagree with the notion that SN may not be suitable for developing business relationships (Hayes, 2008), nonetheless, the supporters of SNs outnumber the criticisers (Ellison et al., 2007; Fulgoni, 2007; Ofcom, 2008). Hearn et al. (2008) state that in social media, communication may occur through both a computer or a mobile phone, and that communication is typically directed from one to many, but to be effective, in many cases it should be interactive and an engaging process and so to improve relationship building as stated above.

According to the E-consultancy report (2009) SN exploded during 2007 and 2008, mainly because of the immediacy of the internet together with the ease of communicating to a huge audience with a strong desire for self-expression. It is this explosion that has caused many companies to realise the marketing potential of SNs. Although this sudden explosion may have taken many by surprise, the effectiveness of SNs may not be as quick to reveal. Young (2008) believes that just like any other relationship, the relationships formed through SNs

take time to show their value, and thus companies need to remain committed to it in order to reap these benefits.

Internet technology means that there are changes in the marketing domain of planning, strategy creation and especially in market communication (Vasiljev et al., 2007). According to Jefkins (2000), the dynamic development of the internet will affect all areas of a business and therefore will have a huge potential for marketing. Internet marketing involves companies' efforts to market products or services as well as building relationships over the internet (Kotler and Armstrong, 2006). Brassington and Pettitt (2007) agree that since more homes and businesses are getting connected, the internet has now become a very important marketing tool.

Currently there are a number of SNs: to name a few, Facebook [as according to Mintel (2008) the leader in the SN market], Bebo, MySpace, Hi5, LinkedIn. Facebook was the seventh most popular site on the World Wide Web with respect to total page views (Ellison et al., 2007). SN sites have different focuses; LinkedIn is oriented towards work related contexts; MySpace was mainly created for unknown musicians to get their music heard; Bebo is targeted for young teenagers. Facebook has perhaps almost all the university student population, which was also the original purpose for the formation of this social networking site. A recent report by Mintel (2010) suggests that online social networking is expanding with 248 million unique monthly users in December 2009. Furthermore, the marketing spend on SN sites has also increased by 166% from 2007, thus reaching \$2.4 billion in 2009 (Mintel, 2010). Facebook groups, for example, can grow at an incredible pace, and it has been known for groups to have formed and grown to more than one million members in just one week (Holzner, 2009).

Adding any new form of communication vehicle requires integration into the overall communication and even marketing strategy. Similarly, social media marketing needs to be incorporated into the overall strategy. Social media requires that companies need to interact and engage with their audience but they should also realised that their customers are now the main drivers of conversations (Brown, 2010).

## **Marketing Public Relations**

It is a fact that the way people in the 21<sup>st</sup> century communicate is significantly different with how they used to in the last century. Today nearly a billion people have Internet access and subsequently communicate instantly with others. They are able to retrieve and analyse information about people and organisations instantly with a desire to share the information with others. Enabled by internet-driven new media consumers have become 'intermediaries' and have the power to filter the message. Today, more than ever before, it has become crucial for organisations to find more credible and durable ways to develop a two-way brand relationship with their customers and prospects, one that utilizes both traditional and new media channels. This 'new' emerging environment has led to marketing strategies that use



the fundamental ideas and tools of public relations in innovative approaches, fostering interactions between organisations, products, consumers and the media.

Marketing Public Relations (hereinafter MPR) refers to public relations activities designed to support marketing objectives (Harris, 1993) such as raising awareness, informing and educating target audiences, gaining understanding, building trust, giving consumers a reason to buy and motivating consumer acceptance. According to Kitchen (2010), MPR has a potential to be a leading tool in integrated marketing communication due to the general ability of public relations (PR) to contribute in achieving marketing objectives. MPR is a program that aims at protecting or enhancing the image of a brand and building the brand sales by encouraging a number of intermediaries (connectors) for example the traditional mass media, the electronic media, opinion leaders and consumers to voluntarily pass a message about the firm or product to their target audiences.

MPR is a late 20<sup>th</sup> century phenomenon with a wide coverage in the public relations, advertising and marketing press. It is a tool often used to complement and extend the reach of advertising in reaching niche markets where it may be expensive to advertise. It is also used at certain periods in the product's lifecycle in order to generate interest and excitement. MPR can also enhance the impact of personal selling by instilling trust and long-term relationships with the customers. It can provide that linkage with the customer that nourishes loyalty and continued usage. What was a long-time ago considered to be product publicity, integrated in the public relations effort has evolved into a package of techniques and tools that aim at increasing a company's sales of its products a services. Armstrong and Kotler (2009) stipulate that a number of marketing tools classified as consumer-generated marketing (CGM) have evolved over time, one of which is MPR, in which consumers voluntarily create and share messages and other brand exchanges themselves. The literature reviewed refers to these messages and exchanges as word-of-mouth and buzz. The essence of MPR is that it requires the marketer to hand over his or her promotional message to an intermediary in order to reach the ultimate customer. The intermediary will then voluntarily pass a message about the firm and its products to their audience of businesses or consumers.

Henry (1995, p.3) describes MPR as: "a comprehensive, all-encompassing, public awareness and information program or campaign directed to mass or specialty audiences to influence increased sales or use of an organisation's product or service." Giannini (2010, p. 4-5) defines MPR as: "any program or effort designed to improve, maintain, or protect the sales or image of a product by encouraging intermediaries such as traditional mass media, the electronic media, or individuals to voluntarily pass a message about the firm or product to their audience of businesses or consumers."

### **MPR and the Marketing Communications Mix**

MPR has the potential to enhance the impact of promotion in the marketing efforts of a firm and it can complement the more traditional tools such as advertising, sales promotion,

personal selling and direct marketing. This is primarily due to its focus on creating consumers and media “buzz” which can extend the impact of advertisements beyond the thirty seconds. MPR’s media mentions and considerable word-of-mouth communication can assist the firm’s sales promotion efforts by generating publicity, can instil trust between the salespeople and the customers, and can overcome the customer’s inherent resistance to the salesperson’s and direct marketing efforts. Essentially, MPR can work effectively with the traditional promotional tools to generate immediate response, foster long-term relationships, spread word-of mouth and elicit media mentions.

It is important to recognise that the traditional promotional tools are paid for by a sponsor, usually an organisation. At the same time a firm in using these tools does not use intermediaries to spread the message, which is at the heart of MPR. It usually uses the media and for this reason the messages are often faced with suspicion and criticism by the target audience. On the contrary, in the case of MPR, where the messages are spread voluntarily, they tend to be more believable and the target audiences are more receptive to them since they are characterised by a third-party endorsement. This is the most valuable contribution of MPR to the traditional promotional mix.

Media are not the only vehicles for disseminating a promotional message to target audiences. The use of non-media connectors (NMC) to reach out to consumers and create word-of-mouth communication through both live and electronic means is gaining popularity (PQMedia, 2007). A non-media connector is active in a given brand or industry. It can either be a professional in a specific field or simply a consumer with a love for a brand, product or organisation. NMC can be bloggers, experts and opinion leaders, celebrities but also ordinary people who have a passion for a product, industry, issue or an organisation (Giannini, 2010). NMC can be used by organisations to create a buzz, to spread the word, to create excitement through conversations, blogs, live events and social media (Voight, 2007).

### **MPR and Social Media**

The fundamental difference between MPR and the other types of marketing is the connectors that spread the message. MPR is all about creating a buzz about a product by encouraging intermediaries (connectors) such as traditional mass media, the electronic media, or individuals to voluntarily pass a message about a product or company to their audience of businesses or consumers. MPR’s unique characteristic in engaging another party in the communication process other than the marketer and the receiver creates another dimension in the communication process, which can be both a challenge and/or an opportunity.

Media are not the only communication channels for getting a promotional message across to target customers. Although approaches for using non-media connectors (NMC) have always been used, today they have received a heightened interest. PQ Media (2007) reveals that these techniques whether they are called buzz, grassroots, community, or cause-marketing aim at facilitating word-of-mouth communication through live and electronic

means. A non-media connector who can either be a professional or simply a consumer with a passion towards a brand, corporation or a product category has the power to influence their social circles. Voight (2007) suggests that marketers using NMCs expect them to use their resources in order to exercise influence over their friends, family, professional and social groups through conversations, blogs, live events and social media. This however, implies that the marketer will lose control of the message since connectors usually do not simply transmit messages but they also edit them. Since connectors can use electronic media as well as social media to connect with their audiences around the globe marketers have in their hands a great opportunity; to influence their connectors so that they will generate favourable publicity. Social media creates an environment that encourages a two-way conversation that corporations can capitalize on it in a way that can benefit their business and their customers.

Marketers have become increasingly interested in social media since a study carried out by Cone Inc. in 2008 showed that 93 percent of social media users believe that companies they buy from should have a presence in social media. In addition, 85 percent share the view that a company should interact with its customers via social media. Also, 56 percent feel a stronger connection and more satisfaction with the service received by a company when they interact in a social media environment (ConeInc, 2008).

Social media has become the vehicle 'of the day' for connecting marketers with connectors and their audiences. At the same time, it has become a challenge for them since when a marketer shows up in a social network such as LinkedIn or Gather.com this can create a negative reaction among its members. Firms that wish to make a presence in a social network must focus their efforts on creating an interesting content, fostering a community, and engaging with their customers in a more direct, casual and personal way. Customers embrace and appreciate this and they can become more receptive towards their favourite brands. The change that social media has brought about to communications has been quite significant. Appreciating this, marketing managers must accept the fact that a great amount of information (either negative or positive) is being communicated by individual consumers to other consumers via social media, and this information is directly influencing all aspects of their purchase and post-purchase behaviour. They must also realise that consumers are turning away from traditional elements of the promotion mix, by reducing the reliance on advertising as a source of information. Finally, managers must learn to talk with their customers rather than talking at them which has been the case with traditional media (Mangold and Faulds, 2009).

Furthermore, the majority of public relations professionals state that their job has been made easier because of the use of communication technology by expediting the circulation of information to reach broader audiences (DJandPRSA, 2007). Social media enables practitioners to directly enter into conversations with their audience, but it is also used to strengthen their relation with them, and hence their effectiveness. Although practitioners are

slower to integrate more technologically complicated tools, they seem very comfortable with blogs and podcasts showing that the future does indeed look digital for them as well (Eyrich et al., 2008).

## Conclusion

There is no doubt that traditional marketing has changed. Endorsements are now passed from trusted customers and other third party sources to prospects. Prospects no longer rely on ads solely. They use a multitude of information sources. Marketers must now become brand ambassadors with a real understanding of their brand's value proposition. Word-of-mouth communication and hence, MPR have not changed. What has changed are the opportunities that enable it. These have increased due to social media. Social media gives the opportunity to marketers to create a 'buzz' about the firm and its products by connecting with people through a dialogue which is more honest and genuine. This brings MPR onto another level. One that has the potential to create stronger bonds with customers, create more positive customer attitudes and enhance the reputation of the firm.

The literature is suggesting that there is indeed a development in the way that marketers now communicate with their audience. The authors are hence suggesting that research needs to be carried out in order to support and further develop the literature. A few questions that arise that could be investigated include: do companies also appreciate this development of social media as a communication tool, and specifically as an ally of MPR activities? Do companies use, or do they consider using social media to complement their MPP efforts? How do consumers view social media as a communication tool used by companies?

With social media being in the forefront of today's consumption world, it is imperative that further research is carried out to clarify whether social media is indeed all that it promises to be, or whether its just another buzz word.

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## COOPERATIVES AND GOVERNANCE: FORWARD-LOOKING OR STUCK IN THE PAST?

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### Abstract

Compared to equity-based companies, the challenge posed by partnerships resides in the nature of the undertakings given by their partners and owners, which may be backed by all their personal wealth. Although financial performance is rarely questioned, even if it is debatable, the concept of “social performance” remains to be defined, and gives rise to a core question, namely its relationship to financial performance, i.e. an organisation’s ability to generate the necessary surplus for it to expand, and to obtain the funding required to generate that surplus. It is actually the nature of the project that is being questioned, together with the shared view of the resources required to achieve the targets that have been set.

**Keywords:** Cooperatives, equity-based companies, performance, governance

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### Introduction

The concept of Corporate Social Responsibility, or CSR, and its development, has been the subject of extensive research. Likewise, a large amount of material on social performance and *stakeholders* (Freeman, 1984) has been published, together with discussions on the role and place of organisations in society (Carroll, 2008).

Although problems have arisen, “*the movement for corporate social responsibility has won the battle of ideas*” (Crook, 2005). Matten and Moon’s (2008) research has demonstrated this trend and analysed it as the result of institutional developments. Based on the research published

by neo-institutionalists such as DiMaggio and Powell (1983), and Meyer and Rowan (1977), the authors would stress the importance of the concept of legitimacy in organisational practices, which is based on three mechanisms: coercive isomorphism (compulsory laws, rules and standards), mimicry (influence of those practices considered as best practices) and normative pressure (influence of new educational and professional standards). The concept of CSR, as conveyed by these processes, has therefore gained legitimacy.

However, in the “field”, a study conducted by *Groupe Alpha* (2009), based on companies included in the CAC 40 Index, has highlighted its limitations, since the year in which the French New Economic Regulations Act (NRE) came into effect<sup>75</sup>. Although the average rate of compliance with the Act, which ranges between 85% and 90%, is fairly high, and has remained relatively stable since 2004, the average quality of the information provided has not, conversely, met expectations, with a satisfaction rate of 50% to 55%. This situation has prompted the authors to draw the following conclusion: “Although sustainable development is attracting considerable attention in terms of the potential solutions that it offers for recovering from the financial and economic crisis, companies are still not using social reporting as a risk and opportunity management tool, but merely as an external communications aid”. This conclusion is only one step away from saying that “[...] for most conventionally organized public companies -which means almost all the big ones- CSR is little more than a cosmetic treatment” (Crook, 2005).

The question that arises, therefore, is finding out how the concept of Corporate Social Responsibility can find its place in corporate governance, as a response to social issues that have been widely discussed elsewhere, in the knowledge that implementation of the concept also depends on organisations’ willingness to pay some attention to the interests of all their stakeholders, even if they do not take them into account.

In order to make a contribution to this debate, we looked at a specific organisational structure, which is supposedly more democratic in terms of its corporate governance (Dunlavy, 2006). This organisational structure can be described, somewhat generically, as a cooperative<sup>76</sup>.

We selected seven companies based in the Paris or Lyon regions. The names of the companies are as follows: *Coopaname*, *Les Menuiseries de l’Ain*, *Chèque Déjeuner*, *SECAD*, *CNE*, *Cité Création* and *Maison de la Danse*. As SCOPs are not required to publish social reports, and the data we needed to obtain were mainly qualitative, the method we selected to gather information was the meeting. We conducted our meetings in three stages, each of which included a portion of the questions that reflected our research assumptions.

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<sup>75</sup> Official Record of May 15<sup>th</sup> 2001

<sup>76</sup> For historical reference purposes, please see François (1997), Prinz (2002) and Holyoake (1902).



## **Comparison between a traditional Limited Company and a SCOP**

Under French law, a company is defined as a corporate entity that has been “founded by two or more persons who have contractually agreed to assign goods or their labour to a common company, in order to share the profits thereof or benefit from the ensuing business. In the cases specified in law, a company can be founded based on the will of a single individual. The members undertake to share the company’s losses”.

The intention of our research is to analyse the implications that the type of company – as defined by its legal status and governance procedures – has for the conditions that make implementing an effective CSR policy possible. In order to do so, we will compare so-called traditional Limited Companies and Cooperative Enterprises, which are Limited Companies with specific governance procedures.

These companies are both equity-based companies, but present significant differences, which may have an influence on their governance in terms of their CSR.

Whereas traditional Limited Companies do not set a minimum level for employee shareholders, 65% of SCOPs’ voting rights must be held by employee-shareholders. Operating procedures for traditional Limited Companies do not specify a minimum equity capital requirement for employee-shareholders while conversely, SCOP employee-shareholders must own at least 51% of the equity capital. Employee profit-sharing is not compulsory if a company has fewer than 50 employees, and is equivalent to 5% of net income for traditional Limited Companies; however, for SCOPs as a whole, employee profit-sharing amounts to between 25% and 84% of net income. We have also noted that SCOPs’ legal status limits dividend payments to 33% of net income, which is not the case for traditional Limited Companies. One final important difference is the voting method at General Meetings of Shareholders, which is based on the “one man, one vote” principle for SCOPs, while the traditional “one share, one vote” model is used for traditional Limited Companies. We believed that it was significant to study this differing involvement in decisions.

Although SCOPs’ employee-shareholders appear to be consulted in a more democratic manner, which is not the case, apparently, for traditional Limited Companies, does this mean that the former are a more fertile ground for social dialogue? In other words, does democracy lead to greater social dialogue?

The SCOP case therefore enables us to study a company where ownership, control and responsibility are concentrated in the hands of the same individuals. However, whenever responsibility, control of the decision-making process and the corresponding risk are concentrated, decision-makers are likely to tend to avoid taking risks (Jensen and Fama, 1983). The governance system may hinder innovation and investment as a result.

### **The democratic structure of SCOPs leads to greater social dialogue**

According to a study of the “social reports” published by 36 companies in the CAC 40 Index, the vast majority of those companies do not, apparently, present the report to their Employee Committee before it is published, although this is provided for in the NRE Enactment Decree (*Groupe Alpha*, 2008). Only three companies in the sample make the effort to let their employee representatives have their say.

In contrast, voting in a SCOP takes place on a *one man, one vote* basis. In addition, over half the voting rights must be held by the SCOP’s employees. Therefore, all employees may have their say, without any distinction being made as to the position or the number of units that they hold in the company. We can therefore assume that a social dialogue is easier to establish in this type of organisation.

A SCOP would also appear to allow both physical and social closeness between those involved in the decision-making process. Indeed, unlike what happens in traditional Limited Companies, both factors no doubt enable greater empathy in the decision-making process. If we refer to Levinas (Bevan and Corvellec, 2007), it is through encountering “the Other” that taking responsibility becomes possible. By making room for a democratic dialogue, a SCOP might therefore enable more responsible decisions to be taken.

### **Greater autonomy means having responsibilities**

If one wants to behave responsibly, the first condition to fulfil is undoubtedly to *be able* to exercise that responsibility. This means that one needs to have a certain amount of room for manoeuvre in one’s actions, and to retain the option of making a choice, i.e. being confronted with an *undecidability* situation (Derrida, 1996). Indeed, it seems extremely difficult to talk about *responsibility* in the case of an action performed under constraint or as part of exercising a form of duty. In our examination of published material on governance and the organisation of work practices, we noted the increasing importance granted to taking the owners’ interests into account in the strategies adopted by organisations (Jensen and Meckling, 1976). Reading traditional Limited Companies’ social reports enabled us to establish a certain number of facts that support this assertion: employees have little involvement in the decision-making process, while charters and procedures guide the company’s actions. More emphasis is placed on rational factors than on human ones, and the reports support that assertion: they display a collection of numbers and little stories that have no real connection, and contain no real thought. The data seem self-contained, without the need to explain a *human* approach: “*it seems that the organization is ruled by nobody – that is, it is moved only by the impersonal logic of self-propelling principles*” (Bauman, 1994).

What emerged from our meetings with SCOP employees and management depicts a very different reality. First and foremost, it is reflected in a management structure that seems less entrenched. In this context, Joffrey Bernard, from *Menuiseries de l’Ain*, referred to

communication flows that are flatter than in a traditional company. He added: *"There is no set reporting line that we must all adhere to. It's actually more flexible [...]"*. Odile Michel, from *Cité Création*, explained that there were no social differences and confirmed *"that there was no management structure, which helped communication"*. Elise Naccarato from *Chèque Déjeuner* mentioned *"a management structure that is perhaps a little blurred"*. She also put forward the possibility *"of further discussions with management in the event of disagreements"*.

This more flexible management structure was also reflected in the relatively high degree of autonomy granted to employees in day-to-day decisions. This point was clearly apparent in several answers: *"We have a wider freedom of action and greater autonomy"* (*Chèque Déjeuner*). The *Cité Création* employee that we interviewed gives four marks out of five to the discretionary powers granted to her within her field of expertise. SECAD's quality assurance manager mentioned a *very wide* margin for manoeuvre.

In fact, this relative freedom of action is enabled by the atmosphere of trust that reigns in the organisation. Interviewees emphasised this concept, which appears absolutely vital to the way in which a SCOP is run. *"We don't always have a boss on our backs checking up on us"*, was the colourful summary offered by *Chèque Déjeuner's* press attaché. The concept of *trust* also appears in the comments made by *Cité Création's* co-managing director. CNE's Chairman and Chief Executive also underlined this feature in order to explain his attachment to the organisation: *"when you are happy at a company and you feel trusted and supported, you can't do anything but like that company"*. It even appears that the trust granted is a necessary condition for joining or at least remaining at the SCOP. This idea was summed up perfectly by Didier Debauche (SECAD): *"[...] Compared to a conventional meeting, interviewees needed to come once, and then twice or even three times, so that they wouldn't be hired if we weren't sure that they were coming here for the long-term, and that they had a communal bent. We are happy to have the candidate that we hire join our family and to give them their fair share of the pie. But we need to be sure about the individuals, and that they have proven their skills, their knowledge and their people skills"*.

In some cases, the relationships between SCOP members extended beyond their working relationship. The traditional notion of a company as just a bundle of contracts did not, in many respects, seem very relevant. The bond between SCOP employees appeared to go beyond the legal and formal framework. In meetings, this was reflected by the use of terms that are not very current in a corporate context: *community* (*Coopaname*), *family* (SECAD), *friendly relationship* (*Menuiseries de l'Ain*), *togetherness* (CNE). A SCOP tends to think of itself more as a homogeneous whole, or as a social *unit*, rather than as a place or an interaction network for personal interests. The existence of a collective goal that is served by collective responsibility emerges.

### **A collective goal served by collective responsibility**

Through the responses that we obtained, it seems that an SCOP is a unit where bonds of solidarity and mutual assistance are formed. *Collective responsibility* can and must be

understood in the cooperative, in two forms. First and foremost, it corresponds to the fact that responsibility is not *divided up* according to the level of involvement in a final outcome. This applies as much to day-to-day tasks as to the strategic decisions that are taken unanimously or are voted on a *one man, one vote* basis. In theory, an employee cannot avoid being involved in what the organisation does because of their position. Where strategic goals are concerned, the involvement of the company members brings about *de facto* collective responsibility. There are discussion forums where one can make one's voice heard, while the General Meeting of Shareholders rubberstamps the decisions that have been taken, in some ways. This is how we understood Odile Michel's comments: *"Yes, I didn't always agree. Some decisions were hard to take. I wouldn't have taken them all on my own. I understand that it was better for the company to take these decisions. But there were times when I disagreed. [...] At the end of the day, the decisions are taken by a majority. I expressed my misgivings. The majority took a different view. In the end, I think that it was a good thing, although personally, I found it hard"*. Shared responsibility also emerged in the company's day-to-day operations, since our contact at the *Menuiseries de l'Ain* told us that *"everyone is going to be more involved in everyone else's work because the outcome is the same for everyone"*. In fact, Elise Naccarato from *Chèque Déjeuner* came to a similar conclusion: *"When I ask a director to do an interview, they're all usually very available (even though journalists always make appointments from one day to the next and at impossible times), whereas this was not the case at all in the place where I worked before. You needed to ask six months' in advance, and if they weren't there, that was my problem, even though the goal was the company's best interests, because, as far as I'm concerned, it isn't a problem if they don't do the interview"*.

The other shared meaning that we can apply to the notion of *shared responsibility* is that of *responsibility towards the community*. In other words, there is a will to make sure that the wellbeing of other co-workers is taken into account and that it is not called into question by any member of the organisation. This is the way in which Stéphane Veyer talked about *collective responsibility*. In some cases, group thinking goes the full course – if we choose to use economic terms – in putting the collective benefit above the marginal individual benefit. This appears quite clearly at the *Menuiseries de l'Ain SCOP*, where the members, during a crisis period, decided *"to sacrifice some of that year's profits in order to keep shareholders and part-time workers"*, even though *"they were fully aware that they would feel the effect at year-end"* (the profits to share among themselves would be lower).

## Motivation is at the heart of social dialogue

Motivation is based on the way *the forces that determine behaviour interact*.<sup>77</sup> An individual is motivated when they are convinced that their actions and efforts will achieve a result and bring them an attractive reward (Vroom, 1964). Several factors influence the level of motivation shown by an employee who, like other individuals, is motivated by his or her needs being met. There are three types of need, the need for achievement, the need for power

<sup>77</sup> Le Robert, *Dictionnaire culturel de la langue française* (2005)

and the need for affiliation and one of those needs predominates in every individual. That need is the one that they will seek to fulfil (McClelland, 1961). A study of our interviews shows that these needs are concerns that feature in the way that SCOPs are run, and that they can therefore be met. The need for achievement relates to accomplishment, and internal promotion is very widely practised within the SCOPs that we held meetings with. For example, Jacques Landriot, the Chairman and Chief Executive of the *Chèque Déjeuner* Group, began his career as a salesman. Likewise, René Deville, the Chairman and Chief Executive of *Compagnie Nouvelle d'Electricité* started out as an apprentice. Employees may therefore be motivated by the opportunity to succeed. Second, the need for power depends on the influence that the employee may have. In fact, we should acknowledge the power held by employees in SCOPS, due to the democratic way in which these entities are run. Every employee's opinion can have an influence on discussions. In fact, Juliette Rajon, from *La Maison de la Danse* clearly explained to us "*that the advantage is being at the centre of the information and being able to vote on resolutions*". Lastly, the final need described by McClelland, the need for affiliation, refers to social relationships. Enjoying satisfactory social relationships can therefore be a way to be motivated at work. In fact, this point was raised by a large number of the individuals who answered our questions. Many of them talked about getting along well, a pleasant working environment and friendly relationships. ("*We discuss things. There are no divides, it's more like being friends*", says Joffrey Bernard, from the *Menuiseries de l'Ain*). The SCOP model therefore seems to enable its employees to satisfy at least one of the needs mentioned by McClelland, which enables them to be motivated at work.

Another determining factor for motivation is the sense of fairness (Adams, 1965). When individuals see their situation as being fair compared to others' situations, they are more inclined to be motivated at work. In fact, we tried to find out whether SCOP employees considered their compensation system to be fair, and received a positive response in every case. For example, Odile Michel from *La Cité Création* understood this clearly when she told us, after having explained the compensation system, that "*it seems a good way of rewarding everyone's contribution to me*". Therefore, there is a sense of fair compensation, as well as of a fair distribution of the workload. "*I would define our system as a fair distribution of the workload*", says Joffrey Bernard from *Menuiseries de l'Ain*. The way in which SCOPs are run in terms of working practices and the compensation paid to each employee seems to create the conditions required to motivate their employees.

Finally, employees' propensity to be motivated at work may be due to their involvement in the life of the company. The more an individual is involved in their work environment, the more likely it is that they will be motivated to do their work conscientiously. The SCOP status makes member-employees decision-makers and involves them in the way the company is run. In fact, their involvement is obvious, as is the resulting motivation. This was especially highlighted during an interview at *La Maison de la Danse*, during which Juliette Rajon stated

that: *"People who have decided to be shareholders expect to be informed and involved. (...) they are interested and curious. They want to work for the firm"*.

The SCOP model therefore appears more likely to motivate its employees. Those employees are in turn more disposed to do the best that they can in their work and to be involved in it, which enables them to develop and apply a code of professional ethics.

### **Personal interests that coincide with those of the company**

During our meetings with SCOP management teams and employees, we noted the existence of a strong connection between coming to work for the company and for themselves. Joffrey Bernard, from the *Menuiseries de l'Ain* described that link as follows: *"The fact that we share in the profits is one of the most important points for the company. We don't necessarily have to motivate our troops like normal companies have to. When we get up in the morning, we know that part of the profits will be returned to us. At SECAD, Didier Debauche explained that "for the company to thrive, his salary was in play, and potentially its net income as well. It is to everyone's advantage that the company works, and works well". Employees' interests clearly coincide with those of the company. The way they treat their work can then be assimilated to the way they would treat themselves; in other words, they take good care that their company runs properly.*

For René Deville, Chairman and Chief Executive of *La Compagnie Nouvelle d'Electricité*, *"if a person knows how to share, they will fit in well here"*. All employees therefore need to have traits in common. There seemed to be a very strong corporate culture. In fact, Stéphane Veyer from *Coopaname* used these terms when he explained that *"There is a corporate culture, and if anyone joins the company and is completely out of step with that culture, the other people at the company will make them understand that they are in the wrong place very quickly."* Convergence of individual principles and interests with those of the company appeared to form an integral part of SCOPs. This way of running a company could thus enable everyone to be involved and to abide by a code of professional ethics. In fact, Juliette Rajon, from *La Maison de la Danse*, stated that *"the way the company is run suits me perfectly. I want to be involved in the company"*.

Employees are more likely to act in accordance with the standards and values of a company if they feel proud of belonging to it (Gara-Bach and Gaha, 2007). Pride in belonging to a company might therefore play a role in aligning the interests of the individual and of the organisation. As Odile Michel said *"I am proud of the SCOP's business. I am proud of contributing my skills and my energy so that we can keep going as long as possible. I am proud of now being able to say that the company is 30 years old"*. Meanwhile, Elise Naccarato, from the *Chèque Déjeuner* Group, added that all the employees shared this sense of pride (*"They are all quite proud of their company"*.) It therefore seems that SCOP employees are more willing to behave in a way that is in line with their company's principles and interests.

Identifying individual interests with the company's interests can also be the result of an individual's attachment to their company and of whether they are able to identify with it (Mowday, Steers and Porter, 1979). Effectively involving an employee in their company motivates them to do their work well and to work towards the good of the company; this is another incentive to adhere to a code of professional ethics.

Stéphane Veyer, the Chairman and Chief Executive of *Coopaname* described it like this: *"My level of attachment is huge (...). The cooperative project implemented by Coopaname is undoubtedly part of my identity. This project carries my convictions and those of all the others as well. We all have some of the same convictions on that point"*. This attachment is also very evident if we look at the seniority of the employees. *"People rarely leave our company before they retire. Because they are attached to it and because they are involved"* (René Deville – CNE). The same applies to the *Chèque Déjeuner* Group. Elise Naccarato told us that the current Chairman and Chief Executive was in fact the one who succeeded Georges Rino, who founded the Group in 1974. At *SECAD*, Didier Debauche confirmed that many of the founders were still there, which demonstrates the involvement of the employees in their company. The seniority of the management team and the attachment of individual employees to their company is therefore another characteristic feature of SCOPs, where the operating procedures therefore seem favourable to motivating and involving every employee.

In the SCOPs that we studied, the financial side did not, in fact, seem to be the most important one. Salaries, for example, did not increase as quickly and as significantly as in the private sector, although SCOP employees remained there for a very long time. In fact, employee motivation stemmed from other factors that are linked to the specific way in which SCOPs are governed.

A common interest is what drives these companies. The people that we interviewed told us this, almost word-for-word. At *Cité Création*, in Odile Michel's opinion, *"The team is going in the same direction, towards expanding Cité Création's business. No one is looking to expand their own business within the group. The collective interest is always paramount"*. Later, Odile Michel added that: *"The collective interest is paramount, i.e. the interest that the company survives"*. When talking about his colleagues' goals, René Deville (*La Compagnie Nouvelle d'Electricité*) put it this way: *"If we are talking about the managers, who are in charge of projects' profitability, theirs is a personal action that works for the group. Everyone therefore takes responsibility for the collective good, i.e. for the collective interest. Lastly, Stéphane Veyer explained to us that at Coopaname, "We innovate, we experiment and we invent within the social economy framework, with the aim of seeking what is in the collective interest of our members"*.

Our research enabled us to understand the importance of the collective interest within these companies. The individual is therefore not only motivated by individual reward, which would be purely financial, but also by seeking the common interest, which can bring them more. For Stéphane Veyer at *Coopaname*, the collective interest is linked to pooling risk and

therefore being able to become an entrepreneur in a safe way (*We pool a certain kind of risk-taking, we don't need to register, we take the risk and we spread it over 400 people*). The Chèque Déjeuner Group's employees also enjoy a certain safety net, which is authorised by the collective, if we take into account the solidarity fund, to which 3% of annual profits are allocated and which all employees may access in the event of a personal problem.

### **Are the decisions taken more responsible because they are discussed?**

As we have seen, the importance granted to social dialogue, which does not exclude risk-taking, is significant in SCOPs. It enables any potential problems that the company may encounter in the near or distant future to be anticipated. *"We don't leave anyone out. We don't need to break down any barriers, unless people don't dare to express themselves. We should not leave any dark, unexplored areas. I think it creates more value"*. (Didier Debauche, SECAD). These discussions are at the very centre of SCOPs' strategy. They make it possible for them to think of innovative solutions. Employees' concerns are also one of the drivers for the company's strategy. For example, almost all the SCOPs that we met are involved in socially responsible initiatives, in terms of the environment, or professional development, etc. We would note that these initiatives were mostly instigated by the SCOPs' employees. This is precisely because they include people who are very involved in the voluntary sector, in aid, and in humanitarian initiatives. *"Anything that involves "hard core" economics and finance is beyond them. When they come back from Mauritania or the Sahel and they get here, talking about a 13<sup>th</sup> month bonus or profit sharing is beyond them. Let's start by thinking about what we could do so as not to use too much water and to save water and electricity"*. *"So, as Didier Debauch also explained during our interview, we drew up an estimate of the building's energy consumption and what it costs us"*.

This initiative enables the company to retain a high level of internal skills and to be more socially responsible.

Nonetheless, employee relations have their limits. The directors of the SCOPs that we met were aware of this issue. *"The more we try to get as many people as possible involved in specialised issues, the greater the risk that people do not have the necessary capabilities for taking the most responsible decisions"*. This point emerged from our interview at La Maison de la Danse, when Juliette Rajon told us that: *"People always have an opinion about everything. The problem is then how reliable that opinion is. Once again, where day-to-day decisions are concerned, I think that asking everyone's opinion is unnecessary and sometimes even dangerous"*. Joffrey Bernard (*Les Menuiseries de l'Ain*), added that, as far as he was concerned, it wasn't always right to believe that someone who was very good at their job as a furniture installer would be able to take the right decisions for the company. *"And that's where, in my opinion, the SCOP system reaches its limits, because we need directors and managers who are aware of the environment in which we operate."*

It would therefore seem that it is not suitable to take all decisions on a collegiate basis, although issues needed to be discussed within the SCOP. Management were aware that an



SCOP where there are no discussions or democracy can rapidly become an empty shell. In other words, if an SCOP does not take the opinion of its employees into account, it forfeits all the advantages of the discussion process and everything that helps it to be more socially responsible. Even if there was a social dialogue at the companies where we conducted our interviews, most of them observe that this process was not obvious. For instance, when we questioned Didier Debauche, (SECAD) about the opportunity for employees to express themselves, his answer was: *"I think it's an advantage for the company, a real advantage. However, it requires a real organisation process to make it happen. When I talk about organisation, it's so that it benefits the company. The process has to be organised. And it needs to be properly prepared to be organised. This means an agenda and preparing projects in advance"*. M. Debauche added: *"We never anticipate, which means that people often receive the agendas for Board or Shareholders' meeting on the day, and have no time to take a step back. This increases the number of questions and slows down the process"*. The social dialogue process must be organised so that it is effective and makes the company more socially responsible.

## Conclusion

Nowadays, Corporate Social Responsibility is a concept that most company management teams can no longer allow themselves to reject, or even avoid. From an economic and social standpoint, that would mean taking a risk with rating agencies, politicians, voluntary organisations and civil society as a whole. The resulting cost could therefore be significant. This means that the entire corporate world is boasting about its initiatives for the benefit of society. However, we very often forget the main point, namely responsibility, which the CSR acronym is in fact increasingly tending to replace. Most of the time, responsibility is replaced by a study that is like a corporate social responsibility assessment, prepared along the same lines as a financial performance report.

For us, responsibility is first and foremost an approach, a human review of what "I can do", what "I am able to do", as well as who the people I need to account to are, and what their needs are. For me to be able to exercise "my" responsibility in an organisation, that organisation needs to offer me the possibility of answering these three questions as part of its day-to-day operating procedures. Before talking about CSR, we need to ask ourselves whether it is possible in a model where management is the dominant force.

What our research has enabled us to highlight is the fact that a traditional Limited Company, which is the most widespread and symbolic model of a major equity-based company, did not really allow CSR to be implemented. In fact, it is hard for such companies to meet the three conditions set out above, which served as the basis for our review, no doubt because it is more subject to the shareholder constraints promoted by its governance system than to a democratic process.

The reason for this observation can be found in the way we look at the management team. In the dominant organisational model – which includes traditional Limited Companies – the

“scientific” concept of management, combined with a negative perception of its representatives’ behaviour, has given rise – via a dual hermeneutic process – to individualistic and irresponsible practices (Ghoshal, 2005). In fact, talking about CSR in these companies becomes something of a contradiction: *“Our theories and ideas have done much to strengthen the management practices that we are all now so loudly condemning”* (Ghoshal, 2005).

Contemplating genuine CSR would therefore involve overhauling working relationships, in order to move closer to an enlightened democracy. In fact, this is what the alternative SCOP model sets out to do, and it seems to achieve that goal. Through our meetings, we discovered that SCOP employees appear to enjoy more autonomy and to take part in major strategic decisions, which enables them to recognise that they are taking on a collective responsibility. Their personal interests are aligned with the collective interest through two processes, namely self-regulation and the incentive system. Finally, because social dialogue is at the heart of an SCOP’s principles, it seems easier to include all the stakeholders in the decision-making process. Can we then say that *“Within the old form [of ownership], workers’ cooperative factories actually represent the first break with the system. (...) We should consider capitalist equity-based companies, and likewise cooperative factories, as forms of a transition from the capitalist mode to the collectivist mode. The difference is that, in the first case, the contradiction is resolved in a negative way, while it is resolved in a positive way in the second.”* (Marx, 1974, p. 105)?

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## HOW TO ENHANCE VALUE? A COMPARATIVE APPROACH BETWEEN MARKETING AND FINANCE

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### Abstract

What people do with brands has always been considered a source of value for them. Nonetheless, during the last decade, this phenomenon has been accelerated by the rising power of consumer communities, backed by the development of the internet and social media. It has been shown today that the success of a brand increasingly relies on the existence of a community of totally captive and loyal fans who co-create the value of that brand through their numerous practices. This paper seeks to respond to both these questions on brand value by drawing relationships between three worlds still unknown to each other: the world of the *brand communities*, the world of *brand management* and the world of *brand valuation*.

This paper seeks to respond to both these questions on brand value by drawing relationships between three worlds still unknown to each other: the world of the brand communities, the world of brand management and the world of brand valuation. One of the challenges is thus to avoid creating adverse effects by exercising too much shareholder pressure on the company-consumer relationship, while at the same time ensuring that the exchange value created is well-redistributed to the shareholders and not deviated to other ends of common knowledge or reputation, to the detriment of the wealth distributed to the owners of the company. On the other hand, it is also necessary to ensure that shareholder and financial demands do not jeopardise the means deployed for brand orchestration in order to acquire practices likely to carry exchange value.

**Keywords:** brand valuation, , consumer communities, brand management, brand communities, exchange value, use value.

### Introduction

In the wake of this affirmation contained in the name of the track, the question we ask ourselves is twofold: on one hand, how interactions between the brand and its customers (Hatch and Schultz, 2010) can be transformed/ synthesised into "monetisable" shareholder value (de Chernatony, 2006 ; Salinas and Ambler, 2009) for investors, and on the other hand, how brand orchestration, supported particularly by/arousing the collaboration of consumers

grouped into communities (Muniz and O'Guinn, 2001 ; Schau, Muniz and Arnould, 2009) can manage to increase or endanger shareholder value.

What people do with brands has always been considered a source of value for them (Arvidsson, 2006). Nonetheless, during the last decade, this phenomenon has been accelerated by the rising power of consumer communities (Cova, Kozinets and Shankar, 2007), backed by the development of the internet and social media. It has been shown today (Veloutsou and Moutinho, 2009) that the success of a brand increasingly relies on the existence of a community of totally captive and loyal fans who co-create the value of that brand through their numerous practices (Schau, Muniz and Arnould, 2009).

This paper seeks to respond to both these questions on brand value by drawing relationships between three worlds still unknown to each other: the world of the *brand communities* (Muniz and O'Guinn, 2001), the world of *brand management* (Hatch et Schultz, 2010) and the world of *brand valuation* (Salinas and Ambler, 2009).

### **Brand values**

The polysemantic nature of the word "value" is well illustrated by Foster [(Foster, 2011); see also (Willmott, 2010) and (Arvidsson, 2009)] in its three senses: moral, semiotic and economic. In the last case, its meaning rests on the distinction made by Marx between use value and exchange value. It is this latter sense that we shall employ in the course of reasoning in order to connect it to shareholders.

The term "use value" is to be taken in the generic sense, as applied to a *commodity*, [(Foster, 2011)] which « *is, in the first place, an object outside us, a thing that by its properties satisfies human wants of some sort or another. The nature of such wants, whether, for instance, they spring from the stomach or from fancy, makes no difference (...). Every useful thing ... is an assemblage of many properties, and may therefore be of use in various ways. To discover the various uses of things is the work of history* » (Marx, 1978, p. 51) and, it could be said, of consumers. In any case, "*use values must therefore never be looked at as the real aim of the capitalist; neither must the profit on any single transaction. The restless, never-ending process of profit-making alone is what he aims at*" (Ibid., page 157). Use values serve as the support for exchange value: "*only produced [by capitalists] ... in so far as they are ... the depositories of exchange value*" (Marx, 1978, p. 188), the source of shareholder value.

Exchange value does not characterise human relations – it is only one face of value (Marx, 1980, p. 207) - but rather, the dynamics of capital valorization on which these relations are built. It is the value created by the movement that gives rise to the increase in the value of the capital mobilised to produce it; i.e., the growth in the value of the capital applied to the production of goods and services.

We are thus not talking about the symbolic, ethical value created in exchange, but about an exchange relationship, the vector of which is the currency that represents the monetary

embodiment of this value. Money, the “universal equivalent” of wealth, the “socially recognised universal equivalent” (Marx, 1980, pp. 173, 214) is a special commodity that functions as a general exchange equivalent “against the particular and singular forms of wealth” (Ibid.), acts, goods or even services: “*The type of use value that backs value is of little importance; but value must be backed by use value*” (page 189). In other words, the goal of capitalist production is to increase the value of capital and to facilitate investment decisions that will result in opportunities for such increase, which modern financial theory calls the creation of shareholder value.

Hence, the creation of shareholder value is nothing but that exchange value that sustains the capital cycle through shareholders / investors.

### **Community practices and brand value**

In these “use-exchange” dialectics, brand communities (Muniz and O’Guinn, 2001) or consumer tribes (Cova, Kozinets and Shankar, 2007) are ever on the forefront, on the crest of a wave of exchanges/exploitation that runs the risk that the sphere of exchange – through the policies followed by the company, and thus through shareholder pressure – may drive back the frontiers of use to appropriate its underlying exchange value (what has been called the “merchandising” of activities, as in the example of Modigliani).

The question is thus:

- on one hand, to define modes of transforming community practices (Schau, Muniz and Arnould, 2009) into exchange value acceptable to the community (the capacity of the company to make a product acceptable to the market) while encouraging that community to respond to it and also being able to anticipate its needs and projects related to identity (Arnould and Thompson, 2005)
- on the other hand, to “raise” shareholder value (brand value creation → brand valuation) on the basis of practices bearing/underlying/qualifying the brand [see the Coca-cola case (Foster, 2011)], so as to respond to shareholder expectations and/or attract new shareholders (investors in both cases)

One of the challenges is thus to avoid creating adverse effects by exercising too much shareholder pressure on the company-consumer relationship, while at the same time ensuring that the exchange value created is well-redistributed to the shareholders and not deviated to other ends of common knowledge or reputation, to the detriment of the wealth distributed to the owners of the company (Jensen and Meckling, 1976). On the other hand, it is also necessary to ensure that shareholder and financial demands do not jeopardise the means deployed for brand orchestration in order to acquire practices likely to carry exchange value.

Another challenge is the fact that at some given time there can be a perception of “exploitation” among the consumers [(Foster, 2011); (Willmott, 2010); (Tiffon, 2010)], a

withdrawal and at the same time a rupture, arising from a relationship that has revealed a dimension of unpaid work, the results of which are appropriated, “acquired” (Cova and Dalli, 2009) by the other party – the company and its brand – without any tangible compensation for the consumers. The question is, “*why do they not receive [the consumers] any economic reward for this labour?*” (Cova and Dalli, 2009, p. 326).

The response is that, in that case, the company, more precisely the shareholder(s), would be compelled to share a part of the additional income coming from that unpaid activity. Consequently, remunerated or not, the dialectic “brand value creation – brand community practices” carries a risk of being perceived as an appropriation attempt: “*As a lived experience, the appropriation consists of the fact that purposes incompatible with my motives are imposed upon my social activity*” (Sève, 2008, p. 505).

Thus, “*the value of brand provides a central performance measure and should serve as a performance indicator for various management purposes*” (Clifton, 2006, p. 52)

An important sequence thus comes into play. Any company activity, whatever the nature of its assets, is subject to a system of non-linear constraints:

- the constraint of accumulation; to wit, to acquire the capital necessary for its activity, whereby this capital may be tangible or not, social or human, etc.
- the constraint of valorization, which means the creation of potential added value (to the extent that it does not materialise on the market, see next point) through the incorporation of competences – possibly outside the market – on the basis of the assets mobilised and the services or goods purchased, or not
- the constraint of realization, which means that the new product proposed to the market should be validated by the consumers. This validation in market economy involves the purchase of and payment for the said product – i.e., a monetary transaction – and also, increasingly, the emergence, outside the market, of a dynamic’s socially validating values, whether or not these hold shareholder exchange value

This realization is thus a risk by itself, since if financial validation “*is more linked to the risks and insecurities of life itself*” (Arvidsson, 2006, p. 132), to that extent, its outcome originates in the quality of the market relationship through the brand “*made by a kind of loop*” (Arvidsson, 2006, p. 127).

The central operational difficulty is that this quality is hard to evaluate and the underlying risk is likewise hard to quantify. Study of the methods in use (Salinas and Ambler, 2009) shows that if the financial dimension of the brand community is well integrated (Isakovich and Johnston, 2009), the quality and modes of orchestration or, more precisely, of interaction between the company (Brand Value Creation) and the community (Brand Community Practices) would seem non-existent. When is there a risk of perceived exploitation? What

about the perception of faithfulness to the history, statements and values held by the company? How are these risks and stakes quantified, integrated, modelled, for them to be taken into account in the policies drawn up by the Board? [(Hatch and Schultz, 2010); (Tiffon, 2010); (Willmott, 2010)].

A study of tools and methods shows that both seem overly centred on the traditional concept of a passive client and not an active consumer whose behaviour and expectations interact with the financial objectives of the company regarding its brand, conceived as an intangible asset and source of income [Batchelor, quoted in (Willmott, 2010, p. 519)].

**A blind point: the dynamics of the relationships “finance-market-community”.**

The exchange value of brands has been the subject of significant research, both academic and practical (Salinas and Ambler, 2009).

Indeed, like an asset entered on a balance sheet, the brand should be validated by both the consumer market and the financial investment market. The specific feature of an intangible asset such as a brand is its dependence on the validation of its “value” by the market; i.e., brands must demonstrate the capacity to create value, not only for consumers (Ochs, 1998) but also (above all?) for the shareholders, who, at one time or another, will have the need, the urge or the choice to judge from among diverse investment opportunities. In this case, the possibility of selling will depend on the acknowledgement by a third party of the potential of the company strategy to create shareholder value, and thus the capacity of the seller to prove his capacity to ensure the monetary performance of the brand.

Consequently:

- either a buyer and a seller “meet” on the goods and services market, and make tangible, at a given moment and for a given buyer, the economic reality of the brand by means of a monetary exchange (its capacity to create “hard cash” value)
- or a market – the financial market – testifies to this capacity through purchases and sales of the securities of the company owning some brands, in witness of their capacity to extract shareholder value through value creation strategies for and by consumers

There thus exists a reality check: an realization, which is an exchange on a market – the goods market, where consumers acknowledge the value(s) of the brand, and the financial market, where investors validate an exchange value potential held by the brand. In both cases, the brand thus serves as *“a relational entity that only creates value in the context of an interaction and differential game between diverse agents”* (Heilbrunn, 1997). This validation by the financial market is so necessary that a company can only enter a brand as an intangible asset on its balance sheet during a purchase, an acquisition attesting to the interaction between a seller and a buyer on the market (Vernimmen, 2005).



This explains the stakes that the valuation of a brand represents for companies; i.e., how to coherently articulate two disciplinary fields such as marketing and finance in a context of development, where raising capital increasingly involves giving tangible form to contributions and expectations in terms of creating shareholder value.

According to Salinas and Ambler (2009, p. 42), there are three great methods on the subject: a cost approach, whereby *“the brand is valued on the basis of the cost of creation”*; a market terms approach, *“by reference to open market values”*; and an approach oriented above all towards income, *“based on the premise that future cash flow attributable to a brand dictates its value for its owner, our potential investor”*.

Not surprisingly, the authors note that the latter *“is the most popular approach”* (2009, p. 44), thus confirming that the entire stake around the debate about brands, from the point of view of companies, is actually the creation of shareholder value, exchange value, which involves not only developing the productivity of the company, but ensuring that this is capable of tapping the potential value likely to emerge from the production process and appropriating it.

One thing is to be noted: the different approaches presented by the authors cited remain static in that they fix the evaluation sequence in determining shareholder value (market value in the financial sense) without asking themselves about the global dynamics of the production process, including the moment of circulation in which new uses are developed that may be a source of values.

The question of the value of a brand is not new as shown by Fernandez (2001). He presented different methods used for doing it<sup>ii</sup>. Among them, he mentioned *“Interbrand, Damodaran, Financial World, Houlihan Valuation Advisors, Market Facts, Young and Rubicam and CDB Research and Consulting”*. In his paper he mentions two important things:

*“when valuing a brand, it is particularly important “for whom” the value is being determined (...)”*

*“Likewise, it is vitally important to define “for what purpose” it is wished (...)”*.

If we adopt the shareholder standpoint, it is crucial, depending on if he is a seller or a buyer of a company with a brand: their expectations are not the same.

In this perspective, what are the methods used to calculate the value (Rodrigues, 2001; Fernandez, 2001; Lindemann, 2004; Salinas and Ambler, 2009)? One considers that the value of a brand is the value of the share on the financial market according to the fact that if someone wants to buy a share it is because he/her expects future earnings supported by the brand<sup>iii</sup>. Another approach seems to be more interesting for us. The value of a brand could be understood as the cost of its replacement:

*“Present value of the historic investment in marketing and promotions.*

“Estimation of the advertising investment required to achieve the present level of brandrecognition.” (Fernandez, 2001).

Among others approaches, this one is interesting for our comments because it directly links the management of the consumers to the management of the financial performance. Some authors like Rodrigues (2011) consider that this method is not able to evaluate the value generating by the brand and propose to use Economic value approach like Interbrand does. But our concern is not to calculate the future earnings but to identify the constraints face by the company to build its brand. In this perspective the so call Cost Based Approach is interesting to identify actions, and their cost, implemented by the company to manage its brand and its community.

Others methods focus more on the deal between a seller and a buyer about the expecting value of the brand, that means its capacity to create value in the future. The main problem is clearly quoted by Lindemann (2004) *“event today, the evaluation of profitability and performance of businesses focuses on indicators (...) that excludes intangibles ...”*. The problem is “for who” this evaluation is made. From a market standpoint, it is sure that intangibles must taking into account, because the expectation of A investor is about his future earnings; but from a bank point of view, which is focused on solvability, an intangible, a brand, has a value only if the firm is in a good situation. If it faces some problems (look at Lacroix), uncertainty rises about those earnings and so the value of the brand is in distress. To say the debate is between an individual approach, a firm facing an investor or a seller and a buyer, and a more systemic approach integrating others stakeholders, like consumers but also inside the firm itself between finance function and marketing function.

### **Conclusion: our research program.**

To take into account the limit of the Cost Based Approach and the need to consider shareholder expectations, we will concentrate our analyze on Interbrand which is very well known since two decades because its method is focused on this relationship. *“Interbrand’s method looks at the ongoing investment and management of the brand as a business asset. This means that our method takes into account all of the many ways in which a brand touches and benefits its organization – from attracting and retaining talent to delivering on customer expectation.”* (Interbrand, 2010). This method has been recognised by the ISO standard 10668 (ISO, 2010). The organization argues that *“The standard guides users through a globally harmonised three-tiered analysis focusing on financial, legal and behavioural aspects. Examples include the legal rights and protection of a brand, market size and trends, its effect on purchase choices and the different attitudes of stakeholders towards the brand”*.

The measure of brand value is based on three pillars<sup>iv</sup>:

- the financial performance, measured from investors standpoint with a concept close to the Economic Value Added (EVA; Brealey, Myers, Allen, 2006) to determine the profitability of the organization as a whole (Interbrand, 2010);
- the role of brand “*measures the portion of the decision to purchase that is attributable to brand*” (Interbrand, 2010);
- the brand strength “*measures the ability of the brand to secure the delivery of expected future earnings.*” (Ibid; Fernandez, p.12, 2001)

Interbrand has developed the understanding and measure of these “connector brands” (Isakovich and Johnston, 2009). Their brand strength can be determined based on the brands’ ability to ensure strong future connections. These metrics include a customer’s: 1) Brand loyalty; 2) Interactivity with the brand; 3) Engagement with community; 4) Perception of brand uniqueness. Concerning the third metrics “Engagement with community”, Interbrand (Isakovich and Johnston, 2009, p. 3) defines it as follows: “*The stronger the community that a brand creates for its customers, the more they will rely on the brand to create and sustain the community. This connection can refer to an actual community or a sense of community*”. Thus, some brands – the cult brands - are able to foster a sense of zealous appeal and resulting loyalty which is very valuable for companies owning them.

For us, the question is less about the tools than analysing the manner in which marketing/finance functions interact with each other in the process of putting an income-generating product or service on the market.

Going back to our outline, it would seem that “brand valuation” methods are built around the relationship with third-party financiers without taking into account among financial strategies certain contradictions that can potentially destroy value or serve as levers to create additional value: shareholder and investor demand for (short-term) profitability, marketing, the identification and implementation of activities, and their impact on communities.

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*i This said, the term "exploitation" in the Marxist context is ambiguous, since for Marx exploitation only exists in the production process, when the employee works beyond the time necessary and produces "surplus labour". It thus involves a contractual relationship, which is not the case of consumers. The fact remains nonetheless that their work, done outside the capitalist production process, determines a use value that carries a potential exchange value, provided it is integrated into this process (Marx, 1980, pp. 34, 182-183, 376).*

*ii According to Fernandez (2001) "There are many definitions for the brand concept but they are not feasible for brand valuation. For example, Aaker defines the brand as "a set of assets and liabilities linked to a brand's name and symbol that adds to or subtracts from the value provided by a product or service to a firm and/or that firm's customers". According to Lance Leuthesser (1995), the brand is "a product's additional value (for its customers) compared with what would be the value of another identical product without the brand". According to the Marketing Science Institute (1998), the brand is the "strong, sustainable, and differentiated advantage with respect to competitors that leads to a higher volume or a higher margin for the company compared with the situation it would have without the brand. This differential volume or margin is the consequence of the behavior of the consumers, the distribution channel and the companies themselves".*

*iii See Fernandez (2001), Salinas and Ambler (2009), Rodriguez (2011), ISO (2010).*

*iv They can be detailed as 1/ market segmentation, 2/ financial analysis, 3/ demand analysis, 4/ competitive benchmarking, 5/ brand value calculation (Lindemann, 2004).*

**MICRO-INSURANCE IN EMERGING MARKET: CHAPTER BANGLADESH****Parvez, Md. Shahriar<sup>1</sup>**

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**Abstract**

The study focuses on Micro-Insurance in Bangladesh, an emerging market. The policy environment for Micro-Insurance market in Bangladesh is studied with the initiatives by various sectors. This paper also aims at understanding the perspective of Micro-Insurance in emerging market in Bangladesh.

The study uses published secondary data from various relevant sources websites, journals, publications and the researchers have used personal observation and experience regarding the country's socio economic and political background and their impact on the Micro-Insurance.

Microfinance institutions are developing new financial products and services to meet increasing client demand and Micro-Insurance is one of the products that are gaining wide attention in the world of microfinance. In Bangladesh this Micro-Insurance product of Microfinance is newly adopted various MFIs/NGOs and offer various products to the poor people and ensure their unknowable risk.

Bangladesh has been considered a pioneer in Micro-credit, yet diversification of financial products and services for the poor is not up to the mark. Although many MFIs are offering Micro-Insurance products to the poor, there are a large number of poor people uncovered by Micro-Insurance. Current Micro-Insurance products offered by MFIs/NGOs are coming from the supply side and other than the demand side. Although many MFIs/NGOs are offering Micro-Insurance products to protect their loan as well as provide social security to their clients though reducing risks and vulnerabilities, product diversification and professional Micro-Insurance operations are not developed. There are huge scopes of Micro-Insurance practical implications in the financial sector of developing countries and Bangladesh is one of them.

**Keywords:** Micro - Insurance, Microfinance Institutions (MFI), Non-Government Organization (NGO), Target Clients & Insurance Industry.

**Introduction**

Intensify risk and defenselessness is a core element of daily life for poor people. Poor people must often struggle hard to slowly generate income and build their assets to get out of poverty. Crises are recurrent in the lives of the poor. Such crises - personal, social, or natural - often involve high expenditures and drive poor families deeper into poverty. Most common crises are accidents, sudden hospitalization, and death of a bread earner, and loss of crops or

assets. Expenses incurred during such crises are met either by borrowing from moneylenders, sales or mortgaging of assets or by drawing on scarce saving resulting into a simultaneous reduction in income and saving, and an increase in debt and expenditure. Each crisis leaves a poor family weaker and more vulnerable. Traditional micro-finance schemes do not address such vulnerabilities and the necessity of risk reduction for the ultra poor. The informal coping mechanisms offer limited protection and are less available to poorer households and break down when most needed. Formal financial services can offer greater benefits at a lower cost than informal mechanisms but there is vulnerability to risk is reducing effectiveness and financial performance of micro-credit.

Insurance or risk protection is one mechanism that ties both the borrower and the institution. Mostly the MFIs only cover lenders part of risk by securing the credit whereas borrowers' part of risk is always overlooked. Any improvement in this area will help the MFIs not only to bring better customer satisfaction through better risk protection of unwanted risks faced by the borrowers but also contribute to the poverty alleviation role of micro finance. Undoubtedly, risk coverage of borrower's part of micro-credit is an important and interesting area to work with. For products like micro-insurance, increased attention is given to address clients' needs for risk management that in a sense helps the bottom of the pyramid to have more savings and thus pool them from the destitution.

Exacerbated risk and vulnerability is a core element of daily living for the poor people. Poor people must often strive hard to slowly generate income and build their assets to get out of poverty. Microfinance makes this process smoother. For this reason Microfinance is considered as proven strategy of poverty alleviation. But in the perilous world of scarcity, impulsive shocks such as illness, death within the family, especially primary household earners, and damage of property affect the process of income and asset building. Sometimes Microfinance itself is not sufficient enough to cope with these types of shocks. To cope with the shocks and vulnerabilities, poor people expect some financial as well as social security products like Micro-Insurance is increasing day by day.

### **Purpose**

Millions of people in developing countries live in a state of destitution. Their opportunities for development are extremely restricted by economic and political conditions as well as their financial and social situations. Through different micro finance and insurance policies the poor could attain a better standard of life through programs prepared in the field of financial business services. Globally micro-credit is considered as an important tool for poverty reduction. Different micro finance institutions (MFIs) have different mechanisms and practices for micro-credit. Poor people confront many of the same risks faced by the non-poor (e.g., death, illness or injury, loss of property due to theft/fire and natural disasters), but these risks have greater financial impact and occur with greater frequency.

Moreover, the vulnerability of poor people is exacerbated each time they incur a loss, creating a vicious cycle that precludes lasting improvements in human and economic welfare. And Micro-Insurance is one of the most imperative products of Microfinance, and in Bangladesh it has a huge perspective market.

This paper aims at understanding the Micro-Insurance in the emerging market in the economic of Bangladesh.

### **Methodology**

The study uses secondary data collected mainly from the office folder of International Network of Alternative Financial Institutions (INAFI), (Asia and Bangladesh) a worldwide network of development practitioners that are committed to improving the lives and livelihoods of the poor in the regions of Africa, Asia and Latin American by offering a range of financial and non-financial services as a means of poverty alleviation. And other related websites, journals, publications etc. all information and reference is provided in the reference section of this research paper. In addition to this the researcher has used personal observation and experience regarding the country's socio economic and NGOs/MFIs and their impact and standpoint of Micro-Insurance in Bangladesh.

### **Progression of Microfinance and insurance in Bangladesh:**

The Microfinance industry in Bangladesh has been able to demonstrate a remarkable growth during the last two decades and to provide access to credit to around 30 million poor households (according to the Credit and Development Forum (CDF) Bangladesh). According to the Bangladesh Bank there are around 12000 (twelve thousand) branches of NGO/MFIs in Bangladesh. The average member size and borrower size of a branch is 1883 and 1413 respectively. Up to June 2006 - 2007 four big institutions including Grameen bank dominate the microfinance market of Bangladesh.



Table – 1  
Coverage of Micro-credit Program

Organization	No. of Borrowers	Outstanding Loan (in million Taka)
NGO-MFIs (June 2006)	18,415,878	78,930.57
Grameen Bank (June 2006)	6908704	33235.46
Government Program (December, 2005)	1,997,240	7,710.05
Sub Total	27,621,573	120,493.52
Nationalized Commercial Banks (December, 2005)	2311150	32783.45
Private Banks (December, 2005)	164113	1106.46
Sub Total	2,475,263	33,889.91
Grand Total	30,096,836	154,383.43

Source: Micro-credit Regulatory Authority (Bangladesh Bank). <sup>\*1</sup>

\*1 - <http://www.bangladesh-bank.org/>

Grameen Bank, BRAC, ASA and PROSHIKA account for 60% of the total amount of outstanding loans made by all MFIs, and it is widely believed that top 20% institutions account for 80% of the total market (Bangladesh Bank).

#### Development of MFIs/NGOs in Bangladesh:

The Microfinance industry in Bangladesh has exposed a significant growth over the last two and half decades. Before 1990, there were only 37 MFIs/NGOs operated Micro-credit programs.

Table – 2  
Growth of MFIs/NGOs

Year	Number of MFIs
Before 1976	02
1979 - 1980	02
1981 – 1985	07
1986 - 1990	26
1991 - 1995	127
1996 - 2000	409
After 2000 in progress	1883

Source: Bangladesh Bank report & Microfinance Statistics of CDF (2007 - 2008)

The main dilemma of insignificant growth of MFIs/NGOs before 1990s were of Capacity to operate Micro-credit program and another important issue was availability of revolving loan fund. After establishing PKSF in 1990 as an Apex funding organization for funding Micro-credit program, there was a significant growth in the microfinance sector of Bangladesh. The

significant growth in the microfinance sector of Bangladesh was observed from 1996 to current year 2011.

#### **The Insurance Industry in Bangladesh:**

The insurance industry of Bangladesh has been considered as a growing sector. According to the publication of Bangladesh Bank (Financial Sector in Bangladesh) the insurance sector is regulated by the Insurance Act 1938 with regulatory oversight provided by the Controller of Insurance on authority under the Ministry of Commerce. A separate Insurance Regulatory Authority is being established. A total of 62 insurance companies have been operating in Bangladesh, of which 18 provide life insurance and 44 are in the general insurance field. Among the life insurance companies, except the state owned Jibon Bima Corporation (GBC) foreign American Life Insurance (ALICO), and the rest are private. Among the general insurance companies, state owned Shadharan Bima Corporation (SBC) is the active in the insurance sector. A total of 31 insurance companies are listed in the capital market, of which 8 offer life insurances.

*Table – 3*  
*Number of Insurance Companies in Bangladesh*

<i>Insurance Industry in Bangladesh</i>	<i>Number of Companies</i>
<i>Public sector Life Insurance company</i>	<i>01</i>
<i>Private Sector Life Insurance Companies</i>	<i>17</i>
<i>Total Life Insurance Companies</i>	<i>18</i>
<i>Public sector General Insurance Company</i>	<i>01</i>
<i>Private sector General Insurance Companies</i>	<i>43</i>
<i>Total General Insurance Companies</i>	<i>44</i>
<i>Total Insurance Companies</i>	<i>62</i>

*Source: Bangladesh Insurance Association (Provided by INAFI, Bangladesh) year- 2008-2009*

Although the country has huge prospect in insurance sector due to large population, but this sector remains underdeveloped compared to that of neighboring countries. In FY 2007 - 2008, the growth of insurance sector was 7.6 percent (according to the Bangladesh Bank report, provided by INAFI); whereas in FY 2002 - 2003 this growth was 12.4 percent. The GDP share of insurance Sector is increasing, in FY 2006-2007 the share of insurance sector in GDP was 0.4 percent, whereas in FY 2002 - 2003 it was 0.3 percent.

According to the Khaled Mahmud Raihan publication (Insurance industry in Bangladesh; A rater's perspective) The Financial Express (October 11, 2008), Overall financial performance of the general insurance companies was found moderate. On an analysis, it was found that 15.38 per cent companies revealed poor financial performance, followed by 30.76 per cent marginal, 46.15 per cent above average and rest 7.71 per cent satisfactory financial performance. The average gross underwriting margin stood at 43.07 per cent ranging from 59.32 per cent to (43.92 per cent) during the period under report in this write-up. Considering the reserve for

unexpired risk, the average net underwriting margin was found at 8.78 per cent ranging from 24.58 per cent to (77.27 per cent). The average pre-tax operating margin was 12.89 per cent having wide deviation among the companies. The average return on average asset (ROAA) and return on average equity (ROAE) respectively stood at 5.54 per cent and 7.98 per cent. The average return on average investment (ROAI) stood at 8.48 per cent with a very small variation.

Unlike general insurance companies, the financial performance of life insurance businesses are measured by the surplus generated from the gap between actuarial valuation of liabilities and life fund. It has been found that average policyholders' surplus to net premium was 6.66 per cent ranging from 18.76 per cent to (2.44 per cent). Average surplus on assets stood at 4.53 per cent. Average incremental surplus to incremental life fund during the period stood at 7.84 per cent (ranging from 20.79 per cent to -0.02 per cent) indicating moderate growth of surplus against the life fund generation. Return on assets was also found moderate with an average of 7.82 per cent among the companies in the sample. (Table – 4: Chronicle of Insurance Industry in Bangladesh)\*2

*\*2 - Appendix B*

## **Simple Clarity & Overview of Micro-Insurance in the Emerging Market OF BANGLADESH**

According to the Monique Cohen and Jennefer Sebstad (Microfinance opportunists\*3) “Insurance is a mechanism that uses risk pooling to compensate individuals and groups adversely affected by a specified risk or event”. Insurance can be defined as such a social and economic security that pool risk, reduces vulnerability and provides more complete compensation.

Micro-Insurance is a subset of insurance that provides social security and plays role of social safety net to the poor. Its clients and operational methodology are different from the existing formal insurance companies. The clients of Micro-Insurance are poor and they depend on low income. Usually this income flows fluctuate considerably throughout the year.

In a very simple sense Micro-Insurance means insurance services provided to the low-income people. In a wide sense “Micro-Insurance is an insurance service which provides the protection of low-income people against specific perils in exchange for a pre-specified payment determined in proportionate to the likelihood and cost of the risk involved and made in advance” (according to the ADB viewpoint). So, Micro-Insurance is an integral part of the financial services for the poor and low-income people.

The definition of “Micro-Insurance” can be understood in two parts. First, the “Micro” portion of the definition refers to the subset of product that is designed to be beneficial and affordable for low-income individuals or groups. Second, the “Insurance” component refers

to a financial service that uses risk-pooling to provide compensation to individuals or groups that are adversely affected by a specified risk or event. Risk-Pooling means that a large group or pool of individuals or group contributes to share the losses resulting from the adverse situation or occurrence of a risky event. Persons affected by an adverse situation and negative event enjoy benefits from the contributions of many others that are not affected and due to risk sharing the affected persons receive compensation that is greater than the amount they have invested in the insurance policy. Products that allow affected individuals to receive only up to the amount they have contributed are considered savings products, and not insurance products. So insurance is different from saving as well as other financial products.

### **An Overview of Micro-Insurance in Bangladesh:**

Micro-Insurance is a new concept, which is gaining attraction and popularity in Bangladesh. As a new concept a new product, the information and documents on Micro-Insurance, both from MFIs/NGOs sector and private insurance companies are very scarce. The Delta Life Insurance is the first private regulated insurance company in Bangladesh that entered in the Micro-Insurance in 1988<sup>\*4</sup>, inspired by the growing success of the Grameen Bank and other Micro-credit schemes in Bangladesh.

<sup>\*3</sup> - [www.microfinanceopportunities.org/pubsMI.php](http://www.microfinanceopportunities.org/pubsMI.php)

<sup>\*4</sup> - <http://www.deltalife.org/micro.htm>

Delta launched an experiment of its own, Grameen Bima and Village Insurance. Initially, the design for Grameen Bima called for collaboration with a Micro credit, NGO that provided the delivery structure for Delta's endowment product. This partnership dissolved after a short time because of a difference in objectives. With the tremendous success of Delta Life Insurance, some MFIs/NGOs as well as private insurance companies came forward to offer Micro-Insurance products to the poor people. The MFIs/NGOs came forward with health insurance and also loan insurance to protect their portfolio and reduce portfolio at risks.

Bangladeshi microfinance NGOs came into the Micro-Insurance scene in the late 1990s and early 2000s. Important players in Micro-Insurance are BRAC, Grameen Kalyan, ASA, Proshika, Gonoshashtho Kendra, Sajida Foundation, Shakti, Dhaka Community Hospital, Nari Uddug Kendra, Dushtha Shasthya Kendra, Integrated Development Foundation (IDF) and Society for Social Services (SSS). (Source: all information provided by the INAFI, Bangladesh). Gonoshashtho Kendra is the first NGO which offered Health Micro-Insurance in Bangladesh. BRAC started its health Micro-Insurance in 2001, Grameen Kalyan started Micro-Insurance in 1997 and SSS launched health Micro-Insurance in 1993. ASA launched Micro-Insurance products in 1993, with loan insurance with a view to help the member's family in case of sudden death (source: ASA annual report 2004).

Proshika started Micro-Insurance products in 1997. IDF started Micro-Insurance program in October 1997 in response to requests of group members to help their families in the case of serious sickness or death of any earning members (source: IDF annual report 2004). In 2003,

the ILO's WEEH (Women's Empowerment through Employment and Health, July, 2005) project carried out an extensive study to take inventory of Micro-Insurance product in Bangladesh. The study covered twenty organizations that provide thirty-six schemes in various parts of the country. Three of these are large NGOs, namely BRAC, Grameen Kalyan, and Proshika. These NGOs have nationwide reach though their organizational infrastructure built on established micro-credit groups across the country. Sixteen schemes are provided by small to medium locality based NGOs such as the Chittagong based IDF. These schemes provided by the NGOs are not for profit and cover risks such Primary health, Hospitalization, Life, Loans and Property. Lastly, one scheme is run by a commercial insurance company – Homeland Life Insurance.

Their schemes have nationwide coverage and their risks coverage is limited to Life insurance. According to ILO study, they have isolated the thirty-six schemes of twenty organizations in five categories.

*Table – 4*  
*Types of Micro-Insurance in Bangladesh*

<i>Types of Schemes</i>	<i>No of Schemes</i>	<i>Distribution (%)</i>
<i>Health</i>	<i>14</i>	<i>39</i>
<i>Life</i>	<i>13</i>	<i>36</i>
<i>Loans/Capital</i>	<i>06</i>	<i>18</i>
<i>Livestock</i>	<i>02</i>	<i>05</i>
<i>Disaster</i>	<i>01</i>	<i>02</i>
<i>Total</i>	<i>36</i>	<i>100</i>

*Source: Inventory of Micro-Insurance Schemes in Bangladesh by WEEH ILO, September 2003-2004 (provided by INAFI Bangladesh)*

The premium of Micro-Insurance collected Taka.636.14 crore in 2006, which went up to Taka. 767.10 Crore in 2007 and Taka. 917.98 Crore in 2008\*5

### **The Practice of Micro-Insurance in Bangladesh:**

According to the Contribution of Micro-Insurance Augmenting the Poverty Alleviation Role of Microfinance\*6 by Professor M. Ziaulhaq Mamun, PhD (IBA, DU), Bangladesh a country of 140 million people is very densely populated. Majority of the population is living in the rural areas and are deprived of basic social services (e.g., health, Medicare, etc.). Micro-insurance is rapidly expanding in Bangladesh.

Micro-insurance products are becoming more competitive, and there are varieties of risk mitigation options available to the low-income market. The very first micro-insurance scheme was introduced 1972 by Gono Shashtho Kendro. Besides regulated insurers, many MFIs have some level of insurance provision covering disability and/or death. Recognizing the link

between good health and productivity, some MFIs are also trying to bring quality health care to people who have not had access to these in the past.

The MFIs/NGOs came forward with Micro-Insurance Products during the late 1990s and early 2000, when they observed that due to death of Microfinance clients, the felony and portfolio at risks of the organization usually increases. When the NGOs/MFIs scrutinized the demand from the clients' side then they offer Micro-Insurance products. Beside, the success of Micro-Insurance products a private insurance company also encouraged MFIs/NGOs to offer insurance products for there Microfinance clients.

\*5 - <http://www.thedailystar.net/newDesign/news-details.php?nid=81269>

\*6 - *Contribution of Micro-Insurance Augmenting the Poverty Alleviation Role of Microfinance by Professor M. Ziaulhaq Mamun, PhD (IBA, DU), (A Draft Paper Prepared for the 11th APRIA Conference at National Chengchi University, Taipei, Taiwan (July 25-28, 2007).*

### **Nature of Products of Micro-Insurance in Bangladesh:**

In Bangladesh the existing 61 MFIs/NGOs are offering total 81 insurance schemes of different products i.e. Loan, Life, Health, Livestock and Property insurance.

Table: 5

*Nature of Micro-Insurance Products of MFIs/NGOs*

<i>Name Of Products</i>	<i>No of Schemes</i>	<i>Frequency Distribution (%)</i>
<i>Loan Insurance</i>	57	71%
<i>Life Insurance</i>	13	16%
<i>Health Insurance</i>	05	06%
<i>Livestock Insurance</i>	04	05%
<i>Property Insurance</i>	02	02%
<i>Total</i>	81	100%

*Source: Market Study on Micro-Insurance Products 2007-2008, by INAFI, Bangladesh, Supported by Oxfam Novib (www.oxfamnovib.nl).*

In the subsequent we observe some tables (according to the Market Study on Micro-Insurance Products 2006, by INAFI, Bangladesh, Supported by Oxfam Novib (www.oxfamnovib.nl), which provide us a clear overview of different insurance product at a glance.

Table – 6  
Loan Insurance product at a glance

<i>Product Description</i>	<i>Product Features and Packages</i>
<i>Target clients</i>	<i>The Micro-credit borrowers</i>
<i>Premium rate</i>	<i>Average premium charges per Thousand (1000) Taka loan insurance is Taka8. The maximum amount charges Taka.40 and the minimum amount charges Taka.2 per Thousand (1000) Taka insurance coverage. Moreover, some organizations collect certain amount between Taka.10 to Taka.50 during loan disbursement.</i>
<i>Premium collection procedure</i>	<i>Most of the MFIs collect premium during loan disbursement</i>
<i>Duration of insurance policy</i>	<i>Most of the MFIs offer insurance policy for the loan period only like 45/46 weeks or 1 year. Moreover, some MFIs/NGOs offer insurance for whole membership term.</i>
<i>Size of insurance coverage</i>	<i>For loan insurance, after the death of client the outstanding loan amount is exempted. The size of this outstanding loan amount varies and usually not more than Taka.20, 000. But some organizations cover more outstanding loan. Moreover, some MFIs provide additional benefits along with loan exemption.</i>
<i>Types of risk coverage</i>	<i>In most of the cases the death risk of insurance clients is covered. Moreover, some MFIs also cover the death risk of household head or earner, accidental risks, and property loss.</i>
<i>Claims paid or premium refund</i>	<i>After the maturity of insurance term if the client doesn't die then no premium is refunded. If the client dies, then outstanding loan is exempted.</i>

Source: Market Study on Micro-Insurance Products 2007-2008, by INAFI, Bangladesh, Supported by Oxfam Novib ([www.oxfamnovib.nl](http://www.oxfamnovib.nl)).

Table – 7  
Life Insurance product at a glance

<i>Product Description</i>	<i>Product Features and Packages</i>
<i>Target clients</i>	<i>The Micro-credit clients</i>
<i>Premium rate</i>	<i>The premium rate varies from Taka.01 to Taka.10 per week. Some NGOs charges premium between Taka.10 to Taka.50 during loan disbursement and amalgamated the loan insurance with life insurance.</i>
<i>Premium collection procedure</i>	<i>Usually life insurance premium is collected weekly. But some organizations that compounded loan insurance with life insurance collect premium once at a time during loan disbursement.</i>
<i>Duration of insurance policy</i>	<i>The duration of insurance policy varies form 4 to 8 years. But some organizations offer life insurance for whole membership term of clients.</i>
<i>Size of insurance coverage</i>	<i>The size of insurance coverage usually varies from 3 to 7 times of deposited amount. But some organizations that combined loan and life insurance provide Taka.1000 to Taka.5000 as grant along with outstanding loan adjustment after the death of insured client.</i>
<i>Types of risk coverage</i>	<i>In most of the cases the death risk of insurance clients is covered. Moreover, some MFIs/NGOs also cover the death risk of household head or earner, and accidental risks.</i>
<i>Claims paid or premium refund</i>	<i>Some organizations refund the premium with 4% to 5% interest after the maturity of insurance term if there is no claim. But some organizations either don't refund the premium or not provide interest on deposited premium, if there is no claim.</i>

Source: Market Study on Micro-Insurance Products 2007-2008, by INAFI, Bangladesh, Supported by Oxfam Novib ([www.oxfamnovib.nl](http://www.oxfamnovib.nl)).



Table – 8  
Health Insurance product at a glance

Product Description	Product Features and Packages
Target clients	The members of the organization
Premium rate	Some organizations charges annually Taka.08 to Taka.25 on per thousand (1000) Taka loan disbursements. And some organization charges Taka.250 to Taka.300 annually for health insurance depends on the condition of the insured.
Premium collection procedure	Usually health insurance premium is collected weekly. But some organizations collect premium once at a time during loan disbursement.
Duration of insurance policy	The duration of insurance policy is usually up to the whole membership term of clients. But some organization offers the health insurance for one year.
Size of insurance coverage	The NGOs provide primary health care services and also offers discount between 25% to 50% on hospitalization and essential drugs. Some NGOs/MFIs provides Taka.1500 annually as medical grant as part of insurance coverage.
Types of risk coverage	In most of the cases some portion of the primary health care, essential medicine and hospitalization costs of clients are covered.
Claims paid or premium refund	Generally the deposited premiums are not refunded. But some organizations refund the deposited premium, if there is no claim within certain years.

Source: Market Study on Micro-Insurance Products 2007-2008, by INAFI, Bangladesh, Supported by Oxfam Novib ([www.oxfamnovib.nl](http://www.oxfamnovib.nl)).

Table – 9  
Livestock Insurance product at a glance

Product Description	Product Features and Packages
Target clients	The members of the organization
Premium rate	Some organizations charges annually 2% to 10% premium on disbursed loan or purchase price on livestock/poultry. Besides, some organizations charges Taka.300 per cattle.
Premium collection procedure	Usually premium is collected during disbursement of loan.
Duration of insurance policy	The duration of insurance policy is for one year (during the loan period)
Size of insurance coverage	The outstanding loan is exempted if the cow dies or there is any epidemic in poultry. Usually, the size of insurance coverage varies from Taka.500 to Taka.10, 000 depends on losses of livestock/poultry.
Types of risk coverage	Losses of livestock/ poultry are covered.
Claims paid or premium refund	In most of the cases the deposited premiums are not refunded. But some organizations refund the deposited premium, if there is no claim within certain years.

Source: Market Study on Micro-Insurance Products 2007-2008, by INAFI, Bangladesh, Supported by Oxfam Novib ([www.oxfamnovib.nl](http://www.oxfamnovib.nl)).

Table – 10

*Nature of Micro-Insurance Products offered by Insurance Companies*

<i>Key Factor</i>	<i>Product Features and Packages</i>
<i>Target clients</i>	<i>Occupation based low income people of informal economy. Usually the households who earn less than US\$100 per month. Some insurance companies offer Micro-Insurance products whose monthly income varies from Taka.600 to Taka.5000. The age range of the policy holders is between 18 to 45 years. Some companies also offer Micro-Insurance products up to 55 years clients.</i>
<i>Premium rate</i>	<i>The premium charges per Thousand (1,000) Taka insurance coverage varies from Taka.3.25 to Taka.13.33 per month depending on nature of products, insurance plans, size of insurance coverage, insurance maturity period, installment procedure of premium and the age of policy holder. Another Micro-Insurance package named single premium policy, where the premium rate per Thousand Taka insurance coverage varies from Taka.757.40 to Taka.1448.80 depending on insurance plans, the age of policyholder and insurance maturity period.</i>
<i>Premium collection procedure</i>	<i>Usually premium is collected monthly/ quarterly/ half yearly/ yearly installments depending on insurance plans and policy holder's interest.</i>
<i>Duration of insurance policy</i>	<i>Most of the cases the duration of insurance policy vary between 6 to 15 years. But in some insurance plans the duration of insurance policy is up to 30 years.</i>
<i>Size of insurance coverage</i>	<i>The size of insurance coverage usually varies from Taka.5000 to Taka.100, 000 depends on policy holders premium rate. But in some insurance plans the size of insurance coverage amount is up to Taka.3, 60, 00. For single premium term package usually the size of insurance coverage is 2.5 times or 250 percent of insured amount.</i>
<i>Types of risk coverage</i>	<i>In most of the cases the death risk of insurance policy holder is covered. Some Micro-Insurance products also cover health and accidental risks along with life by charging some additional premium. Besides, there are some insurance plans which provide fund for child education, and marriage of daughter after the death of parents. In these insurance plans the parent of children is policyholder. The death risk of this insurance policyholder as well as death risk of children is covered in these plans.</i>
<i>Claims paid or premium refund</i>	<i>Usually the claims are paid to the family members of deceased policy holder. Moreover, a certain percentage between 10% to 25% bonus on insured amount is paid after a certain period (3 to 4) years. Some Micro-Insurance product packages also include a certain percentage of profit like 7% on bonus if the policy holder doesn't withdraw it when due and this interest along with bonus is paid after the maturity of insurance term if the policy holder is alive. Some plans have also pension system. If the policyholder doesn't withdraw the full insured amount along with profit bonus, she/he will get monthly pension for 5 to 10 years. If the policyholder dies during this pension period, then the rest of the pension amount will be paid to the successor of the policyholder. In child stipend or education plans, the children will get a certain amount of stipend in</i>

	<p><i>very month up to completion of his/her master's level education.</i></p> <p><i>In female children marriage endowment plan, the daughter of the policyholder will receive the insured amount along with profit at the age of 18years. For single premium package if the policyholder doesn't die, then the policy holder usually receives 2 times or 200% of the deposited premium</i></p>
<i>Other benefits</i>	<p><i>Some Micro-Insurance Product package includes other benefits like savings and credit opportunity. Usually the policyholders can withdraw a certain percentage of deposited premiums as loan after a certain period.</i></p>

*Source: Market Study on Micro-Insurance Products 2007-2008, by INAFI, Bangladesh, Supported by Oxfam Novib (www.oxfamnovib.nl).*

### **Proportional Analysis of Micro-Insurance Products Offered by NGOs/MFIs and Mainstream Insurance Companies:**

“Micro-Insurance” the insurance for the poor, this is core theme of Micro-Insurance and already it has observe that both NGOs/MFIs and Commercial Insurance Companies offered this product of the Microfinance. If the product design and packaging, and the management and operational methodology of NGOs/MFIs and mainstream insurance companies are critically analyzed then there are some fissure or gap and it will be observed between NGOs/MFIs and mainstream insurance companies.

The following tables can clearly depict the comparative or proportional analysis of Micro-Insurance products offered by NGOs/MFIs and mainstream insurance companies.

*Table – 11*  
*Comparison of Micro-Insurance products of NGOs/MFIs and*  
*Mainstream insurance companies*

<i>Key Factors</i>	<i>NGOs/MFIs</i>	<i>Mainstream Insurance Companies</i>
<i>Target Clients</i>	<i>The Members of NGOs/MFIs. The target clients of NGOs/MFIs are usually both rural and urban poor people specially the women</i>	<p><i>Occupation based low income people of informal economy. Usually the households who earn less than US\$100 per month and the age range between 18 to 45 years.</i></p> <p><i>Some insurance companies offer Micro-Insurance products whose monthly income varies from Taka.600 to Taka.5000.</i></p>
<i>Product Design Methodology</i>	<i>Usually the product is designed by considering Microfinance context and usually try to amalgamate with various</i>	<i>The Product is designed by considering the income level of target clients and also following some guidelines of the</i>

	<i>Microfinance products like loan and services</i>	<i>insurance regulatory authority and actuaries.</i>
<i>Premium Rate</i>	<i>The premium rate varies depending on the nature of products. The premium rate is determined through unstructured calculation upon assumptions.</i>	<i>The premium rate varies depending on the nature of products, insurance plans, size of insurance coverage, insurance maturity period, installment procedure of premium and the age of policy holder. The premium rate is determined through structured calculation by the Actuaries who are authorized to calculate the premium rate.</i>
<i>Premium Collection Procedures</i>	<i>The premium collection procedures depend on the nature of the products. In most of the cases premium is collected once at a time during loan disbursement. Sometimes premium is collected through weekly installments.</i>	<i>Usually premium is collected monthly/ quarterly/ half yearly/ yearly installments depending on insurance plans, financial conditions and policy holder's interest.</i>
<i>Duration of Insurance Policy</i>	<i>In most of the cases the duration of insurance policy is for 45/46 weeks of 1 year. Moreover, some MFIs offer insurance for 4 to 8 years and also for whole membership term of client</i>	<i>Most of the cases the duration of insurance policy vary between 6 to 15 years. But in some insurance plans the duration of insurance policy is up to 30 years.</i>
<i>Size of Insurance Coverage</i>	<i>The size of insurance coverage varies depending on the product nature. In Loan and Livestock insurance usually the outstanding loan is exempted. For Life insurance generally 3 to 7 times of deposited amount or a certain amount of money is provided as insurance coverage.</i>	<i>The size of insurance coverage usually varies from Taka.5000 to Taka.100, 000 depends on policy holders premium rate. But in some insurance plans the size of insurance coverage amount is up to Taka.3, 60, 00. For single premium term package usually the size of insurance coverage is 2.5 times or 250 percent of insured amount.</i>
<i>Types of Risk Coverage</i>	<i>For each insurance product the types of risk coverage is different. For Loan and Life insurance the death of insurance client and sometimes the death of household head/earner are also covered. Some organization also covered accidental risks. In Health insurance usually the some portion of the primary health care, essential medicine and hospitalization costs of clients are covered. For Livestock insurance losses of livestock/poultry are covered.</i>	<i>In most of the cases the death risk of insurance policy holder is covered. Some Micro-Insurance products also cover health and accidental risks along with life by charging some additional premium. Besides, there are some insurance plans which provide fund for child education, and marriage of daughter after the death of parents. In these insurance plans the parent of children is policyholder. The death risk of this insurance policyholder as well as death risk of children is covered in these plans.</i>
<i>Investment of Deposited Premium</i>	<i>The NGOs/MFIs invest most of the deposited premium as revolving loan fund and the rest of the amount is</i>	<i>The insurance companies invest the most of the deposited premium in government bond and securities, stock exchange or</i>

	<i>deposited in the bank.</i>	<i>readily marketable securities. Some deposited premium is also invested for long term investment</i>
<i>Claims Paid or Premium Refunded or Bonus Paid</i>	<i>In most of the cases in premium is not refunded if there is no claim. But some organizations offering Life and Health insurance refund premium with 4% to 5% interest after the maturity of insurance term if there is no claim.</i>	<i>A certain percentage between 10% to 25% bonus on insured amount is paid after a certain period of 3 to 4 years.  Some Micro-Insurance product package also include a certain percentage of profit like 7% on bonus if the policy holder doesn't withdraw it when due and this interest along with bonus is paid after the maturity of insurance term if the policy holder doesn't die. For single premium package if the policyholder doesn't die, then the policy holder receives 200 percent of the deposited premium.</i>
<i>Other Benefits</i>	<i>NGOs/MFIs sometimes provide additional benefit i.e. some lump sum amount and funeral cost along with providing insurance coverage amount.</i>	<i>Some Micro-Insurance product package includes other benefits like savings and credit opportunity. Usually the policyholders can withdraw a certain percentage of deposited premiums as loan after a certain period.</i>

Source: Based on Table – 6, 7, 8, 9 & 10.

### Prospect of Microinsurance in Bangladesh

Insurance has been considered as security product for the high and moderate income level people of the society. But during the last one and half decades it is observed that along with the affluent people of the society, there is a dormant demand for insurance among the poor community and earlier they couldn't expose it. But after involving with Micro-credit program and also other development activities, the poor people considered that their social security is important to survive in this harsh world of poverty. From this realization the quiescent demand for insurance came forward and after the first Micro-Insurance product offered in 1988 in the country, the growth of this product was tremendous and significant growth also has been observed till now. It is expected that the growth will continues.

There are different types of uncertainty and vulnerability for low-income households, such as life cycle events, death, disability, loss of property, etc. in the lifecycle events of the poor some risks and vulnerability is negligible, but there are some occasional events such as epidemics, serious natural disasters that are all considerably more risky then life cycle events. Life cycle events are relatively predictable as compared to disability, illness or losses to property resulting from accidents, disasters, etc. Correspondingly, the resulting losses or costs for each of these sources of vulnerability can vary form small to very large. The uncertainty and vulnerability is daily companion of the poor people of the country and the

government social security and social safety net program alone can't compensate their different type's losses. So there was a demand for Micro-Insurance from long time and the demand will also exist in future.

### **Conclusion:**

Insurance is the risk protecting product, which is not only the mechanism for reducing vulnerability but also, ensures social and economic security to the insured. Insurance protects households against those risks that they are unable to protect themselves through informal mechanisms, savings or credit. Insurance providers are concerned that coverage of risks can be provided on a sustainable basis. Therefore, insurance is appropriate when there is an overlap of perspectives of both the household and the provider.

Poor people have different needs and priorities. Designing insurance products on a one-size-fits-all platform runs the risk of neglecting these differences and affecting any insurance program adversely. There are two main issues i.e. product design and policyholders issues that discourages MFIs/NGOs and Insurance companies to tap poor households with insurance products. The product design issues include high transaction costs, irregular income flows, and due to the difficulties in controlling moral hazard and due to adverse selection. The policyholders' issues include higher risks in providing this product as well as issues regarding affordability.

Furthermore, poor households have limited understanding about insurance and there is a misconception about insurers. Microfinance providers are also challenged by their need to achieve scale, the need for data and skills for actuarial analysis, reinsurance and investment.

It is worldwide recognized that Bangladesh has been considered as pioneer in Micro-credit with diversified products. Many NGOs/MFIs in Bangladesh are striving to offer demand driven and diversified financial products and services to the poor people. But still a significant number of poor people are vulnerable to adverse situation in their life cycle and untapped with social security products like insurance that can be a social safety net for them. Although, different types of institutions providing Micro-Insurance which is relatively new in Bangladesh. A small number of schemes have been in operation for more than six years while the majority has operated for three years or less. The evolution of the Micro-Insurance concept stems from the development and wide spread implementation of Micro-credit models as a development strategy. The viability of the credit-model was heavily constrained by contribution defaults, micro-credit institutions needed to complement credit with social security type services. Today, the Micro-Insurance model has become an important development tool aiming to safeguard or reduce the likelihood of credit defaults by addressing certain high economic costs to credit groups and their family dependants resulting from emergency health expenditures, death of a family member, and damage to property caused by fires or natural disasters, but that are not significant.

It is true that developing and offering new product always has some risks. Sometimes NGOs/MFIs and Insurance companies ignore poor people because they consider the financial sustainability of this Micro-Insurance product. But many of the risks and vulnerabilities faced by the low-income clients served by MFIs are insurable, in these cases; well-designed Micro-Insurance products can have an important development impact.

The challenge is to ensure that the product developed is appropriate for the needs and preferences of the households, is financially viable, and is provided through institutions that have the resources and expertise to manage the finances and the risk inherent in the product. If the Micro-Insurance products can be developed in such a way that addresses the needs of the poor, then this product can be financially viable and sustainable. Moreover, Insurance companies can also come forward with social security products for the poor. As a pioneer of Micro-credit NGOs/MFIs as well as Insurance companies can address the needs of the poor to achieve the United Nations Millennium Development Goals and cover all poor people of the country with social security product like insurance and ensure social safety nets by the year 2015.

By observing the upper situation we are now able to say that the Micro-Insurance is one of the products of Microfinance, which is new but valuable and its prospect in Bangladesh is up going because, Bangladesh is a developing country, and in every development there are some risk factor involve, Insurance is one of the risk protecting product, but most of the insurance companies offer it to the well earned people, no body think about the poor, but the Micro-Insurance changes this kind of believe, and bring the insurance product for the poor people for Bangladesh, which protect the poor for there various miserable hazard, and keep a happy smile in their face, for this reason day by day the number of clients of Micro-Insurance increases, and now demand side of this product is increases and in the meantime the supply side is also increases by the NGOs/MFIs and Insurance companies, and now they want to implement new polices according to the demand of the poor, so if the NGOs/MFIs and insurance companies ensure their promise then the Micro-Insurance prospect is increase day by day in Bangladesh.

### **List of Acronyms:**

- ASA            Association for Social Advancement
- BDT            Bangladeshi Taka
- BIA            Bangladesh Insurance Association
- BRAC          Bangladesh Rural Advancement Committee
- CDF            Credit and Development Forum
- GDP            Gross Domestic Product
- IDF            Integrated Development Foundation

- ILO International Labour Organisation
- INAFI International Network of Alternative Financial Institutions
- JBC Jibon Bima Corporation
- MFIs Microfinance Institutions
- MDGs Millennium Development Goals
- NGOs Non Government Organizations
- PKSf Palli Karma-Sahayak Foundation
- SBC Sadharan Bima Corporation
- SSS Society for Social Services
- UCD Urban Community Development Programs
- WEEH Women's Empowerment through Employment and Health

**a.**

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## Appendix A: Bangladesh Economy

The economy has grown 5-6% over the past few years despite inefficient state-owned enterprises, delays in exploiting natural gas resources, insufficient power supplies, and slow implementation of economic reforms. Bangladesh remains a poor, overpopulated, and inefficiently-governed nation. Although more than half of GDP is generated through the service sector, nearly two-thirds of Bangladeshis are employed in the agriculture sector, with rice as the single-most-important product. Garment exports and remittances from Bangladeshis working overseas, mainly in the Middle East and East Asia, fuel economic growth.

<i>GDP:</i>	<i>\$208.3 billion (2007 est.)</i>
<i>GDP growth rate:</i>	<i>6.3%</i>
<i>GDP per capita:</i>	<i>\$1,400</i>
<i>GDP composition by sector:</i>	<i>agriculture: 19%</i> <i>industry: 28.7%</i> <i>services: 52.3%</i>
<i>Labor force:</i>	<i>66.6 million</i> <i>note: extensive export of labor to Saudi Arabia, Kuwait, UAE, Oman, Qatar, and Malaysia; workers' remittances estimated at \$1.71 billion in 1998-99</i>
<i>Labor force by occupation:</i>	<i>agriculture: 63%</i> <i>industry: 11%</i> <i>services: 26%</i>
<i>Unemployment:</i>	<i>2.5% (includes underemployment)</i>
<i>Budget:</i>	<i>revenues: \$5.993 billion</i> <i>expenditures: \$8.598 billion</i>
<i>Industries:</i>	<i>cotton textiles, jute, garments, tea processing, paper newsprint, cement, chemical fertilizer, light engineering, sugar</i>
<i>Electricity production by source:</i>	<i>fossil fuel: 93.7%</i> <i>hydro: 6.3%</i> <i>nuclear: 0%</i> <i>other: 0%</i>
<i>Agriculture:</i>	<i>rice, jute, tea, wheat, sugarcane, potatoes, tobacco, pulses, oilseeds, spices, fruit; beef, milk, poultry</i>
<i>Exports:</i>	<i>garments, jute and jute goods, leather, frozen fish and seafood</i>
<i>Export partners:</i>	<i>US 24.2%, Germany 13.2%, UK 10.6%, France 6%</i>
<i>Imports:</i>	<i>machinery and equipment, chemicals, iron and steel, textiles, foodstuffs, petroleum products, cement</i>
<i>Import partners:</i>	<i>India 14.7%, China 14.6%, Kuwait 8%, Singapore 6%, Japan 4.4%, Hong Kong 4.1%</i>
<i>Economic aid recipient:</i>	<i>\$1.575 billion</i>
<i>Currency:</i>	<i>taka (BDT)</i>

## Appendix B

Table – 4  
Chronicle of Insurance Industry in Bangladesh

Year	Milestone for Insurance Industry
1818	First life company of India Sub-Continent named Oriental Life Insurance Company was established in Kolkata.
1850	First Non-Life insurance company name Triton Insurance Company commenced business in Kolkata.
1938	British Government enacted Insurance Act 1938 to regulate Insurance business in Indian Sub-continent
1947-1971	49 insurance companies transacted both life and general insurance schemes. Ten insurance companies had their head offices in East Pakistan, 27 in West Pakistan, and the rest elsewhere in the world
1972	The government of Bangladesh nationalized insurance industry in 1972 by the Bangladesh Insurance Order 1972. All 49 insurance companies and organizations transacting insurance business in the country were placed in the public sector under five corporations.
1973	On 14 May 1973, a restructuring was made under the Insurance Corporations Act 1973. Following the Act, in place of five corporations the government formed two: the Sadharan Bima Corporation for general business and Jibon Bima Corporation for life business.
1973	The government established Bangladesh Insurance Academy (BIA) in Dhaka to impart training to insurance professionals and others taking up insurance as a career. The academy started functioning in early 1974.
1984	Insurance Act 1973 was amended in 1984 to allow insurance companies in the private sector to operate side by side with Sadharan Bima Corporation and Jibon Bima Corporation.
1988	Bangladesh Insurance Association was formed on 25 May 1988 under the Companies Act. It is registered with the Registrar of Joint Stock Companies and has 30 members.
2000-2005	Up to 2000, the government has given permission to 19 general insurance companies and 10 life insurance companies in the private sector.
2005 – Current 2011	62 Life and General Insurance Companies both form public and private sectors are operating business in Bangladesh.

Source: The information excerpted from the Banglapedia (Provided by INAFI, Bangladesh) year-2008-2009.

## **A STUDY ON KEY DIMENSIONS OF DIFFERENT VARIABLES FOR CONSUMER ACCEPTANCE OF BRAND EXTENSION**

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### **Introduction**

A successful brand works as an emotional attachment force that always encourages consumer's perception toward that brand among the other brands. A new product's brand name is an important determinant of its success in the market place (Cooper, 1994). A successful brand makes this relationship stronger than earlier. Now-a-days firms are increasingly seeking to leverage this good relationship by extending their brands into new product areas and that is brand extension, refers to the use of established franchise to a different product class (Keller, 2008). Substantial research has been done on how consumers evaluate brand extensions (e.g. ;Keller, 2003; Balachander and Ghose, 2003). Because These days Brand extension is a very popular way of the organizations to challenge the competition with new intensity because new product with a new brand name is always risky and there lies a lot uncertainty that the product may not be accepted. The statistics tells new products experience failure rates between 80% and 90 %, and brand extension fails at a lower rate (Keller 2003). Another advantage of using brand extension is the reduction of communication costs (Tauber, 1981; Aaker, 1990; Aaker and Keller, 1990) 5. Instead of launching a new brand, brand extension is becoming a branding strategy for new products. For Fast Moving Consumer Goods as well as services, more than 80% of the new products introduced are brand extensions (Rangaswamy, et.al., 1993; Ernest and Young and Nielsen 1999) Keller (2003).

In brand extension research, brand equity is predominantly considered as consumer based brand equity rather than company based brand equity and that is why success or failure of brand extension is mainly dependent on the consumer evaluation of brand extension (Klink and Smith, 2001). Past research in brand extensions have established main determinants that influence the extension success (for reviews see Grime et al., 2002; Czellar, 2003; Voßlckner and Sattler, 2006) mainly factors related to brand associations, extended category, perceived fit and consumer characteristic (Czellar 2003; Reast, 2005; Volckmer and Sattler, 2006).

A negative impact of brand extension would cause a great damage to the essence of core brand values. Research results produced by Ernest and young and Nielsen (1999) (Völckner & Sattler, 2006; Mahajan, Muller & Wind, 2000) in European countries brand extensions failure

rate of around 80% in fmcg field. This statistics are also not much mind southing. Like any other strategy, it has both positive and negative side. Therefore, despite their benefits, extensions can be risky (Ries and Trout 1986).

Brand name encourages with a symbolic meaning to assist consumer recognition and decision-making processes (warnerfelfelt, 1988) and likewise brand extension facilitate consumer decision making process by the established brand names (Alba and Hurchinson,1987).For a successful brand extension among various consumer characteristic, consumer innovativeness plays an important role because consumer innovativeness influences consumers learning and purchasing process of new products in the market place. (Yu Henry xie,college of Charleston).Innovators are more likely to be receptive to the new ideas and experiences. Consumer's propensity to try and purchase new products earlier (Roger1983/2003)in the market place nevertheless has certain impacts on consumer's brand loyalty(Hirschman 1980)14 and ,consequently ,acceptance of brand extension ,because brand extension have been extensively applied in the launch of new products(Aaker and Keller 1990). The International handbook on innovation By Larisa V. Shavinina describes innovators as having marketplace knowledge, opinion leadership, price insensitivity, higher level of income and gregariousness (cosmopolitanism).There are several factors responsible for reigning of a product in a innovative minds. The scope of study is to pinpoint the dimensions of innovativeness, which are early adoption of newness (Roger,1983/2003),high income (The International handbook on innovation By Larisa V. Shavinina,2003 ) and Satisfying a desire for knowledge" (Sheth, Newman, & Gross, 1991, p. 162) for product category or brand.

Perceived similarity is found to be the most relevant variable that can highly influence the acceptance of brand extension (Völckner & sattler 2006). The fit of extension with the core brand category depends on physical features, functions, prestige value, or the skills required manufacturing the product (Aaker and Keller, 1990).Consumers have to perceive some dimension of similarity between a parent brand and the extension to obtain the effect (Boush et. Al. 1987; Aaker & Keller 1990; Völckner & Sattler 2006; Ahluwalia 2008).Similarity dimensions induces acceptance of brand extension a lot. In recent times the idea of fit refers three dimensions namely usage similarity, association similarity, and competence similarity (Leif E. Hem and Nina M Iverson, 2008)21.And this fit is equally important for tangible products(Boush et al. , 1987;Aaker and Keller,1990,Park et al.,1991) and services (de ruyter and Wetzels,2000, Van Riel et al.,2001;Hem at al. ,2003;Lei et al.,2004).Some researchers have found that higher consumer innovativeness increases purchase intention of new services (Hem at al., 2003; Siu et al., 2004) and tangible products (Völckner and sattler 2006).

Brands credibility provides its consumers with assurance of quality. credibility is based on the sum of past behaviors has been referred to as "reputation" in the information economics literature (see Herbig and Milewicz 1995). Now brand reputation or brand credibility can be measured by considering two dimensions namely brand expertise and brand trust (Erdem

and swait, 1998, 2004). Because reputation can be built based on brand trust that consumer gain after having expertise on the brand. This study also proposes, this two dimensions mainly leads to parent brand reputation. Moreover brand reputation become strengthened if an organization delivers service and product as expected (Argenti & Druckenmiller, 2004).

## Research Gap

Innovativeness Satisfies a desire for knowledge (Sheth, Newman, & Gross, 1991, p. 162). In general, the knowledge of a target group is highly decisive for how decisions are made for branded products (Alba & Hutchinson 1987, Keller 2003) 28. According to Czellar, 2003 ). Past research shows mixed results for the effects of consumer knowledge on extension evaluations (e.g. Dawar 1996; Herr et al. 1996). More research on the effects of perceived knowledge on assessments of brand extensions is required. innovativeness researchers stress the importance of the social or symbolic component of consumer innovativeness (Roehrich, 2004; Rogers, 2003; Venkatraman, 1991) 29b. In this connection this study propose higher income is another dimension for measuring innovativeness.

Consumers tend to evaluate extensions more positively when they identify some similarities with the parent brand (Aaker & Keller 1990; Czellar 2003; Hem et al. 2003; Völckner & Sattler 2006) 23. However, there are number of examples for successful brand extensions that lack an overall perceived similarity with the parent brand ( Klink & Smith 2001; Maoz & Tybout 2002). The virgin brand has been extended to huge range of products, such as magazines, train company, holidays, personal computers, bridal services (Keller 2008). For more specific insights the dimensions of perceived similarity should be considered. Proposed dimensions of perceived similarity are usage similarity, association similarity, and competence similarity (Leif E. Hem and Nina M Iversen, 2008). Considering this dimensions lead to us to know the many different ways a consumer can perceive a similarity between parent brand and the extended product.

The attitude towards extension is favorable when consumer trusts the brand (Reast, 2005) and buys the brands products regularly or shows a commitment to purchase them (Völckner and Sattler 2006) and this lead to them as experienced consumers who are more likely to try the extension (Swaminathan et al, 2001; swaminathan, 2003) and develop brand reputation. In past research Trust is recognized as a complex consumer concept and there is also not much study on brand expertise.

Product categories (Bristol 1996, Schmitt and Dube, 1992) is also important in extension success (reviews see Grime et al., 2002; Czellar, 2003; Völckner and Sattler, 2006) because Consumer attitude towards extension will be different for different product category.

There is not much study on the dimensions of theses accepted variables and that is why brand extension failure made the scope of the study on the dimensions of these variables with account of the product category.

## Objectives

- 1) To understand the dimensional significance of these three variables in acceptance of brand extension.
- 2) To know the strength of the dimensions and how they differs in account of product category.
- 3) To investigate empirically whether there is any significant dimensional difference between overall brand extensions in two different sectors respectively fast moving consumer goods (Lays) and service sectors (Bsnl).

## Conceptual framework and hypotheses

### brand extension

Extending the equity of a brand is brand extension. A “good” brand extension strategy is one where the brand name aids the extension, while a “very good” brand extension also enhances the parent brand name (Aaker, 1991). Estimates vary, but as many as eight out of ten new products are introduced as a brand extension (Simms 2005; Keller 2008). Brand extension not only reduces communication cost as well as new brand introduction cost but also increases the success probability, as the advantage of extensions compared to new brand names is that extensions borrow awareness and positive associations from the parent brand (Aaker & Keller 1990; Völckner & Sattler 2006; Ahluwalia 2008).

### Category fit and fit dimensions

Similarity fit is considered to know how far the consumer perceives the extended product category is similar to the parent product (Smith and Park, 1992). Bridges et al. (2000) findings suggested that the connection of any salient and relevant parent brand association (e.g. category, brand concept, brand specific associations) to the extensions can be used by consumers in forming the perception of fit. Higher perceived fit involves a better evaluation of extensions (Aaker and Keller, 1990; Boush et al., 1987; Aaker and Keller, 1990; Boush and Loken, 1991; Dacin and Smith, 1994; Keller and Sood 2002) as Perceived similarity is found to be the most relevant variable that can highly influence the acceptance of brand extension (Völckner & Sattler 2006). To obtain the effect of fit Consumers have to perceive some dimension of similarity between parent brand and the extension (Boush et al. 1987; Aaker & Keller 1990; Völckner & Sattler 2006; Ahluwalia 2008). The fit of extension with the core brand category in turn depends on physical features, functions, prestige value, or the skills required manufacturing the product (Aaker and Keller, 1990). The idea of fit refers three dimensions namely associations similarity, usage similarity, and competence similarity (Leif E. Hem and Nina M Iversen, 2008). Association is nothing but a brand's image is also more likely to transfer to an extension (Broniarczyk & Alba 1994). Usage is what extent extensions and existing product share the same usage context (Aaker & Keller, 1990) and similarity of the competence is resources needed to produce the two products (Aaker & Keller 1990; Klink

& Smith 2001). So these three dimensions should positively effect on overall evaluation of extension.

It is easier to understand functional similarity in case of extension from complex product because to understand other similarity dimension a consumer require a good level of expertise. Thus we predict in case of extension from complex product category, usage similarity has stronger significance than other similarity dimensions.

H1 Associative similarity, usage similarity and competence similarity have a positive effect on evaluations of extensions.

H2 usage similarity has a stronger positive effect than association and competence similarity on attitude towards brand extensions in case of extension from complex product category.

### **Parent brand reputation and brand reputation dimensions**

Parent brand plays an important role in the success of an extension (Reddy, Holak and Bhat, 1994) 59. In brand extension research brand reputation has been defined in terms of consumer perceptions of quality associated with a brand (Aaker and Keller 1990, Barone et al. 2000, p. 390) 60. High quality brands lead to be more credible, expertise and trustworthy (Dhananjay Bapat and J.S. Panwar, 2009). But consumers evaluate less favorably for average quality brands (Keller and Aaker, 1992). The concept of reputation can be termed as credibility. Credibility is based on the sum of past behaviors has been referred to as "reputation" in the information economics literature (see Herbig and Milewicz 1995). After Aaker and Keller (1992) again Erdem and Swait, (1998, 2004) proposed brand reputation or brand credibility can be measured by considering two dimensions that is brand expertise and brand trust. This study also strengthens the same. Because the attitude towards extension is favorable when consumer trusts the brand (Reast, 2005) and buys the brand's products regularly or shows a commitment to purchase them (Völckner and Sattler 2006) and this leads to them as experienced consumers who are more likely to try the extension (Swaminathan et al., 2001; Swaminathan, 2003). Because experts variably process a rich and well-organized knowledge structure in the specific domain (Alba & Hutchinson) and can yield greater customer trust in the brand.

Day by day consumers are faced with more complex market results confusion among them. The Apple case study on brand experience for their iPhone, use tag line **Simplicity is the ultimate sophistication** by Steve Jobs, Co founder and chief executive officer of Apple. He emphasizes on simple and useful experience and that leads to more experience. So as simple as, consumer perceive the parent brand's skills and ability in the new product category as a brand Expert that improves the brand extension evaluation (Swaminathan et al. 2001; Swaminathan 2003). Because the experts can easily trace the similarity between original brand and extended product. Thus, we have hypothesized that,



H3 Brand trust and brand expertise have a positive effect on evaluations of extensions.

H4 Brand expertise has a stronger positive effect on attitude toward brand extension, for extensions from simple product category than complex.

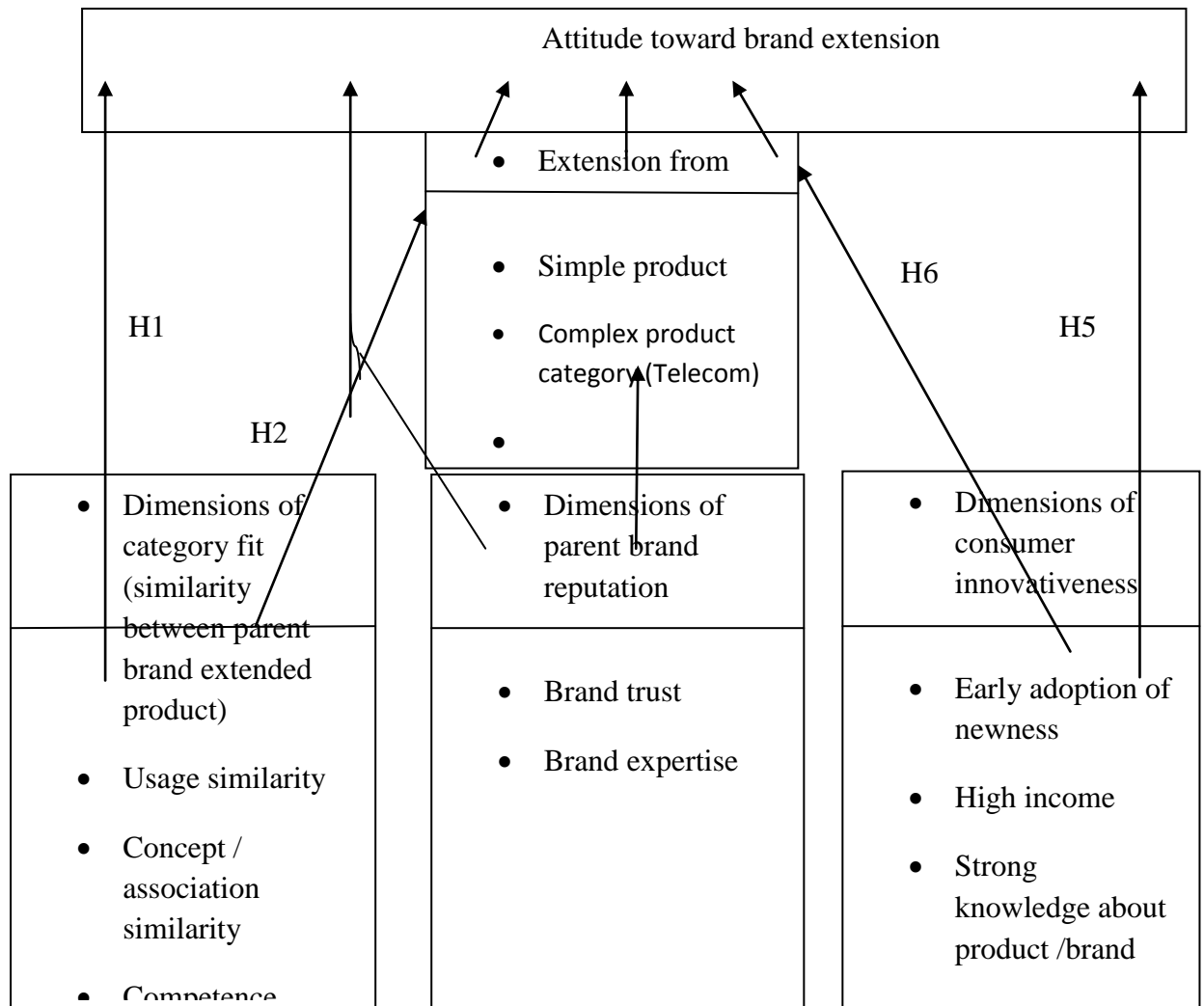
### **Consumer innovativeness and innovativeness dimensions**

There is huge importance of consumer innovativeness given in the literature on adoption of innovation. A basic tenet of diffusion theory is that individuals respond differently to new products (Gatignon and Robertson 1985). Rogers (1983) considers these differences to be driven by consumer innovativeness. Consumer Innovativeness defined as “the degree to which an individual is relatively earlier in adopting an innovation than other members of his system” (Rogers and Shoemaker 1971, p.27). The early adopters minimize the chance of new product failure (Im et al., 2003) or consider new ideas (Roehrich, 2004) very soon. Marketplace knowledge opinion leadership, price insensitivity, higher level of income and gregariousness (cosmopolitanism) may characterize consumer innovator. (The International handbook on innovation By Larisa V. Shavinina). This research proposes three dimensions of innovativeness respectively earlier in adoption of newness (Midgley and Dowling, 1978) 18, high income. (The International handbook on innovation By Larisa V. Shavinina) and another important dimension is Consumer’s brand knowledge (whilst Muthukrishnan 1991; Roux and Boush 1996) 19 or product category knowledge (Broniarczyk and Alba 1994). So we hypothesize that these three dimensions have a positive effect on overall evaluation of extension.

In this research consumer knowledge implies that how much s/he has knowledge about the product category or brand (Klink and Smith, 2001). Again reaction towards extensions can be affected by the individual’s knowledge of the brand (Klink and Smith, 2001) and which in turn consumer innovativeness. We predict consumer reaction will be more positive with strong product category or brand knowledge for the extensions from complex product category. Because it is more difficult to evaluate and making a purchase decision for a complex product extension.

H5 Early adoption of newness, knowledge about product or brand and high income has a positive effect on overall evaluations of extensions.

H6 knowledge about brand or product has a stronger positive effect on overall evaluations of extensions for extensions from complex product categories than from simpler product categories.



Model for Evaluation of successful brand extension considering dimensions of three variables Fig.1

Selected parent brands and their extensions for this study

Parent Brands	LAYS SNACKS	BSNL TELECOM
EXTENSIONS	CHOCOLATE	PC
	APPLE JUICE	CABLE TV
	ICECREAM	INSURANCE

Table 1

## Methodology

### research design

We have this two brands respectively LAYS is representing simple product category as well as renowned fast moving consumer goods brand and BSNL is representing complex product category as well as renowned service brand.

To test the above-mentioned hypotheses for this study, two brands are chosen and used in similar kind of study by (Aaker and Keller, 1990). The criteria are (i) high quality, having strong brand image, (ii) brand not having been broadly extended previously (iii) ability to elicit relatively specific associations.

#### **questionnaire development and main data collection**

We have made a questionnaire for each of the two parent brands and conducted the study in Jaipur. Questionnaire was distributed among business students in the various places of Jaipur. For each sample Among the 410 questionnaires collected, 28 had to be removed due to non response biases. A total of 382 complete questionnaires were collected for LAYS snacks and BSNL telecom.

#### **Measurement and Scaling**

*Dependent variable* – Overall evaluation of brand extension simply to measure the reactions towards the proposed brand extension measured based on the items used by Bergkvist and Rossiter (2007).

*Independent variable* – Perceived similarity with three dimensions of this extension variables namely usage similarity, concept association and similarity of resources needed to produce evaluated perceived similarity on a five point likert scale anchored from “not at all similar” through to “very similar”.

Brand reputation assessed as the average of perceived expertise and perceived trustworthiness (Keller and Aaker 1992). Respondents evaluated this on five point likert scale with the end points “totally disagree” and “totally agree”.

Innovativeness dimensions namely early adoption of newness, consumer knowledge of product or brand and high income evaluated on five point likert scale anchored by totally disagree and totally agree.

### **Analyses**

#### **Descriptive statistics**

Table (4) and (5) shown the means and standard deviations of each extension of snacks and telecom. The mean scores of the variable not much varied across the extensions of the snacks and telecom.

#### **Factor analysis**

Factor analysis revealed that all dimensions truly loading in their respective variable. For telecom sample Eigen values are in between, 1.56 and 2.38. And total variance is greater than 71% for snacks sample eigen values are in between, 1.55 and 2.27 and total variance is greater than 72%. Following are the factor analysis table for snacks and telecom

*Snacks Rotated Component Matrix<sup>a</sup>*

	Component			
	1	2	3	4
What attitude do you have towards this extension	.811			
If this brand extension existed ,I would be likely to try it	.777			
Overall I am very positive to this extension lays-chocolate	.805			
If this brand introduces new products I would like to try as I am continually seeking new ideas and experiences		.732		
My strong knowledge about the market place helps me to make proper judgment about a new product		.792		
my personal income is currently high enough to satisfy my desire to try something new		.777		
I believe that Lays is a brand that keeps its promise				.864
I understand the features enough to evaluate this brand				.743
Think of the original brand Lays. How similar is the parent brand compared with the extension regarding brand concept association			.675	
Think about brand LAYS. How similar is the usage situation with extension chocolate			.770	
Think of the original brand LAYS. How similar is the resources required to produce the parent brand and the brand extension			.854	

Extraction Method: Principal Component Analysis. Table :2

Rotation Method: Varimax with Kaiser Normalization.

a. Rotation converged in 6 iterations.

*Telecom Rotated Component Matrix<sup>a</sup>*

	Component			
	1	2	3	4
What attitude do you have towards this extension chocolate	.803			
If this brand extension existed ,I would be likely to try it	.755			
Overall I am very positive to this extension	.790			
If this brand introduces new products I would like to try as i am continually seeking new ideas and experiences			.559	
My strong knowledge about the market place helps me to make proper judgment about a new product			.764	
my personal income is currently high enough to satisfy my desire to try something new			.767	
I believe that Bsnl is a brand that keeps its promise				.858
I understand the features enough to evaluate this brand				.734
Think of the original brand Bsnl.how similar is the parent brand compared with the extension regarding brand concept association		.677		
Think about brand Bsnl.How similar is the usage situation with extension chocolate		.768		
Think of the original brand Bsnl.How similar is the resources required to produce the parent brand and the brand extension		.852		

Extraction Method: Principal Component Analysis. Table : 3

Rotation Method: Varimax with Kaiser Normalization.

*Descriptive Statistics Snacks sample*

	Mean	Std. Deviation	N
Overall extension attitude	3.5941	.78787	381
Early adoption of newness	3.5512	.98174	381
Strong knowledge about the brand	3.4882	.95586	381
or extended product category			
High income	3.4541	1.06431	381
Brand trust	3.8136	.87324	381
Brand expertise	3.5879	.92949	381
Association similarity	3.2940	1.02736	381
Usage similarity	3.3018	.96558	381
Competence similarity	3.1732	1.13852	381

Table 4

*Descriptive Statistics telecom sample*

	Mean	Std. Deviation	N
Overall extension attitude	3.5757	.78465	381
Early adoption of newness	3.6273	.97478	381
Strong knowledge about the	3.4829	.95026	381
brand or extended product			
category			
High income	3.4724	1.05999	381
Brand trust	3.8136	.87324	381
Brand expertise	3.5879	.92949	381
Association similarity	3.2940	1.02736	381
usage similarity	3.3018	.96558	381
Competence similarity	3.1732	1.13852	381

Table 5

*Correlations among variables total sample*

	1	2	3	4	5	6	7	8	9
<i>Overall extension attitude</i>	1	.527**	.460**	.348**	.259**	.346**	.447**	.397**	.301**
<i>Early adoption of newness</i>		1	.567**	.444**	.363**	.320**	.395**	.287**	.217**
<i>Consumer knowledge about brand or product category</i>			1	.564**	.378**	.425**	.444**	.314**	.341**
<i>High income</i>				1	.381**	.456**	.369**	.256**	.275**
<i>Brand trust</i>					1	.521**	.313**	.260**	.133**
<i>Brand expertise</i>						1	.375**	.429**	.354**
<i>Association similarity</i>							1	.547**	.512**
<i>Usage similarity</i>								1	.527**
<i>Competence similarity</i>									1

\*\* . Correlation is significant at the 0.01 level (2-tailed). Table:6

*Correlations among variables snacks sample*

	1	2	3	4	5	6	7	8	9
<i>Overall extension attitude</i>	1	.507** .000	.450** .000	.337** .000	.260** .000	.346** .000	.447** .000	.397** .000	.298** .000
<i>Early adoption of newness</i>		1	.613** .000	.483** .000	.344** .000	.327** .000	.405** .000	.290** .000	.230** .000
<i>Consumer knowledge about brand or product category</i>			1	.589** .000	.377** .000	.428** .000	.459** .000	.325** .000	.355** .000
<i>High income</i>				1	.369** .000	.448** .000	.369** .000	.250** .000	.269** .000
<i>Brand trust</i>					1	.521** .000	.313** .000	.260** .000	.133** .009
<i>Brand expertise</i>						1	.375** .000	.429** .000	.354** .000
<i>Association similarity</i>							1	.547** .000	.512** .000
<i>Usage similarity</i>								1	.527** .000
<i>Competence similarity</i>									1

\*\*. Correlation is significant at the 0.01 level (2-tailed). Table : 7



*Correlations among variables telecom*

	1	2	3	4	5	6	7	8	9
<i>Overall extension attitude</i>	1	.548**	.471**	.361**	.258**	.347**	.448**	.398**	.303**
<i>Early adoption Of newness</i>		1	.522**	.405**	.382**	.312**	.386**	.285**	.205**
<i>strong knowledge about the brand or product category</i>			1	.538**	.378**	.423**	.428**	.302**	.326**
<i>High income</i>				1	.394**	.465**	.370**	.261**	.281**
<i>Brand trust</i>					1	.521**	.313**	.260**	.133**
<i>Brand expertise</i>						1	.375**	.429**	.354**
<i>Association similarity</i>							1	.547**	.512**
<i>Usage similarity</i>								1	.527**
<i>Competence similarity</i>									1

\*\* . Correlation is significant at the 0.01 level

### Bivariate analysis

Correlations between the variables are shown in table (3) (4) and (5) .Table (3) considers entire sample irrespective of product category. Considering snacks and telecom sample , each consisting three hypothetical extensions namely Lays chocolate, Lays apple juice and Lays ice cream and Bsnl PC, Bsnl cable TV ,Bsnl insurance. Table (3) reveals positive and significant correlation between three-dimensional perceived similarity and overall evaluation of the brand extensions (H1), two dimensional brand reputations and overall evaluation of the brand extensions (H3), three-dimensional innovativeness and the overall evaluation of the brand extensions (H5). Thus H1,H3,H5 were supported.Again individually For snacks and Telecom sample, H1 is supported.Second hypothesis is only for complex product category I.e. for telecom sample. But usage similarity is not having higher effect than other similarity dimensions.So H2 is not supported, again we will test this hypothesis applying regression analysis for more convincing result. H6 is also supported individually for both sample.We have found knowledge has higher effect on attitude towards extension for complex product category than simpler. So H5 is also supported. Moreover, correlations between the parent brand reputation dimensions and overall extension attitude were significant for both snacks

and telecom sample. Brand expertise have stronger positive effect on attitude toward brand extension for simple product category than complex .So,H3 and H4 were supported.

### Multivariate analysis

To get result that is more convincing we applied multiple regression analysis.

The dimensions of perceived similarity variable, had a strong impact on overall attitude towards extensions. Among the three dimensions usage similarity (snacks  $b = .153^{***}$ ,  $p = .01$ ) ;( telecom  $b = .147^{***}$ , $p = .01$ ) and association similarity (snacks  $b = .166^{***}$  ,  $p = .01$ ) ; (telecom =  $.144^{***}$ ,  $p = .01$ ) had a significant effect in both of the sample. However, no significant effect was found in case of competence similarity in snacks sample ( $b = -.004$ ) and telecom sample ( $b = -.002$ ).So maybe there is some relative importance differs among the dimensions but overall we can say our H1 is supported to a good extent. As per our second hypothesis, usage similarity has a higher effect on overall extension attitude than association similarity and competence similarity when the extensions are from complex product category, is also be supported. Thus, H1 and H2 were supported .

*Regression summery of the model*

<i>Variables included (independent variables)</i>	<i>Snacks</i>	<i>Telecom</i>
<i>2. early adoption of newness</i>	<i>.311***</i>	<i>.362***</i>
<i>3. consumer knowledge about the product or brand</i>	<i>.112**</i>	<i>.154***</i>
<i>4. high income</i>	<i>-.007</i>	<i>.034</i>
<i>5. brand trust</i>	<i>-.022</i>	<i>-.074*</i>
<i>6. brand expertise</i>	<i>.085*</i>	<i>.073*</i>
<i>7. association similarity</i>	<i>.166***</i>	<i>.144***</i>
<i>8. usage similarity</i>	<i>.153***</i>	<i>.147***</i>
<i>9. competence similarity</i>	<i>-.004</i>	<i>.002</i>
<i>Adjusted R<sup>2</sup></i>	<i>.34</i>	<i>.40</i>
<i>F for full model</i>	<i>26.44</i>	<i>32.73</i>
<i>d.f.</i>	<i>372</i>	<i>372</i>

*Table 9*

$P < .01$  \*\*\*

$P < .20$  \*

$P < .10$  \*\*

consumer innovativeness having three dimensions namely early adoption of newness (snacks  $b = .311^{***}$ ,  $p = .01$ ) ; ( telecom  $b = .362^{***}$ , $p = .01$ ),consumer knowledge about the product or brand (snacks  $b = .112^{**}$ , $p = .10$ );(telecom =  $.154^{***}$  ,  $p = .01$ ) showing an overall

positive and strong effect on attitude towards extension but high income (snacks = -.007);(telecom =.034) has no such effect on attitude towards extension.As expected consumer knowledge about brand or product category has a higher standardized beta coefficient for extensions from complex product categories than simpler.So H5 and H6 were supported.

The proposed dimensions of brand reputation are namely brand trust (snacks  $b = -.022$ ); (telecom  $b = -.074^*$ ,  $p = .20$ ) and brand expertise (snacks  $b = .085^*$ ,  $p = .20$ ); (telecom  $b = .073^*$ ,  $p = .20$ ). H5 is partly supported that brand trust and brand expertise has a positive effect on attitude towards extension.. Only experiencing, the brand makes a consumer a brand expert. In addition, It is desired to have simple but useful experience which further intend them to use more products of that brand. Brand Experience has a higher effect for the extensions from simple product category (H6) than complex. Higher standardized beta coefficient reveals that. So H3 and H4 were supported.

### **Discussion and managerial implications**

Undoubtedly, brand extension is a popular brand strategy and marketing approach to come with new products. These Dimensional perspectives surely, will rich the extension literature to a good extent .The entire study, reveals the nature of constant dynamism of a market. Not very far but in a recent past brand trust was a very influencing variable but presently brand expertise is more important for accepting a new product .Consumer knowledge is found to be more significant for extension from complex product category extension. As expected usage similarity has stronger significance than other similarity dimensions on attitude towards extensions in case of extension from complex product categor. As per the industry perspective Usage similarity ,knowledge about brand or product category is more important in service industry but in fast moving consumer goods industry brand expertise is a significant dimension for keeping brand reputation.

This study will contribute not only to understand the dimensions of these three variables mainly influence the market but also it will be helpful for the marketers to understand the changing market dynamism because Strategic planners need detailed insights of changing market to develop brand extension strategies . This research work implies in case of extensions from complex product category managers need to focus on usage situation (smith and Park 1992) other than association similarity and competence similarity. CRM positively impacts customer satisfaction (Mithas, Krishnan, & Fornell, 2005). By building relationship, managers should help consumers to develop their knowledge (Maoz & Tybout 2002) about product category or the brand. Likewise to Hong Youl ha and Helen perks (2005) This research also finds brand expertise as an essential variable.

### **Future research scope**

In brand extension research what actually creates future scope even after substantial research on the same. Simply some brand extensions fails, some extension get succeed, and

this is what creates some more research opportunity. As discussed earlier in the paper, that dimensional perspective is something new to brand extension research so there is a lot and obvious scope of doing research in the same, considering other potential variables. Because now a then there are loads of drivers already came into reflection but hardly there dimensions came into extension study. When you are more into competition, you should be strategic to explore the area of profitability. The same thought applied in this paper by considering the proposed dimensions of three mostly acknowledged variables. However, also other drivers left untouched in dimensional perspective. So the researchers who wants to go, more in depth in brand extension research they can go for other factors with their proposed aspects .This study considers accountability of product category because There is not much study on the same(Bristol 1996,Schmitt and Dube,1992) Because consumers differs in the dimensional perspective for a same variable towards extension attitude for different product category whereas product category is also important in extension success (reviews see Grime et al., 2002; Czellar, 2003; Vořckner and Sattler, 2006).

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## EVALUATING STRATEGIC DECISIONS BETWEEN REVENUE AND VALUE. THE OUTLOOK FOR THE TERMINI IMERESE INDUSTRIAL SITE

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### Abstract

The aim of the paper is to provide an interpretative scheme of the micro-macro interactions which, bearing in mind two perspectives (business oriented and ethic driven), underlines how by taking the ethical path, decisions taken have an effect on income and on business' viability. This provides a starting point for elaborating on the theme of reconciling business viability and social expectations which in some cases can prove problematic when it comes to management choices. Finally, the paper attempts to define a clear demarcation line regarding entrepreneurial responsibility, beyond which businesses must never venture even if this entails harming the viability of the firm.

The empirical case represents an emblematic example of how, when facing an emerging problem where it is difficult to reconcile business viability with social expectations, there are various possible solutions ranging from shareholder-driven choices to stakeholder oriented choices. That of Fiat's CEO seems to have been a choice mainly oriented at safeguarding the owners' interests rather than those of the stakeholders within the relational context of Termini Imerese.

**Keywords:** Corporate Social Responsibility, Ethics, Socio-economic Value, Shareholder, Interactions, Viability.

### Introduction

In the present social, not to mention economic context, all firms require legitimisation and consensus in order to be able to operate (Coda, 1988). It is therefore important to consider a decidedly "relational" vision of the firm where the governing body identifies decisions as strategic when said decisions are characterised by their having a significant impact on micro-macro interactions. The importance given to relations in the sphere of firms' management processes is supported by the assertion of the stakeholder theory (Freeman, 1984) and by studies in corporate social responsibility (Waddock, 2004). It is clear how identifying stakeholders and the possible interconnections that are created between stakeholders and the firm's management is fundamental (Freeman, 2005). From this perspective, according to behavioural theory (Cyert, March, 1963) firms were once considered as a coalition of

individuals, and more recently as a system-network of stakeholders, that is, a system of stakeholders requiring organising (Evan, Freeman, 1993). Even considering that the aim of survival – based on the vital capacity of the firm to generate sustainable value over time, that is, value that comprises an important social dimension and whose relations provide the driving force for development (Wheeler, Davies, 2004) – acts as a fundamental compass that constantly guides management's actions, strategic decisions required to be taken by firms can nevertheless appear very different depending on the viewpoint of the analysis: from the point of view that is predominantly in the interests of the shareholders; or that which seeks value and wellbeing in the interests of all stakeholders involved.

The aim of the paper is to provide an interpretative scheme of the interactions which, bearing in mind the two aforementioned perspectives, underlines how by taking the ethical path, decisions taken - even if they are directly aimed at providing requisite responses to legitimate social expectations - have an effect on income and on viability that must be carefully assessed *ex ante*. This provides a starting point for elaborating on the theme of reconciling firm viability and social expectations which in some cases can prove problematic when it comes to management choices. Finally, the paper attempts to define a clear demarcation line regarding entrepreneurial responsibility, beyond which businesses must never venture even if this entails harming the viability of the firm.

The empirical case represents an emblematic example of how, when facing an emerging problem where it is difficult to reconcile firm viability with social expectations, there are various possible solutions ranging from shareholder-driven choices to stakeholder oriented choices. That of Fiat's CEO seems to have been a choice mainly oriented at safeguarding the owners' interests rather than those of the stakeholders within the relational context of Termini Imerese.

## **Methodology**

Regarding methodology, the paper develops its theoretical analysis and empirical research using a cyclical model which begins with the theory, proceeds to the empirical analysis phase and then returns to the theory (Bryman, 1988; Lazarsfeld & Rosenberg, 1955). From a methodological viewpoint, the case study concentrates on understanding the dynamics behind the forming of various management choices and on the effects they produced (Eisenhardt, 1989). To develop the case study, both secondary and primary data was used (the latter obtained by means of questionnaires). The results from the case study cannot be subject to statistical generalisations or theory testing, but the case study can be used to generate theoretical constructs, propositions and/or midrange theories (Eisenhardt, 1989; Yin, 2003).

### **Firms as a system of relations**

The advent of systemic capitalism (Golinelli, 2005), has induced firms, within their specific context of reference, to develop interests increasingly crowded with relations with both economic and social stakeholder. The stakeholder theory (Freeman, 1984) sees the firm as a entity situated at the centre of a complex web of connections, each of which needs nurturing through structured and lasting relationships. Managing relations with stakeholders, therefore, becomes a defining element for management, in as much as the evolutionary dynamics of the firm are constantly influenced by powers and pressures brought to bear by entities in that particular context as well as the continuous remodelling of the order and priority of interests resulting from management action. All of this highlights the complexity of taking responsible actions that go beyond a merely contractual and conflictual vision of relations to embrace a more co-operative and supportive vision. Based on the above-mentioned perspective, firms can be defined as a network of relations that are activated, regulated and oriented towards the creation of socio-economic value and whose end is to increase the firms' chances of survival (Pellicano, 2004). From this stems an inter-systemic vision, which places emphasis on the individual particularity of each single firm seen as a specific configuration of relational networks (Zan, 1992).

This projecting outwith the firm, introduces the concepts of context and environment, both of which need to be clearly defined.

The relational context comprises all the possible economic and social relations a firm can activate.

The environment, constitutes the setting which extends beyond the relational context. Here we find not only economic phenomena, but also political, cultural and technological phenomena, all of which impact the firm and influence its ability to survive.

Through managing relations, firms "activate the environment" (Thompson, 1967; Weick, 1969) and model it. In this way, firms "create" the context of reference most suited to itself, which helps it develop. These reflections reveal the difference between environment and context, where the former appears an objective given common to many firms; the latter being subjectively perceived, activated and managed by the firm's governing body and appearing specific and particular. In choosing the entities with which to communicate, the governing body must first and foremost be capable of identifying certain dynamics as potential supporters for the creation of value. At this point, for the governing body it is essential to listen to the context with which it relates and, consequently, adopt coherent and responsible behaviours. However, context can be increasingly defined as a synthesis of a range of entities, cultures, instances and expectations, and requires composite governance in as much as it must be capable of bringing together a multiplicity of aspects or it risks the social delegitimation of the firm. In other words, context is characterised by its being a "system of systems", that is, a complex web within which each and every event is influenced by the



intentional and conscious action of each component and where the evolution of each component depends, to a greater or lesser degree, on the actions of each other component and where the evolution of each component depends, to a greater or lesser degree, on the actions of the others. This highlights the overthrowing of the logic according to which the management of the firm can exert a kind of unilateral control of relations with stakeholders (Freeman, Evan, 1990) and instead favour profoundly collaborative relations that are based on forms of involvement and on dialogue (Ayuso, Argadona, 2007). Therefore, if context is seen to be characterised by a closely woven network of interacting systemic entities, for management, this would imply that they have the obligation, as well as the responsibility, of considering not only single relationships with stakeholders (systemic entities), but also of interpreting the effect of relations undertaken in a comprehensive and interconnected fashion. Moreover, management must constantly aim to co-ordinate the interests of various categories of groups of interest with the firm's need for viability. As such, it is clearly necessary to identify and prioritise the important effect that behaviours adopted by firms have on the wellbeing of the context and the environment. From this perspective, the analysis of the impact of firms on the relational context cannot avoid considering the effects of their behavioural dynamics as the result of relations activated with other institutions and socio-economic systems; just as it cannot disregard the influence and pressures the various, complex economic, social and cultural powers exert on firms. The absence or the progressive loss of harmony with the context, and thus also with the environment, can lead to an incorrect orientation of the dynamic evolution of a firm, reducing on the probability of the firm surviving. On the other hand, the various levels of public consensus enjoyed by firms is closely linked to the correct identification and selection of subjective interests and to the methods used to guarantee their fulfilment.

From this point of view, the theoretic premise from which viability originates and develops is represented by the idea of considering firms as being immersed in a specific context subjectively perceived by the governing body and, as such, value, the result of the managing and guiding action of said governing body, is formed within a complex system of contextual relations. From this perspective, action taken by the governing body must tend to reconcile the interests of the various stakeholders of the context with the firm's requirements for viability. It therefore follows that the governing body needs to constantly evaluate the impact (in socio-economic terms) and the risks (in terms of consequences) inherent in the decision to give priority to the satisfaction of one systemic entity over that of another which is held to be less important (Coda, 1995).

### **An interpretative scheme of interactions**

The interpretative scheme (Fig. 1), which we are about to describe, proposes analysing, from the governing body's point of view, how the interaction between the firm and its relational context can influence performance and therefore, by way of summary, the firm's

survival. From this perspective, we adopt the socio-economic value (Pellicano, 1995) as the parameter able to explain the aforementioned interactions in a concise fashion. The proposed scheme, therefore, could help top management to evaluate *ex ante* the effects that typical business decisions can produce on firms' prospective income following specific initiatives, choices and projects of considerable strategic impact. It is clear how evaluations of the type described are decidedly not easy; these decisions inevitably impact the firm's level of risk, but a more extensive and thorough evaluation carried out preventatively increases awareness when taking decisions. As we will highlight, such a delicate trade-off is not only the result of the skilled predictive ability of the decision-maker, but also promotes appropriate ethical conduct.

The starting point is "*ex ante* income", that is, a pre-existing income situation determining strategic options, by which, as we have said, we mean business choices having significant impact on the systemic entities of the context (considered together) and characterised by an equally significant expected effect on the firm. The model supports strategic decisions by using provisional estimates and evaluations, attempting to identify their effects.

The scope of the actions taken, which stem from the dynamic reading of context and of consequent interactions, provide social and economic value, which, ultimately, is evaluated through a measurement system of so called "*expected*" or "*ex post* income". Expected income, therefore, is the effect of interaction dynamics with the context stemming from the choices taken.

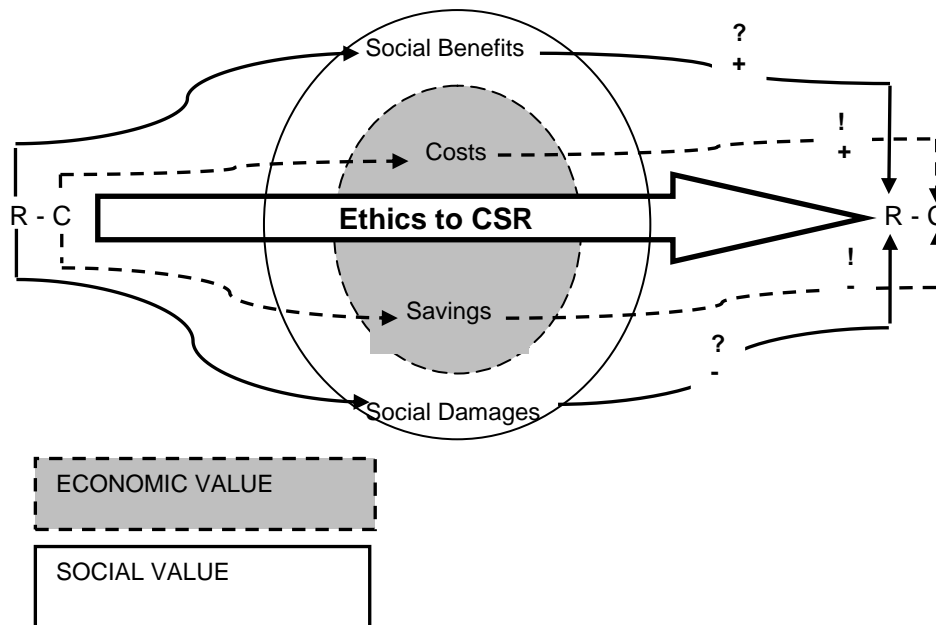
The evaluation of decisions characterised by their significant impact on the relationship between firms and the context can be analysed from two different perspectives:

- Business Oriented, in which stakeholders are scientifically used in an instrumental fashion to improve the outlook for income. In this case, relations between stakeholders tend to be conditioned by the reaching of the aforementioned objective.
- Ethics Driven in which choices taken and behaviour adopted towards stakeholders do not immediately appear directed at improving the outlook for income even though such effects cannot fail to be considered. In this case, interactions with stakeholders tend to create a structural and balanced relationship based on mutual satisfaction in terms of balancing required undertakings with contributions offered.

In reference to the configuration of the interests of associated parties (Laz & Sebenius, 1986, Rumati & Pietroni, 2001), the two perspectives highlight the move from a transactional logic to a relational logic. From the first perspective, relations are based on a predominantly antagonistic win-lose type of logic and stability with each stakeholder is sought on an essentially negotiatory basis with the objective of creating, as far as possible, positions of

contractual strength. From the second perspective, relations are based on a collaborative win-win type of logic aimed at seeking virtuous equilibriums capable of producing agreement and cohesion with the majority of stakeholders.

Figure 1 - The VES model



Source: Our creation

The business oriented analysis perspective comprises two options which, albeit apparently at odds with each other, are based on the same economic logic, which we have already discussed.

Regarding expected income, the perception one has of stakeholders can function as a:

- a) Threat;
- b) Opportunity.

Option a) stems from a conceptual approach for which issues inherent in the firm-context (socio-natural) relationship end up representing limits, constraints or even threats to prospective income for firms. Such a vision sees management committed exclusively to seeking opportunities for economic 'savings' through the socialisation of costs (Vaccà, 1973), meaning that they avoid taking on some of the costs brought about by their firms; that is, through processes of "efficiency" and "savage restructuring" that impose sacrifices on third parties (Dematté, 1997). The immediate and objective effect of such options brings about cost containment or reductions in costs which can be seen in the positive difference between the "ex-post" and the "ex-ante" income. Faced with such a decidedly economic effect, however, only a short-sighted top management could avoid considering the damage that the

socialisation of costs causes to the context's other stakeholders and to the community. But that's not all. In fact, what emerges from the structure of the scheme is that the "negative return effects" should be carefully evaluated. These effects are felt in diminished earnings that can result from damage to the firm's image in the eyes of the stakeholders who feel themselves to be progressively damaged by the choices and behaviour adopted by the firm itself. It is clear, however, that while the evaluation and quantification of the advantages obtained by cutting costs is, as we have said, certain and more or less simultaneous, the effects on the expected income pay the price for conduct that, over time, is sanctioned by the market and by society in terms of a drop in sales and loss of consensus, trust and attractiveness. In other words, a structural deficit on the consensus front risks significantly prejudicing the firm's income.

Option b) stems from a decisional process aimed at seeking constant enrichment of the value content of the systemic output proposed to stakeholders who are characterised by a particular socio-environmental sensitivity, resorting however, to image and manipulatory policies. Such an option sees the firm adopt an attitude aimed at generating offers attractive enough to satisfy the expectations of the different stakeholders that control the resources the firm needs. Faced with the expectation of positive returns in terms of increased earnings, this option involves an increase in associated costs and has a certain and immediate bearing on prospective earnings. It is clear, in fact, that the complex systemic offer of increased value content and, in general, responding to more extensive social demands implies firms facing costs that are often significant, and that impact both economic and financial aspects (Sciarelli, 2002).

The upstream expectation with such an option is that the social advantages that benefit users and improve satisfaction levels, over time can translate into economic advantages in terms of increased flow of earnings and/or lower management costs, or rather into advantages regarding reputation and motivation (Molteni & Todisco, 2008). The above considerations result in an increase in the level of harmony between the firm and its stakeholders which in turn leads to the latter displaying a more helpful disposition towards the former, and therefore in positive returns in terms of the firm's image and sense of appeal.

Therefore, when faced with what are certainly increasing costs, the decision to consider the relationship with stakeholders as an opportunity to achieve increased earnings doesn't guarantee noticeable returns in the short term. Consequently, while the social costs are more or less immediate the benefits are potentially transformed into earnings only in the long term. As we have said, the two strategic options outlined, though substantially speculative, share an exclusively economic common logic whose end must invariably be linked to the prospect and expectation of increased earnings for the firm. Thus the options have a common end, though different means. Analysing the two options together, we can observe how both options, by producing immediate economic effects, 'bet' on achieving a positive reaction from

the social milieu. With the first option, the bet is based on the expectation of being able to contain the decrease in earnings to within the level of the amount saved; with the second option, it's based on the expectation that increased earnings will more than cover the costs sustained.

In the Ethic Driven perspective, decisions aren't taken in the direct pursuit of economic advantage and thus the social vision is not based on a utilitarian type relationship (Bowie, 1999); on the contrary, it is aimed at maximising the well-being of the context through highly collaborative relationships. The governing body has a high level of openness which encourages it to widen its reading of the context in the conviction that each relationship is important. In other words, an enlightened and long-term policy contributes to reducing forms of short-sighted business practices. In this type of logic, long-term business behaviours are capable of matching the firm's requirements for competitiveness and for profitability with the highly cohesive humanistic needs of all stakeholders, so this adhesion to ethics provides not only a guarantee of correct and transparent behaviour but also a solid basis on which to build an engaging and motivational organisational context (Coda, 1985, 2004) that is the result of adequate evaluation processes of those who operate within the firm in various roles. Thus we see the contribution of strategic ethics in the creation of value for the firm's stakeholders. Clearly, the contribution tends to grow in function of the sharing of values, which is fuelled through forms of engagement aimed at strengthening knowledge, trust and agreement, but above all through forms of inclusion aimed at avoiding the unjustified exclusion of stakeholders. On closer inspection, exclusion can be avoided by respecting ethical principles valid in their own right.

Guiding the "ethical path" is a system of values aimed at correctness, transparency and loyalty that is followed by the individuals within the organisation and which, when shared, become founding elements of the firm, and representing for the firm, a kind of identity or conscience. Last but not least, the ethical path can be seen in the heightened sensitivity of a "moral" governing body (Carrol, 2000) that helps give direction to the evolutionary dynamics of the firm through a correct reading of the real contribution that each stakeholder is able to bring to the process for generating wealth (Ghoshal, 2005). The affirmation of ethically correct values, and their incorporation into the firm's practices, necessarily leads to the growth of individual morality of those governing the firm, be they businessmen or discretionary technical management bodies.

Clearly, when firms take the "ethical path" - albeit to supply incumbent responses to legitimate social expectations - there are effects on "ex-ante" income projections and on effective "ex-post" income, effects that on the whole are valuable. Following such a logic, taking decisions that might cause income to contract in the short-term can create the premise for future well-being, increasing the firm's viability in terms of consensus, trust and transparency (Frederick, 1988). As such, it can be said that the ethical option, result of a

governing and management philosophy that pervades the entire firm, defines business behaviour that has a positive impact on firms' risk-return profile. A decisional process aimed at seeking virtuous good-sense solutions tends to reduce intra-systemic and inter-systemic conflicts while also helping to reduce the risk of failing to pursue economic aims.

### **Fiat: disembarking in Sicily and exit strategy**

The plant was founded in 1970 in Termini Imerese thanks to a significant contribution made on behalf of the Region of Sicily to Fiat. In order to obtain this localisation within the territory, a purpose-built company called Sicilfiat was created where Fiat retained a majority hold of 60% of the shares. In 1977, Fiat bought out the other partners with the result that the plant became one of the many belonging to Fiat (Fga). In April 1970, with a workforce of 350, the plant began production, placing on the market the famous "500".

### **A tortured journey**

Termini Imerese immediately became a difficult plant both because of its exorbitant maintenance costs and its poor yield and productivity. Economically, the plant was not particularly important as it made only a modest contribution towards the company's total production. The factory has only ever produced one model at a time, thus linking its performance to the momentary requests of the market. 1993 saw the plant's first restructuring which made thousands of workers redundant, drastically cutting the number of jobs. In 2002, workers were again alarmed following the approval of a reorganisation plan that included extraordinary temporary redundancies and the closure of the plant for a year. There was also the hypothesis that the Termini Imerese plant might be converted into an energy production plant, a sector in which Fiat was already present with its Italenergia and which Fiat's management saw as being strategic. However, the reorganisation never took place. Back then, the company's image was already somewhat damaged; general opinion was that Fiat had realised this establishment thanks to public funding, but that once the economic thrust from that assistance had ceased, Fiat was inclined to close an activity that it considered marginal, but which for the area of Sicily represents (still today) its most significant industrial plant (Volpato, 2008). In 2004, Fiat management again began discussions regarding their Termini Imerese plant, however, interventions on behalf of: politicians, local institutions and the government led to the then managing director signing the agreed reorganisation plan. Thanks to the objectives of increased growth detailed within the 2007-2010 strategic, the agreement with the social entities was signed, in which Fiat's right to effect long-term redundancies was recognised. The agreement not only anticipated the survival of the plant until 2009, but also the realisation of investments necessary for the start up of new production with increasing quantities and the development of an adequate network of suppliers aimed at overcoming the logistical-economic constraints of the Sicilian plant.

### **Full-blown crisis and exit strategy**

Towards the end of 2008, with the arrival of the world economic crisis, there are new problems for the company as well as for the Termini Imerese plant, considered the least productive by Fiat analysts and therefore included in a list of the group's firms to be closed in an attempt to regain efficiency. 2009 begins badly for the plant, with continual announcements of redundancies, probable closure of the plant for an indefinite period of time, and suspension of redundancy payments, all of which leaves the 1,500 workers, the 600 people within the network of suppliers and the local community extremely anxious. The 2010-2014 strategic plan presented to the government on 21st April this year, decrees the official and definitive closure of the plant by the end of 2011.

### **Underlying motivations and associated justifications for the exit strategy**

The copious amount of literature that exists on Fiat (Volpato, 1996; 2004; 2008; Enrietti, 2007), shows how the various periods of crisis that the firm has undergone over time are at least in some part to be blamed on an economic group accused of being overly forceful and arrogant in periods of growth, completely unwilling to reconcile its own interests with the interests of the context from which it draws the resources necessary for the firm's development. This results in the formation of a very poor business culture, a decisional model highly focussed on top management levels where managers expected non-critical acceptance of all the strategies defined (Autieri, 2004), thus transforming collaborators, even capable ones, into 'yes man' executives (Volpato, 2004). If initially the market forgave many of the errors that were committed, from 2000 onwards, things changed. The transformation of the automobile market, characterised by a segmented demand and a preference for particular and exclusive products, has, over time, reduced the level of Fiat market control, their market share having progressively decreased.

According to the new managing body, the turnaround launched in 2004 should have led to a significant reorientation of company culture, the intention being to achieve a double objective: on the one hand, to clearly define the company's role, on the other, to re-conquer the faith on behalf of the company's stakeholders, in particular, social stakeholders, through forms of collaboration aimed at establishing forms of reciprocal advantage (Marchionne, 2007). Moreover, the company began a process of international expansion thorough a series of collaborative agreements with foreign partners.

The brusque interruption of the path of development that appeared in late 2008, became clear with the explosion of the world crisis.

The strategic program that stems from the 2010-2014 industrial plan brings up some points of significant interest.

First of all, Fiat appears to be much more global and increasingly less Italian. In particular, there is a proposal to gradually move the company's board of directors to the United States,

with a reduction of members in Italy, and, at the same time, a de-localisation of production towards low cost areas. In particular, while Italian plants may be used at 50% of their productive capacity, some foreign plants (Like Serbia and Turkey) will be exploited up to 130%.

Moreover, the transfer of the cars from the other Fiat establishments is also scheduled. Fiat believe that with the spin-off of its industrial vehicles, Fiat Auto will also have opportunities for development through mergers and partnerships with other automobile companies. It is clear how such a decision favours financial development rather than real development.

Finally, the following reasons are given as having guided the closure of the Termini Imerese site:

- the establishment is, above all, anti-economic: producing a vehicle in Sicily costs around 1,000 euro more than in other plants;
- there is a more restricted network of suppliers, which means that most components arrive in Termini Imerese from other national factories at great expense to the company;
- to make the situation worse, the size of the plant is problematic; it is small and production is limited. Due to the economic crisis, though it has an effective capacity of 100-200 thousand units, the plant only assembled 60 thousand;
- to all this you have to add the delays and the role of local bodies who, for one reason or another, invariably delayed investments for developing infrastructures and facilitating the presence in loco of firms producing components.

Moreover, the managing director's line of thought, clearly revealed in a number of interviews he gave, can be summed up as this: the conflict of interest is not between Fiat (owners and top management) on the one hand, and the workers at Termini Imerese on the other: rather it is between the Fiat employees at Termini Imerese and all the other Italian Fiat employees. That is to say, in this arbitrary logic, the choice of sacrificing the Sicilian employees, albeit a painful one, appears justified by the need to safeguard the other employees and avoid an even more traumatic and socially devastating choice which would see Fiat Auto obliged to resort to the more incisive option of productive de-localisation. But it is still legitimate to wonder how come the salaries of top and middle management were increased and why, at the same time, they went ahead to distribute profits (250 million euros in dividends).

### **The stakeholders' reactions**

Fiat's behaviour was greeted by bitter criticism and strong protests which arrived principally from the employees of the Termini Emerese site, but increasingly also from various stakeholders (politicians, mayors, media, consumer associations etc.), making quite a



stir both locally and nationally. Even the Church intervened, urging people to unite their efforts in a bid to end the conflict.

In summary, what expires is a loss of faith not only in a company that over time both exploited significant public funding, directly and indirectly, and that not two years previously had taken on the responsibility of strengthening their network of suppliers, but also in the various public institutions held to be incapable of safeguarding social and civil rights. For the local area, it is the end of an industrial dream that lasted forty years and that is a cornerstone of the Sicilian economy.

Moreover, regarding Fiat's industrial plan, union representatives (belonging to about ten organisations), complain that very little recognition was given to their role and they were very poorly informed about the logic of the formation of the plan; in other words, Fiat was only interested in dealing with the government, ignoring the unions' point of view. The compromise reached between Fiat and the government has safeguarded some plants, but with the request of implementing early retirement and redundancies. The fear is that once Fiat have rid themselves of Termini Imerese, they will progressively abandon the other national plants, especially those in the south which are perceived as being the weakest link in the chain.

### **The re-conversion of the Termini Imerese site in Fiat's absence**

There are many hypotheses for the saving of the site. In particular, of the 21 proposals submitted to Invitalia (advisor to the Minister of Economic Development), fourteen are already at a more advanced stage. Of these, eleven have already begun a process aimed at evaluating feasibility, and three are ready to do so. The sectors involved in planning initiatives are: automobile, media, manufacturing, research and agriculture.

In particular, the project called "Sunny car in a sunny region" seems to be attracting much interest. The project is the result of a partnership between a Sicilian businessman who is president of the Private Equity Cape and the Indian firm Reva Electric Car Company (global leader in the production and marketing of electric cars). The project has two aims: on the one hand, the production of automobiles and vehicles fuelled by renewable energy; on the other, the creation of electric vehicle solar energy recharging plants to be realised all over the region. The project, which

anticipates an overall investment of 935 million euros, would ensure the creation of around 3,500 jobs.

At this point, one can't help wondering why Fiat itself didn't consider the re-conversion of the site, above all when you consider that the firm has been operating for some time in the automobile sector and is a leader in the low-emission engine category. Exponents of Fiat's management while confirming the inevitable closure of the plant due to competitive disadvantages and structural and economic-financial difficulties, underline that there is a

significant collaborative commitment on behalf of Fiat's top management (in particular with central government) aimed at favouring the creation of a serious and credible alternative project. However, no indication has been given as to what this alternative project might be. Moreover, regarding the social impact of the exit strategy, Fiat's responsibility and commitment was confined to their having announced the decision with thirty months notice so as to leave enough time for the necessary re-conversion process.

The results produced by the empirical research underline how company management is reluctant to explain any possible compatibility of alternative projects with the group's strategy. In fact, from the few replies we received (all anonymous) it was impossible to understand what their strategy actually is.

Regarding trade unions, political entities (Municipalities, Regions, Provinces), the many replies we received suggest the following:

- Fiat will not support any alternative project; the international expansion strategy the firm intends to follow wants nothing to do with an area it finds weak and unattractive. This is also confirmed by the fact that the Region of Sicily had declared it was willing to invest 400 million euros in the improvement in infrastructure and technology; nevertheless, Fiat was unmoved by the proposal.
- regarding the proposed projects for the re-conversion, the fear is that the assurances of the government will remain simple assurances and that the initiatives will never get off the ground.

## **Ethics and CSR**

The doctrine highlights the need to match economic operations with ethically inspired behaviour. In particular, behavioural correctness depends completely on ethics in as much as being responsible to someone for something implies a "need to be" (Rusconi, 1997). However, one must clarify that from a methodological point of view, ethics has an individual structure as it is fruit of the values of the single individuals that make up the firm's structure and is expression of a specific and developed internalised culture. On the basis of what we've said, company ethics are a "derived" as they stem from the values and behaviour of individuals; they are "relative" and "subjective" as they are the expression of the greater or lesser combination of moral and economic values, the latter of which are typical of the business world (Sciarelli, 2007).

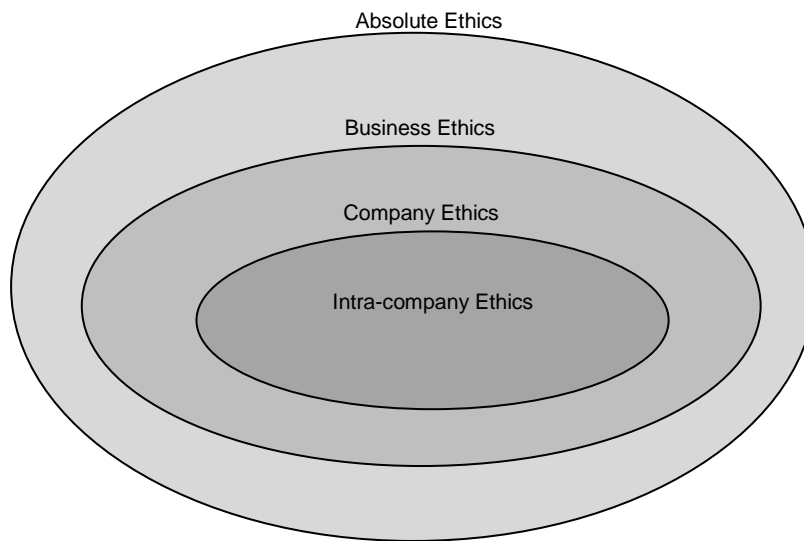
But on closer inspection, the application of ethics in firms also bases its stability on the micro-macro exchange theory. Following such a logic, the firm's "standing in society" is only legitimised when the firm adopts correct behaviour in the exchange between the benefits it receives from society and damage it causes to society (Donaldson, 1989). Thus we see the contribution ethics make to the creation and diffusion of value on behalf of the stakeholders the firm deals with.

To get a better understanding of the meaning of business ethics, you can't avoid considering the most general concept at the heart of firm culture. This is because firm culture puts into practice the elaboration of orientations (values) and behaviours (actions) shared by the majority of the internal components of the firm's structure (Barile, *et al*, 2008). This consideration induces us to argue that it is in the culture itself that ethics (in as far as they are linked to values) and responsibility (in as far as it is linked to behaviour) are to be found. If the firm internalises an ethical value system that can help guide its actions, it is highly probable that the behaviour displayed towards stakeholders will be based on behavioural correctness. In that sense, ethics can be defined as a behavioural model aimed at identifying criteria and values that guide conduct towards good, favouring the principles of honesty, justice, fairness and respect for human dignity.

The socially correct behaviour of firms however, cannot consist in merely respecting the contextual restrictions and laws. Reference must be made to the concept of the wider socio-cultural context and shouldn't be limited to considering as rules only those enforced by specific local legislation, but should also encompass moral and religious obligations.

If it is true that behavioural correctness stems from a system of individual values, that is, subjectively encoded values, then it is also true that these subjectively encoded values are the result of the internalising of absolute principles, filtered by contextual constraints and rules. By their very nature, these values extend beyond context, and tend to be objective in as much as they are universally recognised. Absolute principles encode the inalienable and binding rights of all human beings in all their various shapes and sizes.

To make things clearer, it's a good idea to express the analysis in the following levels (Fig. 2):

*Figure 2 – Levels of business ethics**Source: Our creation*

- Absolute ethics, that is, principles generally universally recognised as such, and therefore, objective. This level defines socially supportive behaviour, and is aimed at the conscience of the firm decision-taker (Rusconi, 2007);
- Business ethics, characterised by constraints and rules of conduct generally accepted in a specific socio-cultural context. Of all the different contexts, business contexts embrace relative ethics (Sciarelli, 2007) aimed at bringing together complex equilibriums, otherwise defined as entrepreneurial ethics;
- Company ethics, inherent values regarding social systems with particular reference to those in the business sector, as they are organisations resulting from the combined action of many individuals, each of whom has his own system of values. At this level, there are strategic company ethics and ethics within companies as held by individuals.

We affirmed that where there is full consistency between values characterising specific business contexts and all the universal principles, firms naturally tend to adopt responsibly correct behaviour. In other words, in order for business conduct to be considered absolutely correct ethically speaking, there must be as high a level as possible of compatibility between the system of values of a specific firm and the general set of principles universally considered to be those reflecting the essential values of fairness, justice, social support and so on. During the subjective internalisation processes of the above-mentioned principles, the filtering action provided by context has a distorting effect if the constraints and rules valid in that same context are not in line with the absolute principles. On the contrary, if there is full compatibility between the contextual constraints and rules and the objective principles, then

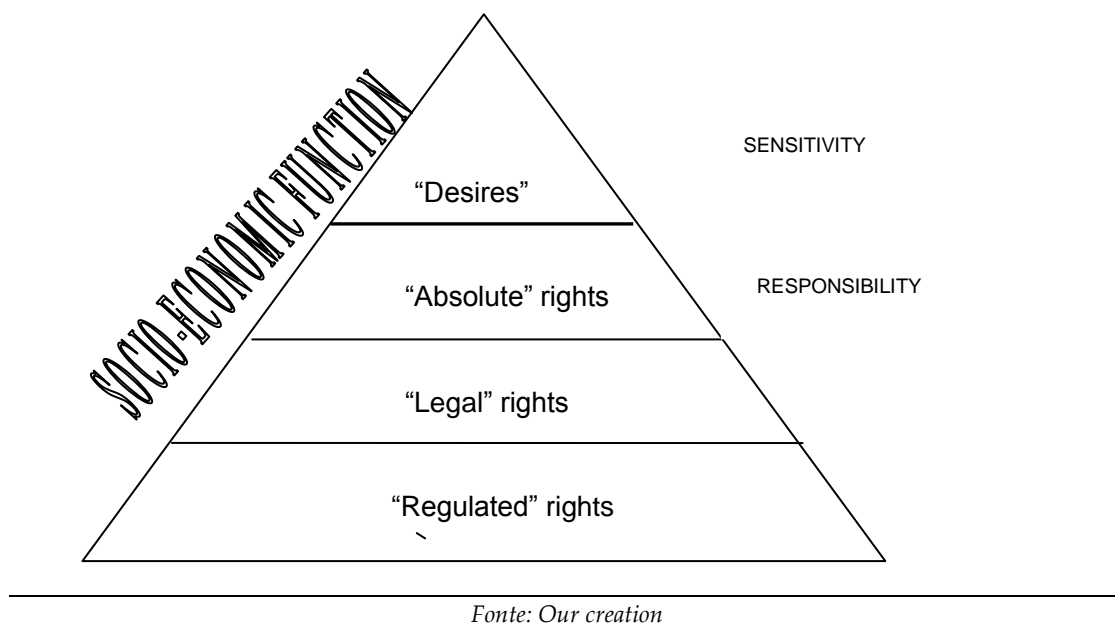
the subjective internalisation process will be facilitated, thus strengthening the subjective values.

It is clear how behavioural correctness is the result of adequate responses to the legitimate expectations of the firms stakeholders. The expectations cover not only the fulfilment of rights, but also interests linked to requirements, needs or mere desires. Considerations of legitimacy must, however, transcend the stakeholders' power of influence and capacity for retaliation. In other words, ethics is that type of management that knowingly causes damage to its own firm rather than damaging the rights of third parties (Donaldson, Preston, 1995).

This respects the fundamental premise that any firm that survives only through the abuse of power to towards those weaker than itself cannot really be considered a firm and therefore doesn't deserve to exist. It is to be hoped that governing bodies concentrate their efforts on coming up with creative solutions that over the long-term, are capable of integrating absolute ethics and company ethics in a synergetic fashion.

In an attempt to further clarify this issue, we suggest taking another look at Carroll's pyramid (1979,1991,2004) regarding firms' responsibilities (Fig. 3).

Figure 3 – Re-examing Carroll' pyramid.



By creating and distributing socio-economic value, firms are able to supply satisfactory responses to the various expectations expressed by their stakeholders.

Above all, one can clearly deduce that the basis of firms' responsibility must be concerned with the fulfilling of their economic stakeholders' (clients, suppliers, employees, distributors etc.) rights based on contractual type relationships (regulated rights).

Based on such an assumption, business responsibilities can increase and change depending on the problems inherent in the relationships between the firm and its socio-institutional stakeholders. And it is the firm's responsibility to respect the legal rights of its stakeholders as they are sanctioned by specific contextual jurisdictions.

Finally, the firm's responsibilities towards its stakeholders must necessarily extend to respecting their universally recognised absolute rights as human beings, minors, workers, women, even if they are not considered 'rights' by law.

Above and beyond the system of business responsibility, but in the sphere of the firm's social function, one can also include helpful or liberal acts aimed at satisfying 'mere' desires. These aren't exactly a firm's duty (as they are not aimed at respecting rights), but rather, a kind of marked sensitivity towards the social context that encourages the firm to adopt behaviours displaying the principle of solidarity. It follows that the firm's overall sense of society is a function of its corporate responsibility and social sensitivity. And it is this, what we now call "summa", that singles out the firm's socio-economic function.

Therefore, in the sphere of firms' socio-economic function one can identify a clear demarcation line between areas of entrepreneurial responsibility and the area of social sensitivity.

By the former we mean firms' obligation to respond in a behaviourally coherent and correct fashion to the expectations of its stakeholders who enjoy various types of rights. This as a result of their having strong enough ethical values to give the correct orientation to their behaviour. It is therefore possible to argue that the area of responsibility shouldn't entail free will since choices are proper and mandatory responses.

Regarding the latter - where social stakeholders' expectations aren't so much rights as justifiable desires - the firm's behaviour appears to be fruit of free will that can nevertheless express a greater or lesser attention, sensitivity and helpfulness towards the social context.

### **Final considerations on the case study.**

In the light of the considerations inherent in the delicate relationship between ethics and social responsibility, and given the findings of the empirical research, it is possible to reach the following conclusions:

- with their decision to abandon Sicily, Fiat's top management can't be "formally" accused of failing in their CSR since it found itself faced with a problem where there were two different conflicting values, each of equal importance; that is, efficiency and solidarity;
- however, while the problem and the particular contextual requirements may have put pressure on the firm, it would seem that the firm undervalued the impact of its choice. In other words, faced with the serious needs and expectations of

stakeholders, management didn't display that due attention, sensitivity and helpfulness that one would have expected;

- the scarce corporate sensitivity displayed, can probably be attributed to an under-developed sense of ethics in as much as Fiat did not display correct behaviour, failing to guarantee an adequate equilibrium through the "social contract" stipulated with the local context from which over time, the company enjoyed more advantages than it was able to contribute;
- one can reasonably argue that top management showed little inclination for change, demonstrating a lack of entrepreneurial creativity. Even though Fiat is a diversified group, it didn't put any effort into identifying possible alternative activities. Clearly, this unwillingness to change did not facilitate the development of widespread creativity;
- from which we can deduce that a greater level of corporate social sensitivity would have resulted in a different degree of willingness to listen and engage with the stakeholders, and a willingness to discuss a choice which appeared predetermined and which was strongly defended. Such an attitude could have helped the firm develop more creative solutions to the problem solving, favouring the emergence of alternative solutions to the exit strategy.
- there is also the hypothesis, though it's impossible to validate both in the short-term and long-term, regarding the choice of an alternative option to the exit strategy. Following this logic, if management had chosen to revitalise the Sicilian establishment realising projects more or less similar to those submitted by other businesses, or had they at least shown the willingness to participate in projects promoted by other businessmen that they thought compatible with the group's assets, one has to wonder if by realising and taking on an alternative project, it might have been possible to come to a more positive conclusion, both strictly in business terms regarding increasing the company's revenue, and improving Fiat's social reputation which has undoubtedly been damaged since they took their decision.

As we have said, the point of view that Fiat's managing director took underlines how the drama of the Sicilian workers shouldn't be interpreted in a way that sets the interests of the owners against those of the workers, but rather should be seen as a conflict between groups of stakeholders. Even if we accept this interpretation, what the paper reveals is how the company's lack of willingness to explore alternative solutions can be attributed to Fiat's top management, solutions that at least potentially could have changed the game that is presently coming to a dramatic end with a win-lose type logic that sees the redundancy of the plant's workers and the subsequent detriment to society, and which in the future, alternatively, could have come to a different conclusion, with an alternative project that was sustainable

both from an economic and social point of view and which could have resolved the problem using a win-win type logic.

### Implications for future empirical research

Further possible developments in research might involve a study aimed at evaluating how the Termini Imerese case will impact - over the medium and long term, from 3 to 5 years - the reputation and market results of Fiat's group, by means of an analysis capable of combining:

- the direct effects produced by the exit strategy both on the Sicilian territory, and the country as a whole;
- the effects caused by further developments to the Termini Imerese site. In this case, it would be interesting to evaluate how a positive or negative implementation of the alternative solution, which will be selected in the near future, will impact Fiat both from an economic point of view and regarding its reputation.

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## THE IMPACT OF CORPORATE INCOME TAXATION ON FOREIGN DIRECT INVESTMENT INTO EUROPEAN UNION MANUFACTURING SECTOR

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### Abstract

This paper investigates the impact of corporate taxation on the location of foreign direct investments in European Union countries. Significant changes have occurred in EU economic environment during last decades: enlargement of European Union (EU) and European Monetary Union (EMU), decreasing the tax levels due to the tax competition, deep economic crisis followed the period of growth, and the FDI flows have increased considerably during the period. The analysis was conducted based on the aggregated manufacturing foreign direct investments world flows into 23 European Union countries. The main result from estimated econometric model based on a cross-section data of country variables is that effects of taxation on manufacturing foreign direct investment are statistically significant. The results show that increase of nominal corporate income tax by one per cent is associated with decrease of manufacturing FDI by 0.03 percentage points. Considerable differences were discovered in the behaviour of FDI flows into small and large countries. Larger countries face lower elasticity of FDI to the tax rate. The results suggest that tax policy aimed to increase FDI is particularly important for smaller countries.

**Keywords:** foreign direct investment, European Union, corporate taxes, manufacturing

### Introduction

The income flows generated by foreign direct investments (FDI) are subject to corporate income tax in most of the host countries. The expected cash flows from investments and the value of investments are heavily influenced by the level and mechanism of taxation influencing in turn the investors' readiness to invest into particular country. The question of how corporate taxation influences FDI is a major research question both from the scientific and policy viewpoint.

Despite the fact that number of studies have been carried out to clarify the problem, it remains topical. The empirical study is motivated by the following facts: (1) economic conditions and business motivation in many countries have been changed due to the enlargement of European Union (EU) and European Monetary Union (EMU) during last

decades; (2) intensive process of tax competition has been present in EU during the same time; (3) it covers the period from 1998 to 2008, starting with the end of last crisis and ending with the approximate peak of last big economic crisis; and (4) the FDI flows have increased considerably during recent years.

The paper draws from two main strands of literature. First, increased attractiveness of countries for FDI resulting from lower tax burden is treated in literature on the tax competition. The choice of variables in this paper is partly based on some results of these articles. Second, the preliminary choice and expected influence of variables is based on studies about the factors influencing inward FDI.

The theory of tax competition suggests that capital mobility and country size have impact on the taxation policy. Krongstrup (2002) pointed that larger countries face lower elasticity of capital to tax rate and therefore choose higher tax rates compared to smaller countries. The asymmetry described by Bucovetsky (1991) implies the following: when a large country changes its tax rate, more capital will move out of the country than when a small country increases its tax rate by the same amount. However, the investment decisions depend on the perspectives of the host country's economy and its openness, on growth rate, quality of institutions and on many other factors.

The tax competition model explains partly the behaviour of European countries whereby they introduce tax policy measures to compete for mobile factors. Small open economies are not able to influence the capital flows considerably. They lower taxes on capital income for the purpose to affect the costs to overcome the problem. As a result of free movement of capital other countries are forced to decrease tax rate too. The asymmetry described by Krongstrup (2002) implies that larger countries tend to have higher tax rates on capital compared to smaller countries when capital is mobile across countries.

Winner (2005) examined the tax competition empirically using a sample of 23 OECD countries. He assessed the impact of two components of tax competition – capital mobility and country size – on the taxation of factor incomes on the basis of period 1965-2000 and concluded that the tax rates in large countries are bigger than in a small countries. A paper by Benassy-Query, Fontangne and Lahreche-Revil (2005) evaluated the influence of taxation on FDI, with a special focus on the impact of corporate tax variables, by taking into account tax schemes for avoiding double taxation. Empirical results of research on China suggest that tax rates and incentives are important determinants of FDI (Tung and Cho 2001). In their regression analysis, FDI is dependent on infrastructure, tax incentives, wage rates, unemployment rate and population. It was found that the wage effect and unemployment effects are insignificant. The focus was on tax and infrastructure variables. According to the results of regression analysis, zones and cities with lower tax rates and greater tax incentives attract more foreign direct investments than other areas.

In recent years some comprehensive researches concerning the influence of corporate taxation policy on foreign direct investments have been done. One of them is the empirical analysis of the European Commission's Directorate for Taxation and Customs Union written by Fatica, where she examines the asymmetric effect of taxation on FDI. Fatica (2009) found that FDI respond significantly to the taxation in countries with low quality of institutions. The effective tax rate was not important enough to attract foreign investments in other countries.

To summarize, the results of previous works indicate that tax policies have significant impact on the investment location decision. Size of the economy influences the level of the tax rates supporting the theory of asymmetric tax competition. It is important to understand that the level of taxation impacts the gains from investment. Past empirical work, which focused on the relationship between foreign direct investments (hereinafter FDI) and corporate tax rate has found mixed evidence about the influence of taxes on the level of FDI flows. Studies undertaken before 1990 show that FDI flows are not sensitive to the changes of tax rates; later studies indicate that the taxation in a country impacts the FDI flows.

The impact of taxation on FDI has been subject of a sizeable literature, as reviewed for example by de Mooij and Everdeen (2006) and Devereux and Mattini (2007). Nicodeme (2009) claimed that home-country taxation is relatively unimportant. Ruding Committee (1992) questioned the firms' managers asking the importance of taxation in the firm's investments decisions. The results supported the view of importance of taxation. Our own earlier empirical studies support the idea that foreign direct investment is sensitive to the changes in corporate income tax rates, especially in the sector of manufacturing and wholesale and retail trade.

The current paper presents an empirical analysis of aggregated FDI inflow into EU countries from all countries in the world. The paper examines the impact of corporate taxation in host country on FDI inflow into the European Union countries and attempts to address two related questions. The first question is how sensitive foreign investors to the corporate income tax differences across European Union countries. Answering to the above-mentioned question requires the determination of corporate income tax differences between EU's countries and ability of EU open economy to attract FDI. Second question is whether the smaller economies are forced to choose a lower tax rate for attraction of foreign capital. The hypothesis is that there is a connection between the size of the country and taxation policy for the attraction of foreign direct investment.

We examine what influences investors' choice on the location for FDI into EU. The analysis follows the empirical research of regional investment decisions in China (Tung and Cho (2001)); according to the results of which zones and cities with lower tax rates and greater tax incentives attract more foreign direct investments than other areas.

The choice of variables in the econometric model was supported by empirical research of Winner (2005). According to his regression equation and statistical evaluation, the impact of

capital mobility on capital tax burden is significantly negative. The statistical equation shows that increase of capital mobility by one percentage point is associated with decrease of capital tax burden by 0.18 percentage points. Positive effect of capital mobility on capital taxation, in case the country size is identified, has the expected sign for capital taxes.

The research conducted by Moore, Steece and Swenson (1987) on determinants investigated the impact of tax rates on foreign direct investment concluded that corporate income tax has a small impact on foreign direct investment. The analysis was also restricted to foreign direct investment in manufacturing. Similarly to Root and Ahmed (1978), the authors assessed the different scopes of independent variables. These are availability of essential resources like level of electricity prices and natural gas prices, economic determinants such as unemployment rate, manufacturing wage rate, corporate tax rate and business climate variable. Significant variables are infrastructure development factors like number of airports, length of railway lines, port facilities, and roadways. Size of the country evaluated with the help of population number, average number of sunshine days, average number of heating days were also among the significant determinants. The authors used three tax variables: statutory marginal tax rate, average effective corporate income tax rate and unitary tax rates. Final choice of variables included into this study was made in the course of empirical modelling.

The paper is organized as follows. This overview serves as a basis for the econometric model presented in the section three. In the second section the overview of data is given and in the last section a summary and conclusions are presented.

## **Data**

The period under examination is 1998–2008 with the sample consisting of 23 investment host countries (11 new Member States and 12 old Member States). The panel data set contains time series of 11 observations per each of the 23 countries. Thus, the total number of observations of all variables is 253. Manufacturing foreign direct investment data were obtained from the database of Eurostat. Since data concerning tax rates and some other variable became available only for the period of 1998–2008 the sample was limited to the mentioned period.

Whether the host country is a member of the Euro zone is expected to be significant for the location choice with expected positive influence. The dummy EURO is equal to one in the case if particular country used common EU currency. Another dummy (EU) with expected positive influence on FDI is equal to one when the examined country is an EU member state. During the period under investigation, the number of EU member states increased from 15 to 27.

The main objects of the study are the tax variables. Nominal corporate tax rate, implicit tax rate in the field of corporate income and number of double tax treaties in the host country are

the tax variables expected to affect foreign direct investment. Double taxation is avoided with help of the agreements between home and host country. Also, the openness of the country toward the foreign investments is partly measured by activity of the country in the international agreements. The variable measuring the possibility of investor to avoid double taxation of earned income is the number of tax treaties signed by the host country (*DTA*). Most of the EU member states are also members of the OECD and the adoption of OECD model agreement is obligatory for its members. 16 countries of the sample were members of OECD in 1998 and 17 in 2008. Data on the tax treaties is extracted from the IBRD database, where the texts of all tax treaties in the world are available.

*Table 1. Nominal corporate tax rates in 1998-2008, EU-23.*

<i>Country</i>	<i>1998</i>	<i>2000</i>	<i>2003</i>	<i>2005</i>	<i>2008</i>	<i>Mean</i>
<i>Austria</i>	34	34	34	25	25	30.73
<i>Bulgaria</i>	30	25	23.5	15	10	19.09
<i>Cyprus</i>	25	25	15	10	10	17.73
<i>Czech Republic</i>	35	31	31	26	21	28.82
<i>Germany</i>	45	40	26.5	25	15	28.77
<i>Denmark</i>	34	32	30	28	25	29.45
<i>Estonia</i>	26	26	26	24	21	24.73
<i>Spain</i>	35	35	35	35	30	34.32
<i>Finland</i>	28	29	29	26	26	27.73
<i>France</i>	33.33	33.33	33.33	33.33	33.33	33.33
<i>Hungary</i>	18	18	18	16	16	17.09
<i>Ireland</i>	10	10	12.5	12.5	12.5	11.36
<i>Italy</i>	37	37	34	33	27.5	34.23
<i>Lithuania</i>	29	24	15	15	15	19.18
<i>Latvia</i>	25	25	19	15	15	19.64
<i>Netherlands</i>	35	35	34.5	31.5	25.5	32.33
<i>Poland</i>	36	30	27	19	19	25.27
<i>Portugal</i>	34	32	30	25	25	28.82
<i>Romania</i>	38	25	25	16	16	24.09
<i>Sweden</i>	28	28	28	28	28	28
<i>Slovakia</i>	40	29	25	19	19	25.73
<i>Slovenia</i>	25	25	25	25	22	24.54
<i>United Kingdom</i>	31	30	30	30	28	29.91

*Source: European Commission (authors' calculation).*

The variable concerning the nominal corporate income tax rate (CORT) is most important in this study. The data are extracted from the intermediate report of the European Commission written in October 2009 (European Commission) (Table 1). In 2008 the average corporate income tax rate was 23% that is approximately 7% less than in 1998. Statutory corporate

income tax rate was decreased during the period under examination by 9 per cent in small countries and by 11 per cent in large countries (European Commission, author's calculation).

The influence of real corporate income tax variable was controlled with the implicit corporate income tax rate extracted from the database of TAXUD of European Commission. An implicit tax rate is calculated by dividing the revenues from taxes on a special activity or good by an appropriate corresponding aggregate tax base from national accounts statistics. The calculation of implicit tax rates is relatively straightforward and requires less statistical input than, for example, microeconomic or marginal tax rates. The usage of effective tax rate would be more appropriate but it was impossible because of unavailability of data. Implicit tax rate is expected not affect very much the FDI flows into EU manufacturing because the tax rate during the period under examination did not change. The mean of implicit tax rate in 2008 was 23,3% and in 1998 – 23,6%. (European Commission, authors' calculation). The influence of implicit tax rate was checked to be sure if it has impact on manufacturing FDI.

The other independent variables in the study are the level of economic development in the country measured by gross domestic product, unemployment rate, the level of development of the country's infrastructure by length of railway lines and length of motorways and number of internet users, market size variable measured by number of inhabitants, expensiveness of labour measured by labour costs index. These country-specific factors are expected to impact local factor costs and factor supply. Some of the above-mentioned variables were used in basic estimation and some of them for robustness checks.

The host market potential is measured by size of host country, unemployment rate and level of infrastructure development. The size of host country, measurable by the (log of) number of inhabitants (POP) that is expected to have positive sign because large countries have to be with large market potential than smaller. Second, the (log of) unemployment rate (UNEM) is used. An increase in unemployment will lower the direct investment as the indicator of slowdown of economic activity on the country level. On the other hand, unemployment is connected with general economic development, which probably will be expressed in the negative coefficient of correlation between growth of gross domestic product and unemployment rate.

According to the Ernst & Young European Attractiveness Survey (2008), international investors claim that provision of physical infrastructure is one of the valuable factors (54% of respondents). The level of development is measured by length of railway lines and roads. The infrastructure variables as the (log of) level of development of motorways and rail lines (LENGTH) are expected to have positive impact on FDI.

### **Econometric model and results**

Based on the earlier research it was assumed that manufacturing foreign direct investments depend on taxes and other macroeconomic variables

$$INV_{it} = \beta_0 + \beta_1 TAX_{it} + \beta_2 X_{it} + u_{it} + \varepsilon_t \quad (1)$$

where  $INV_{it}$  represents FDI inflows to country  $i$  in the period  $t$  divided by nominal GDP and multiplied by 100,  $TAX_{it}$  is a vector of tax variables in the host country, and  $X_{it}$  is a vector of macroeconomic control variables. The term  $u_{it}$  allows for fixed effects that may be across countries,  $i$ , and/or periods,  $t$ , and  $\varepsilon_{it}$  is the error term.

After several attempts we decided on the following log-linearised equation to be estimated:

$$\log INV_{it} = \beta_0 + \beta_1 \log POP_{it} + \beta_2 \log UNEM_{it} + \beta_4 \log LENGTH_{it} + \beta_6 EURO_{it} + \beta_7 EU_{it} + \beta_8 CORT_{it} + \beta_9 DTA_{it} + \varepsilon_t \quad (2)$$

The tax variables included are the number of tax treaties (DTA) and corporate tax rate (CORT). The dummy variables concerning Euro and EU membership are included. A dummy variable (EURO) takes value 1 when particular country is the member of European Union. Additionally, the dummy variable (EU) describes whether the country has adopted the euro.

The results of Hausmann test indicate that random effects model is not appropriate. The fixed effect model was used with different estimated intercepts for each pool member. The likelihood ratio test indicates that the model has cross-section fixed effect. Cross Section Weights method was used for estimation and according to that, cross-section residual variances were the estimated. The tax rate variables are statistically significant while the variables of international taxation, corporate income tax rate, size of the market, measured by population, at the 1% level and level of unemployment at the 5% level. EU membership variable became statistically significant at 10% level. The expected signs are reported in Table 3 together with the regression results.



Table 2. Regression results for the manufacturing foreign direct investments (INV).

	Exp. sign	All observations	Small countries	Large countries	All observations	Small countries	Large countries
Population (LGPOP)	+	2.1616*** (2.8036)	2.2605 (1.2896)	2.9377*** (3.6351)	2.0509*** (2.6092)	2.4670 (1.5067)	2.4541*** (2.8047)
Unemployment (LGUNEM)	-	-0.1304** (-2.5880)	-0.1177 (-0.8447)	-0.0579 (-0.7969)	-0.1376** (-2.4029)	- 0.3374*** (-2.9511)	-0.0411 (-0.4992)
Infrastructure development (LLENGTH)	+	-0.3600* (-1.7121)	-0.7151 (-1.3827)	-0.1944 (-0.9523)	-0.2962 (-1.4543)	-1.1943** (-2.4208)	-0.2082 (-0.8815)
Corporate tax rate (CORT)	-	-0.0258*** (-5.6574)	- 0.0397*** (-4.2280)	- 0.0169*** (-4.3517)	-	-	-
Implicit tax rate (ICT)	-	-	-	-	0.001077 (0.5350)	0.0053 (1.3893)	-0.0007 (-0.3248)
Number of DTA	+	0.0142*** (3.4265)	0.0137* (1.8024)	0.0138** (2.4535)	0.0308*** (9.4023)	0.0280*** (5.6792)	0.0263*** (5.3401)
Euro zone (EURO)	+	-0.0359 (-0.6827)	-0.0588 (-0.5096)	-0.0353 (-0.6369)	-0.0620 (-1.1934)	-0.0926 (-1.0061)	-0.0353 (-0.5571)
European Union (EU)	+	0.0471* (1.9639)	0.0704 (0.7359)	0.0401** (2.0000)	0.1130*** (2.8485)	0.1177 (0.2852)	0.0833** (2.0035)
R-squared		0.8976	0.8693	0.9664	0.8813	0.8407	0.9583
DW statistic		1.2877	1.3395	1.0614	1.2248	1.3135	0.8894
Observations		204	109	95	204	109	95

Source: authors' calculations.

Note: t-statistic in brackets. \*\*\*- significant at the 1% level, \*\*- significant at the 5% level, \*-significant at the 10% level.

Graphical analysis and calculations confirm that the log-linear specification appears to be appropriate for the data. Estimated coefficients, summary statistics, p-values and t-statistics are reported in Table 2. The dummy variables concerning the adoption of Euro became insignificant. The European Union membership and development of infrastructure variable became significant on the 10% level of significance whereas the nominal corporate tax rate and number of tax treaties became statistically significant variables on 1% level. The market size variable became also statistically significant in the model.

The final model describes the relationship between the inflow of manufacturing foreign direct investments in the member state, the market size, the level of unemployment, infrastructure and tax rate variables. The amount of foreign direct investments depends on the corporate tax rate that negatively impact the level of investments and the variables measured by market potential level in the host country influenced positively. The model fits

well with the data ( $p < 0.0000$ ,  $R^2 = 0.9$ ) and the variables are significant at the 10% level, except Euro variable. The model shows that the level of foreign direct investments into manufacturing depends on corporate tax rate, openness of country for foreign investors, measured by the number of tax treaties, and level of unemployment and market size of country. The number of tax treaties also impacts the level of manufacturing foreign direct investments. The growth of unemployment impacts negatively the investments.

It was also examined how appropriate is the baseline model (2) for the small countries and large countries. The estimation results for small member states (population below 10 million) show that corporate tax rate and number of tax treaties are significant. For the large EU countries the nominal corporate income tax rate variable is also significant. Additionally to the tax variables the market potential of the country and EU variable are significant. The level of infrastructure development, adoption of Euro and unemployment are non-significant for the large member states. The taxation has an impact on foreign direct investments into manufacturing.

The coefficient of corporate tax rate is -0.0258 that measure the elasticity of foreign direct investments to corporate tax. The mentioned coefficient for large countries is -0.0169 and for small countries the coefficient is equal to -0.0397. The elasticity is bigger in the case of small countries. In general, the study discovered that a 1% decrease in statutory corporate tax rate increases the percentage of foreign direct investments of country GDP by 0.03%. This seems to be a quite marginal result, but in nominal values this means that 1% decrease of corporate tax rate will attract additional 18 billion euro in year into manufacturing sector of European Union countries. These results point to the importance of the corporate tax policy of making the investment environment more attractive. The results are close to those of Winner (2005).

The influence of implicit tax rate to the manufacturing FDI was insignificant. The reason for the result is probably in the informational content of statutory tax rate. Foreign investors control the legislation of host country before the investment decision.

To control for the robustness of the results the manufacturing foreign direct investments were compared with others sectors and the same estimation model was used for some non-manufacturing sectors (financial intermediation and wholesale trade). All estimated tax elasticity's are summarized in Table 3.

The impact of the degree of human capital as a control variable was checked via Human Development Index (*HDI*). Additionally, the labour cost index (*LABCOI*) was included that is expected to affect manufacturing foreign direct investment. Increase in the labour cost index is expected to have a negative effect on foreign direct investment. Low labour costs are also an important determinant for attracting new investments into the country. The human development index variable has probably positive impact on manufacturing FDI, since more skilled labour attract more FDI (Table 4). Surprisingly, the cost of labour does not affect FDI

significantly. The results show that degree of human capital development affects FDI positively.

Table 3. Overview of the influence of the country size.

Observations	Tax rate elasticity		No of observations
	Corporate income tax	Implicit tax rate	
All observations			
Manufacturing	-0.0258***	0.0014	204
Non-manufacturing			
Whole sales	-0.0087	-0.0264	76
Financial intermediation	-0.0175	0.0450***	178
Small countries			
Manufacturing	-0.0397***	0.0012	109
Non-manufacturing			
Whole sales	0.0163	0.01373	44
Financial intermediation	0.0109	0.0629**	88
Large countries			
Manufacturing	-0.0169**	0.0006	95
Non-manufacturing			
Whole sales	na	na	na
Financial intermediation	-0.0445	0.0490**	90

Source: authors' calculations.

Note: \*\*\*- significant at the 1% level, \*\*- significant at the 5% level, \*-significant at the 10% level.

The development of IT-sector has intuitively significant impact on the further development of manufacturing in European Union. It is examined through the level of IT expenditures as percentage of GDP of the country under investigation (ITEX). The impact of the tax and other variables remains unchanged. The information of level of internet access by households and enterprises is available in Eurostat data base from the year 2002. The results suggest that the higher IT expenses do not affect the amount of manufacturing foreign direct investments significantly. The estimated coefficients are not significant (Table 4).

Table 4. Robustness tests: adding control variables.

	GDP growth (1)	GDP (2)	HDI (3)	Labour cost (4)	Internet users (5)	IT expenditure (6)
Population (LGPOP)	2.5543*** (3.2186)	2.0352** (2.4926)	1.2793 (1.5134)	2.4750*** (2.7694)	1.4139 (1.3814)	-2.6092 (-1.5565)
Unemployment (LGUNEM)	-0.1042* (-1.9584)	-0.1278** (-2.0437)	-0.0789 (-1.4702)	-0.1620*** (-2.8770)	-0.1189** (-2.3188)	-0.1246 (-1.3137)
Length of ways (LGLENGTH)	-0.3860* (-1.7208)	-0.3311 (-1.5423)	-0.4212** (-2.0555)	-0.2203 (-0.9768)	-0.4255* (-1.9597)	-0.0504 (-0.1823)
Corporate tax rate (CORT)	-0.0246*** (-5.3531)	-0.0254*** (-5.2716)	-0.0249*** (-5.5511)	-0.0248*** (-5.3594)	-0.0255*** (-5.5994)	-0.0264*** (-3.1213)
Number of DTA (DTA)	0.0138*** (3.3673)	0.0134*** (2.6076)	0.0062 (1.1714)	0.0153*** (3.3676)	0.0109** (2.1564)	0.02136 (0.5817)
Euro zone (EURO)	-0.0237 (-0.4532)	-0.0333 (-0.6055)	-0.0426 (-0.8328)	-0.0416 (-0.7524)	-0.0331 (-0.6297)	-0.2202*** (-3.5874)
European Union (EU)	0.0509* (1.7692)	0.0405 (1.3230)	-0.0059 (-0.1874)	0.0617** (2.2495)	0.0247 (0.8054)	-0.0448 (-0.9698)
GDP (LGDP)	-	0.0262 (0.2276)	-	-	-	-
GDP growth (GGDP)	0.0095* (1.6196)	-	-	-	-	-
Labour cost index (LABCOI)	-	-	-	0.2006 (-1.1058)	-	-
Human Development index (HDI)	-	-	3.9608** (2.3572)	-	-	-
IT expenditures (ITEX)	-	-	-	-	-	0.0078 (-0.1736)
Internet users (INTUSER)	-	-	-	-	0.0013 (1.1218)	-
R-squared	0.8974	0.8976	0.8975	0.8976	0.8978	0.8935
DW statistic	1.2845	1.2876	1.2576	1.2968	1.2912	1.6818
Number of observations	204	204	204	204	204	204

Source: authors' calculations.

Note: t-statistic in brackets. \*\*\*- significant at the 1% level, \*\*- significant at the 5% level, \*-significant at the 10% level.

GDP growth is also fairly important as it directly determines the dynamics of foreign direct investments. The economic growth (GGDP), measured as percentage growth of GDP, is expected to be important factor for the attracting of investors. The country with greater potential is more attractive for investors and the sign is expected to be positive. Higher expected growth should attract more FDI inflows. The result shows that the higher GDP per capital has not impact on the amount of manufacturing foreign direct investments. The variable of GDP growth is significantly important on 10% level (Table 4).

## Conclusions

The analysis of manufacturing foreign direct investment flows and macroeconomic indicators across the European Union countries during the period of 1998–2008 demonstrates that the policy of reducing the tax burden encourages foreign investors to invest into the sector. Two main questions were examined: the impact of changes of taxation on the foreign direct investment, and the importance of country's size on this impact. Taxation of corporate investments is important for attracting foreign direct investments.

The coefficient of the corporate tax rate in the model is significant and negative. The number of agreements for the avoidance of double taxation signed by the host country with different investor countries was also found to be significant. According to the regression estimation, the corporate income tax rate is significantly important for the inflow of manufacturing foreign direct investments into the European Union countries regardless of the size of the country. But also a development of infrastructure is attracting foreign direct investment.

The results of the study give a clear indication that corporate tax rate is statistically significant for manufacturing foreign direct investments. In general, the study discovered that a 1% decrease in statutory corporate tax rate increases the percentage of foreign direct investments of GDP of EU country by 0.02%, approximately by 18 billion euro in Europe. The mentioned coefficient for large countries is -0.0169 and for small countries the coefficient is equal to -0.0397. The elasticity is bigger in the small countries. These results point to the importance of the corporate tax policy with the purpose of making the investment environment more attractive particularly for the smaller countries.

Benassy-Query, Fontangne and Lahreche-Revil (2005) have suggested that a higher provision of public goods increases the attractiveness of the country for FDI, and the authors suggested that higher taxes can be partly compensated for by an increase in the building up of public infrastructure. The impact was found to exist also in this study.

However, some limitations are worth of mentioning here. First, not all countries were included into the study because of the lack of relevant data. Second, the set of variables should be bigger for the further research. Third, a new variable should be constructed based on the human development index excluding the influence of unemployment and labour cost index to avoid possible problems of multicollinearity. Fourth, in order to simplify the model the tax exemptions were not taken into account that may distort the results in small scale. Fifth, the economic significance of results is relatively low.

Further research is needed for the purpose to evaluate the importance of corporate taxation and incentives of the corporate taxation for the different industries with the wider selection of variables. It's necessary to stress that usually non-manufacturing sector is driven by different factors, but the robustness checks were run with the variables of the base model.

Some results of present study not included here indicated that asymmetries may of the influence of tax regime exist between the different types of countries and that the influences studied in this paper may be dependent on the phase of economic cycle. The further research of these questions has to be based on bilateral data.

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## THE CHANGE IN PRIVATE EQUITY OPERATIONS AND DIVESTMENT DURING THE RECENT CRISIS: AN EMPIRICAL ANALYSIS OF THE ITALIAN MARKET

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### Abstract

This work is focused on the acquisition of minority shareholdings by private equity funds and is organized into different sections. The first section consists in the description of the research project and the type of tools and methodologies used. It also deals with private equity and the venture capital activity as well as several types of classification about the investment stage. This section will also mention the investment process for the acquisition of a shareholding by a private equity or a venture capital fund. In the second section it describes the divestment phase of a private equity fund and lists the different kinds of divestments. The third section presents a questionnaire, whose content will be analyzed in detail. The fourth part describes the results of this research which are then further briefly discussed in the conclusion.

**Keywords:** private equity, venture capital, divestment phase, minority shareholdings, investment stage.

### Private Equity and Venture Capital Activity

This work is focused on the acquisition of minority shareholding by private equity funds. The different stages of the investment process and the divestment phase have got a deep importance.

For the realization of this work, a questionnaire, which will be argued later, has been developed. This questionnaire has been sent to most of the Italian private equity companies affiliate to AIFI: the Italian association of private equity.

The private equity activity concerns the acquisition of control ownership or minority ownership in firms in a middle/long term perspective, in order to realize a capital gain about the future divestment of shares.

Private equity (EVCA Glossary) provides equity capital to firms generally not quoted on a stock market. Private equity can be used to develop new products and technologies, to expand working capital, to make acquisitions, or to strengthen a company's financial structure. It can also resolve ownership and management issues. A succession in family-owned companies, or the buyout and buying of a business done by experienced managers may be achieved by using private equity funding. Private equity is sometimes identified with venture capital. The latter is a subset of a larger private equity asset class which includes



venture capital, LBO's, MBO's, MBI's, bridge and mezzanine investments. Historically venture capital investors have provided high risk equity capital to start-up and early stage companies whereas private equity firms have provided secondary tranches of equity and mezzanine investments to companies that are more mature in their corporate lifecycle. Again, traditionally speaking, venture capital firms have higher hurdle rate expectations, will be more mercenary with their valuations and will be more onerous in their constraints on management than will private equity firms. While these descriptions are technically correct and have largely held true to form from a historical perspective, the lines between venture capital and private equity investments have been blurred by increased competition in the capital markets over the last 18 - 24 months.

Venture capital (EVCA Glossary) is thus used to fund an early-stage (seed and start-up) or an expansion venture. Offsetting the high risk the investor takes is the expectation of higher than average return on the investment. Venture capital is a subset of private equity.

A private equity fund is a vehicle for enabling pooled investment by a number of investors in equity and equity-related securities of companies. Generally, these are private companies and the shares are not listed in stock exchange. The fund can take the form of either a company or a Limited Partnership.

In this way, investors provide capital to firms, not typically listed, that need some cash to grow.

There are three terminologies of private equity and venture capital activity:

1. Usa;
2. Europe;
3. Italy.

In the Usa, the institutional activity on capital of risk is the "activity of private equity" that includes venture capital and buy out transactions. This distinction is done according to the type of investors who do the operation.

Venture capital activity can be divided in two subclasses (Gervasoni and Sattin, 2008):

1. early stage financing in which venture capital funds focused on investing in companies in the early part of their lives (Giorgino, 2006).
2. expansion financing also called development capital. The financing provided with the growth and expansion of a company, which may or may not break even or trade profitably. Capital may be used to: finance increased production capacity; market or products for development; provide additional working capital.

Buyout transaction is a transaction financed by a mix of debt and equity, , where a business, a business unit or a target company are acquired with the help of a financial investor from the current shareholders (the vendor). Buy out transaction can be divided into (EVCA Glossary):

1. Management buyout (MBO): in this kind of buyout the target's management team acquires an existing product line or business from the vendor with the support of private equity investors.
2. Management buying (MBI) is a buyout transaction in which external managers take over the company. The Financing is provided to enable a manager or group of managers from outside the target company to buy into the company with the support of private equity investors.
3. Institutional buyout (IBO): in this buyout operation outside financial investors, as private equity houses, buy the business from the vendor. The existing management may be involved from the start and purchase to a small stake. Alternatively, the investor may install its own management.
4. Leveraged buyout (LBO) is a buyout in which the capital of the new company includes a particularly high level of debt, mostly of which is normally secured against the company's assets (Tartaglia, 2009).

The early stage financing deals with the financing of firms in the first stage of life, whereas expansion financing are based on investments in firms already developed that need capitals to grow further.

In Europe, until now, there is a classification between private equity, concerning all transaction carried out during the different stages of the life cycle of firms subsequent to the initial, and venture capital, that concern start-ups financing.

In Italy AIFI, which is the Italian association of private equity and venture capital, has defined the private equity activity as (AIFI Glossary) "the investment activity in risk capital of unlisted companies, with the aim of promoting the enterprises in a middle-long term". It follows that venture capital activity is a part of private equity activity, which focuses on the financing of businesses in the early stages of their life cycle.

In this work the following classification (Gervasoni and Sattin, 2008) has being adopted:

- a. Early stage financing;
- b. Expansion financing;
- c. Change financing.

Generally, the acquisition of minority shares, is attributed to the second category is attributed, whereas the third category concerns the business of buy-out, usually referring to the majority investment (AIFI, 2010).

After the fund raising activity the investment process should be analyzed to acquire a minority stake.

The investment process is divided into: deal flow; preliminary approach; due diligence; deal structuring; strategic plan; monitoring-reporting; way-out.

The process that defines the price of the shareholding is very important. In the next part of this article the divestment phase, the principal aim of this work, will be described.

### **The Divestment/ Exit Phase**

This phase is extremely sensitive because the main purpose of the institutional investor is to obtain an high return on its investment, usually measured by the IRR (internal Rate of Return)

In this phase we must consider two fundamental issues, whose outcome will determine the amount of gain for the institutional investor::

1. determine the best time in which divestment will get the best possible performance (timing);
2. define the most appropriate channel for disinvestment that, according to the previous factor, will get the maximum economic return.

The exit consists in liquidation of holdings by a private equity fund. Among the various methods of exiting an investment there are:

1. trade sale that consists in the sale of company shares to industrial investors;
2. sale by public offering (including IPO): it is the sale of the shares on the stock market, fall into this category of the IPO, where the public offer is linked to the process of the first listing and the "sale of quoted entity", the sale of the shares on the stock market is made of different moments after being placed;
3. replacement or secondary buyout: the company share is sold to another private equity or venture capital fund;
4. buy back: it deals with the buy back of the company shares by the original member who, during the work of private equity operator, keeps being in the company with a minority or majority share
5. write-off: this last type is referred to the case of total or partial demolition of the value of the investment, resulted in a loss of value due the holding period of the company share.

When choosing the channel of disinvestment should be taken into account:

- the phase that is going through the stock market exchange;
- the market trends of M&A transactions.

According to a research (AIFI, 1995), two models can be identified by observing two different strategic approaches where investors in venture capital use to program the divestment phase; we can identify:

- path sketcher model: in this first model, the investor does not program the previously way-out but try to increase the probability of success. In this way the investor is concerned primarily to complete the divestment without deciding ex ante the type of exit strategy will be realized;
- opportunist model: In this second type of model, the basic philosophy is the ability of management to enhance the target company. The private equity operator can enhance the target company creating the value in absolute terms. The main type of disinvestment, for this model is represented by IPO (Initial Public Offering) (AIFI, 1995).

### **Questionnaire And Content**

In this section, the questions included in the questionnaire will be analyzed. This questionnaire has been sent to the most private equity Italian companies affiliated to AIFI.

The aim of the questionnaire was to explore the current state of private equity in Italy, with particular interest to the divestment phase.

In the header of the questionnaire, the 13 companies in the research sample had to fill the name of the private equity fund, capital raised, capital invested.

The first question required to fill the number of portfolio shareholdings and their amount.

In the second question companies had to enter the number and amount of investment operations during the last three years. Companies must also indicate the number and the amount reported to the minority shareholdings.

In the third question private equity companies had to enter the average amount of investments in the last three years, with particular reference in the minority shareholdings.

The fourth question required to enter the number and the amount of the shareholding sold in the last three years. In this question too, companies must enter number and amount according to the minority shareholding .

In the fifth question they had to fill the interest rate return obtained in the last three years.

In the sixth question, companies had to enter number and amount of the shareholdings, divided and grouped according to different investment stage: early stage, expansion, restructuring, replacement, leveraged buyout...

The seventh question was represented by a table in which private equity or venture capital companies must enter this element reported to each shareholding acquired:

- acquisition year;

- sold year;
- purchase value;
- investment stage;
- expected period of the investment;
- majority or minority shareholding;
- expected divestment type;
- terms and divestment terms.

The divestment terms, that can be included, regard:

- tag along right;
- IPO;
- drag-along right;
- put and call;
- right of first offer.

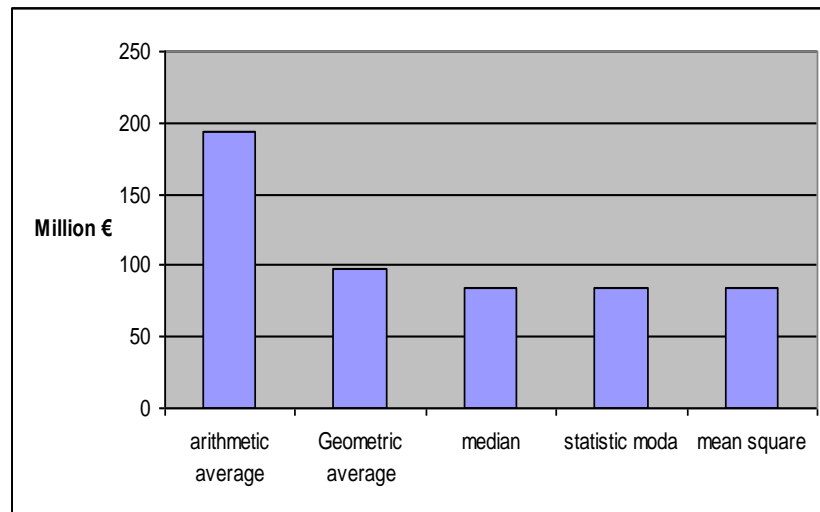
In the last question of the questionnaire firms had to fill the following elements for the sold shareholdings both majority ones and minority ones:

- acquisition date;
- sold date;
- purchase value;
- investment stage;
- majority or minority shareholding;
- holding period;
- divestment type expected;
- divestment type used;
- sales value;
- IRR obtained;
- terms and divestment terms.

## Results

In this section, the research results will be disclosed. Companies that have completed the questionnaire are 13 out of one hundred. The redemption rate was not high (less than 10%), this is the major limit of our research, but fortunately the companies that responded were important and representative of the whole market. In some cases the companies refused to

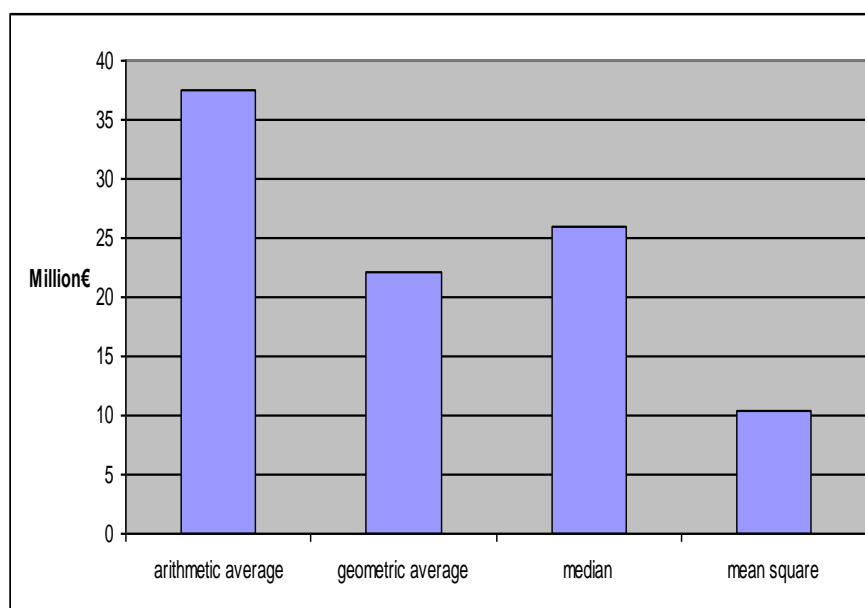
answer even if we assured the privacy, probably due to the unsatisfying results of the last period .



*Fig. 1 – Capital raised*

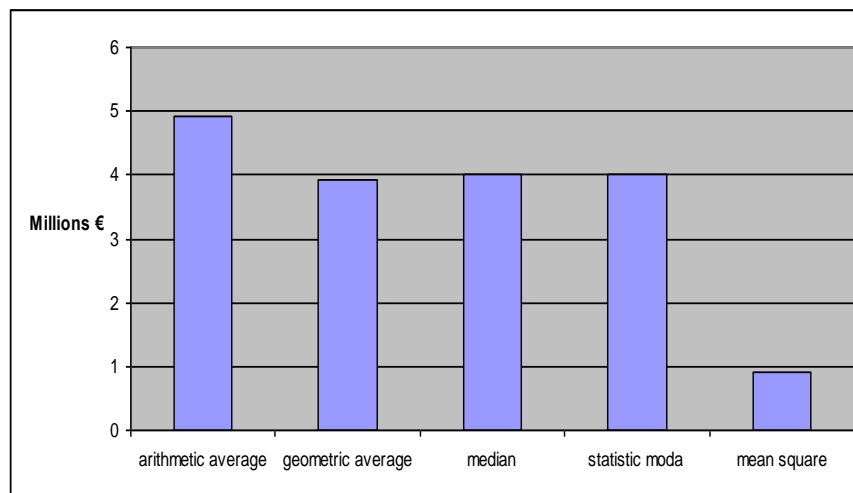
The arithmetic average of the capital raised by these funds is 194 millions euro. This data is influenced by one companies that have raised 1.200 millions euro to create the private equity fund. This value conditioned the mean square, which is 84.87. The statistical median of the range of the value is 85, as the “statistical mode”.

Considering the capital invested, the companies have acquired shareholding for a average of 38 millions Euro. This value takes into account majority and minority shareholdings. In that case, the mean square is 10.34 because the difference between the companies is less than before. The median of the sample is 26.



*Fig. 2 – Capital invested*

The average of the number of the portfolio shareholdings is 4.92 and this value is confirmed by the median and by the “statistical mode” that have the value of 4. The mean square, in that case, is 0.90 and this mean that the value are similar each other.



*Fig. 3 – Number of portfolio shareholdings*

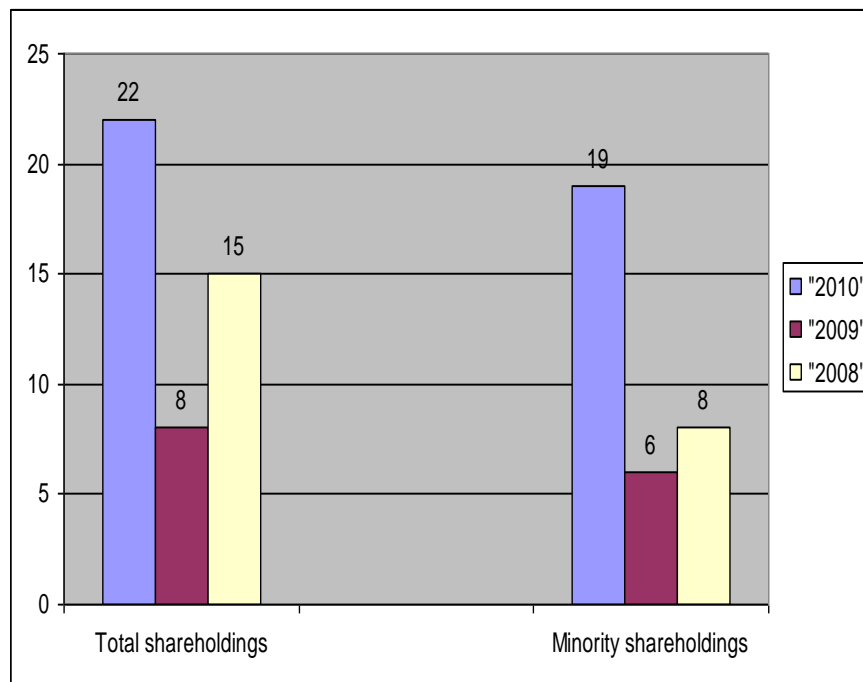
The average value of the portfolio shareholding refers to the sample which is 29.64 millions euro. This value is influenced by a company that has a portfolio shareholding value of 140 and this increases the mean square (11.35). The median is 18.

According to the number of shareholdings acquired, the values are:

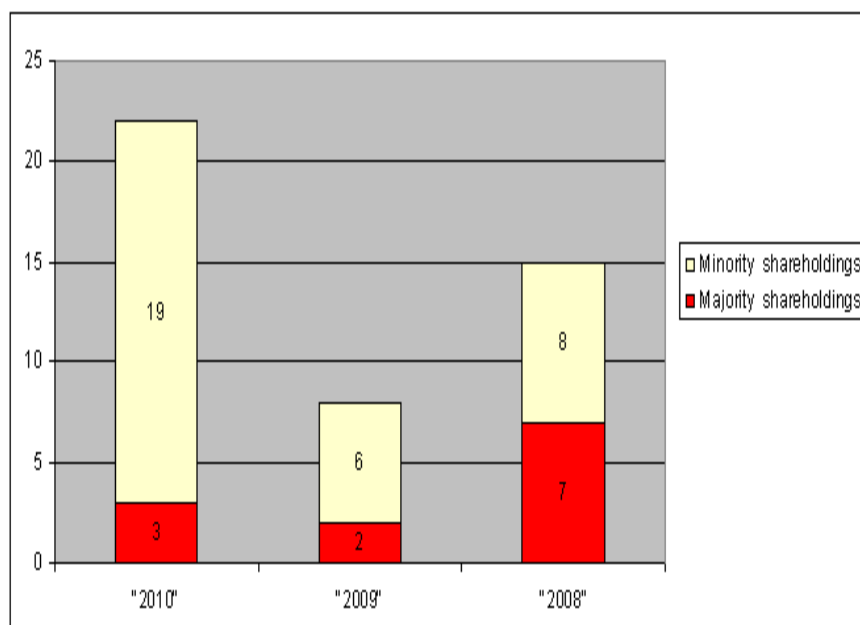
- 2010: the arithmetic average is 1,7 and the median is 1. The value of different companies are similar, in fact the mean square is low (0.75) whereas the mode is 0 because 5 companies out of 13 haven't done investments;
- 2009: in this year companies have acquired less shareholding and the average decrease to 0.61. This value is lower than 2010, in fact median and mode are 0. The value are similar each other and the mean square is lower than 2009, arriving to 0.26;
- 2008: the average is 1.15 that is more than 2009 but minor than 2010. Median and mode are respectively 1 and 0. The mean square is 0.34 and it confirms that the values are similar.

In reference to a sample analysis, in 2010 companies have acquired 22 shareholdings with the 86% represented by minority shareholding. This percentage decreased to 75% (6 minority shareholdings out of 8 total) in 2009 and in 2008 it reach the 53% (8 out of 15).

According to the number of shareholdings acquired in the last three years, the following charts show the trend of the total and minority shareholdings.

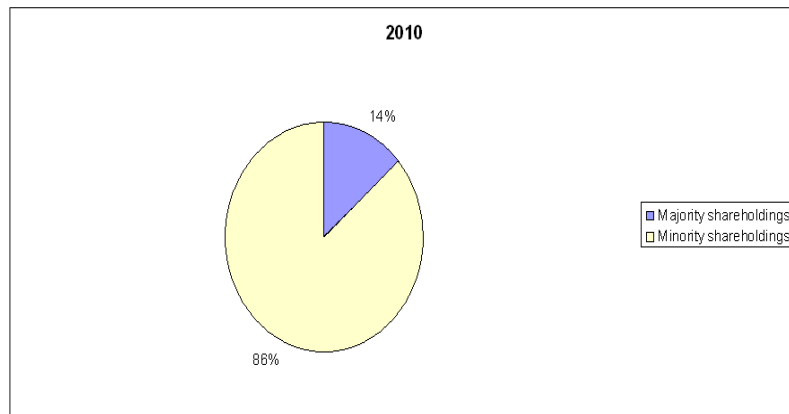


*Fig. 4 – Total shareholdings and minority shareholdings in last three years*

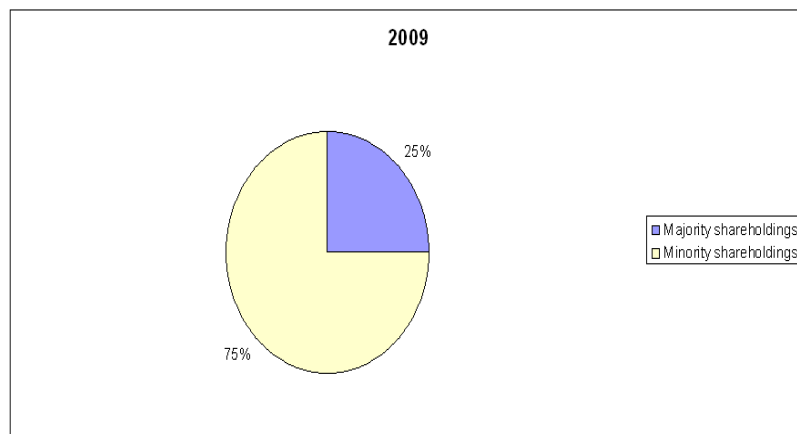


*Fig. 5 – Majority and minority shareholdings acquired in the last 3 years*  
Next figures illustrate the situation of the minority shareholdings.

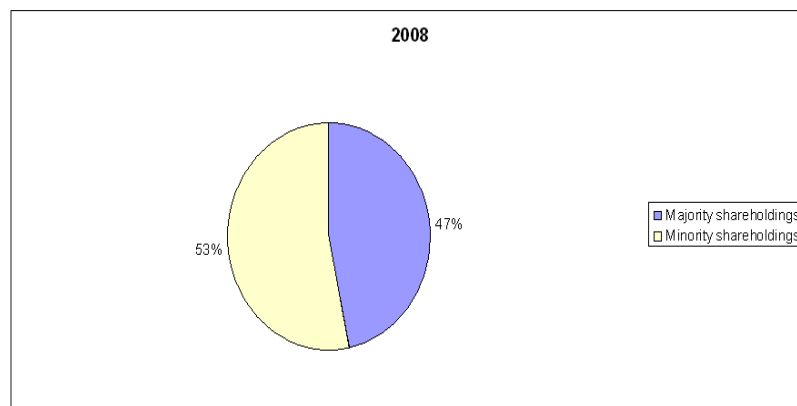




*Fig. 6 – minority and majority shareholdings in 2010*



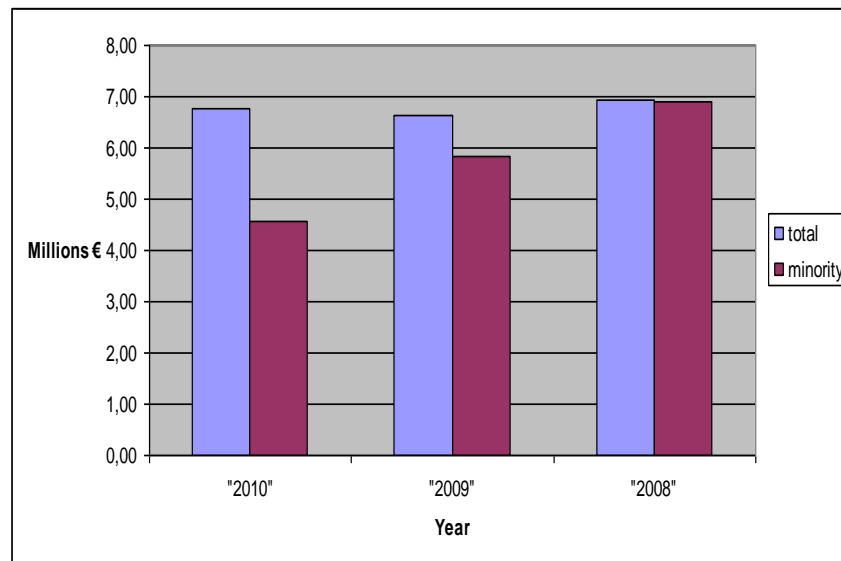
*Fig. 7 – minority and majority shareholdings in 2009*



*Fig. 8 – minority and majority shareholdings in 2008*

We can notice the trend of the average amount of investment in the last three years:

- 2010: the average is 6.78 millions of euro whereas the same value reported on the minority shareholding shows a average of 4.56 millions euro;
- 2009: 6.62 millions euro for total shareholdings and 5.83 for minority shareholdings
- 2008: 6.93 millions euro for total shareholdings and 6.90 for minority shareholdings.

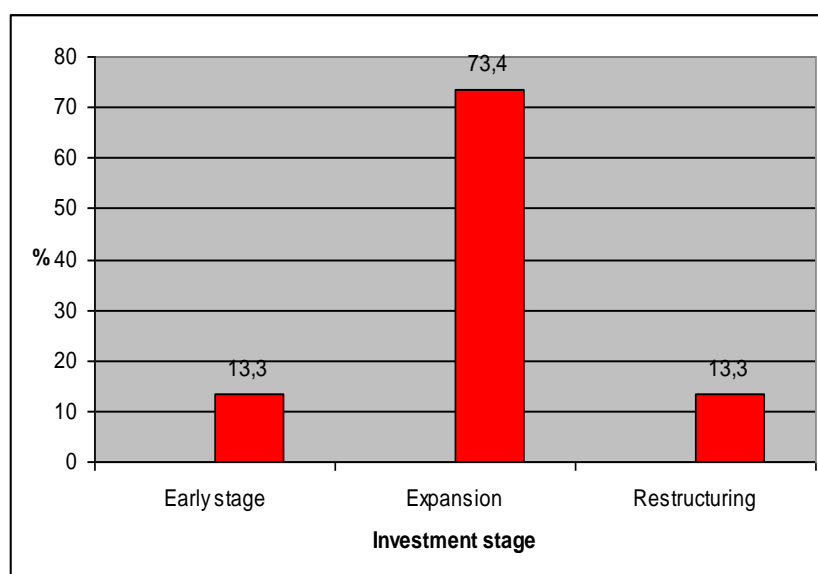


*Fig. 9 – average amount of investment in the last 3 years*

In this work, the average amount of the minority shareholdings decreased in the last three years. These values are correlated to AIFI results of the first half of 2010, where there is a decrease of the average amount.

In 2008 investments were 15: this data can be divided according to the investment stage as follows:

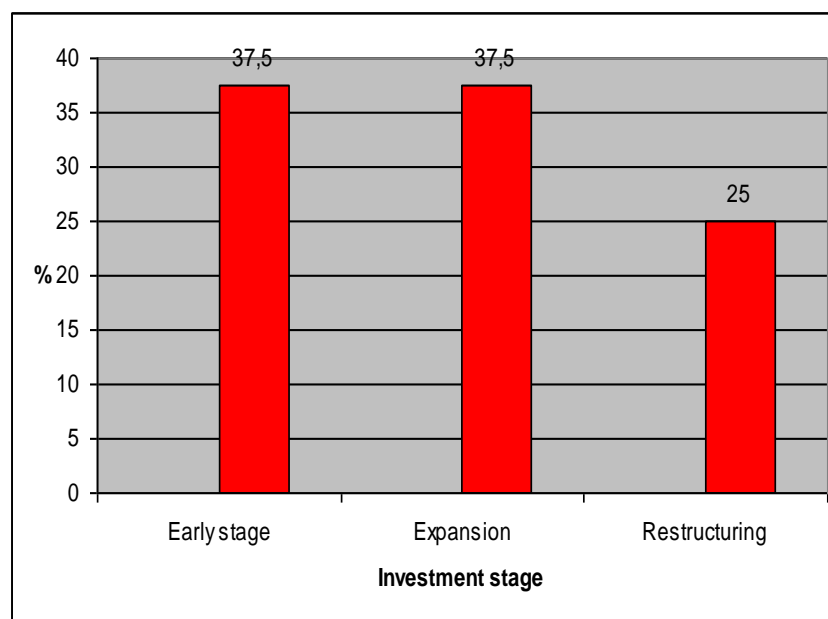
- early stage financing: n° 2 investments corresponding to 13.3% of the total investment in 2008;
- expansion financing: n° 11 investments corresponding to 73.4% of the total investment in 2008;
- restructuring financing: n° 2 investment corresponding to 13.3% of the total investment in 2008.



*Fig. 10 – Investments in 2008 divided according to the investment stage*

As we have seen, investment in 2009 were down 47%. In this year the number of investment operations has been 8, divided as follows:

- early stage financing: n° 3 investments corresponding to 37.5% of the total investment in 2009;
- expansion financing: n° 3 investments corresponding to 37.5% of the total investment in 2009;
- restructuring financing: n° 2 investments corresponding to 25% of the total investment in 2009.



*Fig. 11 - Investments in 2009 divided according to the investment stage*

In 2010 total investment increased in 175% reaching a total of 22 investments. This data can be divided according to the investment stage as follows:

- n° 9 investments in early stage financing corresponding to 41% of the total investment in 2010;
- n° 10 investments in expansion financing corresponding to 45% of the total investment in 2010;
- n° 3 investment in restructuring financing corresponding to 14% of the total investment in 2010.

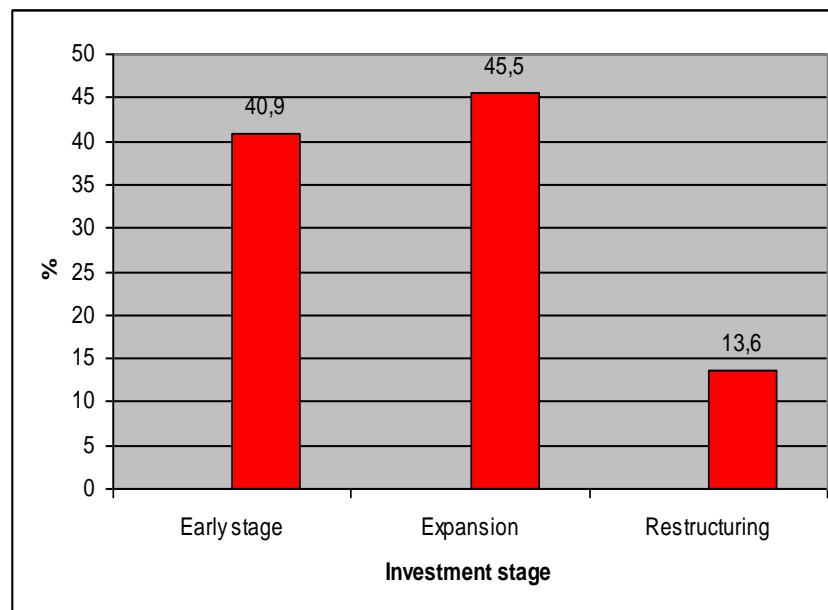


Fig. 12 - Investments in 2010 divided according to the investment stage

The average expected period of the investment was 4.78 years and this value is confirmed by median and mode which are 5. Furthermore, mean square is zero, so the values are very similar to each other. The expected type of divestment most commonly used is trade sale, with 42.31% of choice. The second expected type of divestment is the secondary buy out with 38.46%, the third is initial public offering with 13.46% and the last is buy back with only 5.77%. The chart in fig. 13 shows the trend of the expected divestment type.

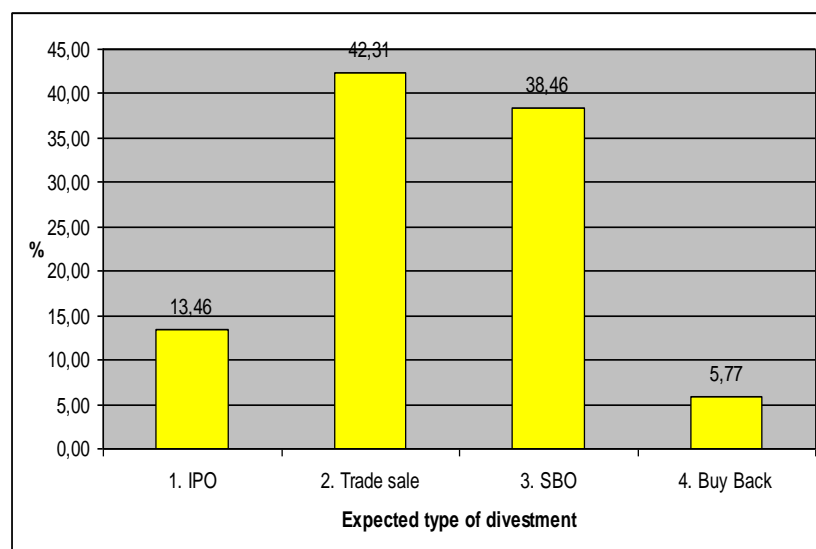
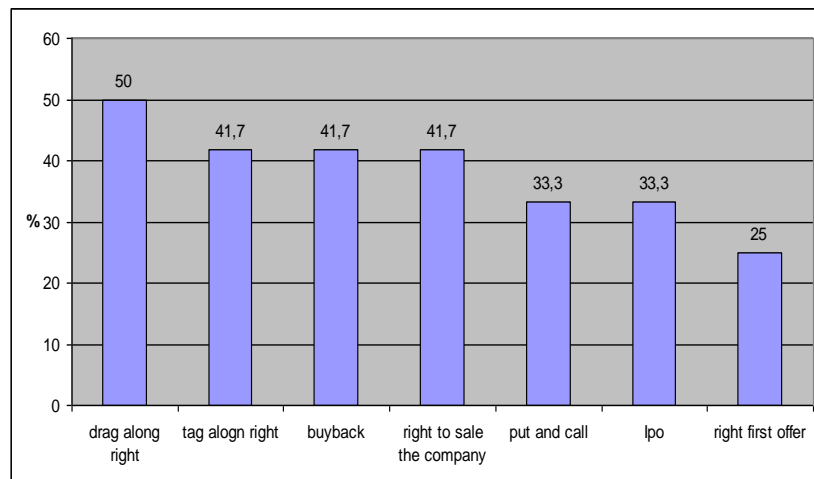


Fig. 13 – The expected divestment type

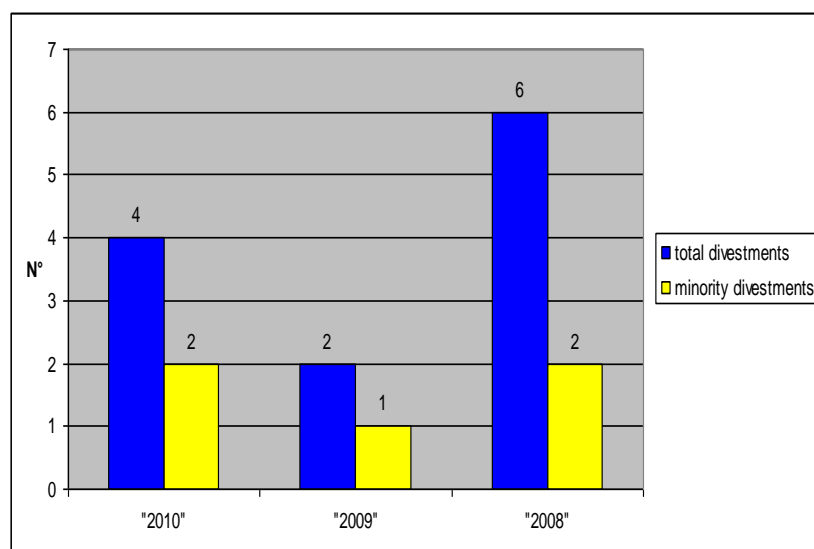
In the 50% of the acquired shareholding, it has been entered the lock-up clause.

If we consider all the acquired shareholdings, the contract term most frequently chosen by the private equity investors is drag along right with 50% of choice. Gradually, it follows that: tag along right (41.7%), buyback (41.7%), right to sale the company (41.7%), put and call (33.3%), IPO (33.3%) and right of first offer (25%).



*Fig. 14 – The distribution of the divestment terms*

In the last three years, because of the financial crisis, divestments have decreased. In fact, in 2010 there were only 4 divestments with two reported on a minority shareholding. In 2009 there were only 2 divestments with only one on a minority shareholding. In 2008 there were a partial recovery with 6 divestments and 2 reported on a minority shareholding.



*Fig. 15 – Divestment activity*

## Conclusion

By analyzing the results obtained in the present research, we can notice the impact of the financial crisis has been remarkable in the private equity sector.

This work shows that, in 2010, there was a slow recovery in fund raising activity but the values are similar to those of 2006.

The AIFI results of the first half of 2010 show that investments activity is decreasing, too. There are positive signs coming from the fund raising activity. This data increased of 63% over the first half of 2009. Early stage financing and expansion financing represent the principal type of investment, as well as the results obtained in this work. In the last year, the

investment of minority shareholdings increased when compared to the previous period, because there was an increase of the investments in expansion financing.

This has happened as a result of the financial crisis. With the increase of the interest rate and the cost of money, buy out operations decreased. In this way the expansion financing increased. In this work, the results of the expansion financing are similar to AIFI results of first half of the 2010.

The impact of the financial crisis has decreased the leveraged buy out operations. Private equity funds are focusing on small and medium-size firms which represent the future of the business.

This consequence is linked to the financial crisis. In 2009 leveraged buy out decreased in the 84% compared to the previous year. So, the acquisition of minority shareholdings has increased.

As this work shows, early stage operations increased in the last three years. This data is confirmed by AIFI results of first half of the 2010. The Italian business of private equity are changing because the private equity interest are increasing towards small and medium-size firms. Early stage and expansion financing represent the way of the future.

In the present work, early stage operations were the 13.3% in 2008. In 2009 they reached 37.5% and in 2010 the 41%. In the Italian business, small and medium-size firms dominate, so that private equity and venture capital can help to these companies to survive in the international competition.

In a period of financial crisis, new opportunities can rise. Private equity seems to be interested to seize the chance given by this recent crisis.

Considering the divestment activity, AIFI results show a decrease over the previous year. Firms are trying to postpone the time of divestment. In the present work, the main type of divestment is trade sale followed by secondary buy out, IPO and buy back.

These years, there is a moment of transition, in which the trend market of the private equity has being accused the negative effects of the crisis. In this work, there was few divestments in the last three years: 6 in 2008 (including two divestments of minority shareholdings), only 2 in 2009 (with one of minority), and 4 in 2010 (with 2 divestments of minority shareholdings). This is happening across Europe.

According to the IRR of sold shareholdings of firms which have answered the questionnaire, we have to remark that only 3 shareholdings out of 12 divestments have been sold. Moreover, 3 write off (2 total and one partial) have been realized. Two write off deal with the minority shareholdings. These last years, as already précised, there have been lots of write off. This data is a consequence of the financial crisis.

A follow up to this research will be an analysis “a posteriori” about the divestment type actually done, relating this to the declared intentions. This also will evaluate if the end of the Financial Crisis modifies the divestments modes of minority shareholdings.

The economy recovery will be slow, but there are some positive signs coming from the private equity and venture capital business.

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## **BANKING PROFESSION AND THE GLOBAL FINANCIAL CRISIS: RHETORICAL STRATEGIES OF INSTITUTIONAL WORK**

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### **Abstract**

Banking activities today are global in nature and impact industry and governments across the world, as witnessed during the banking industry meltdown during the global financial crisis. We investigate the banking profession during the financial crisis by focusing on the rhetoric of chief executives of major banks and relevant stakeholders. Our analysis reveals that institutional maintenance of the banking profession was dominant, whereas institutional change remained difficult due to the limited scale and nature of the rhetoric employed towards it. We also find that while the bankers and various internal and external stakeholders engaged in institutional maintenance, change was mostly focused upon by external stakeholders. Our findings thus highlight the challenges in institutional change related to professions, particularly due to the strong role of the professionals themselves in institutional maintenance and their avoidance of institutional change. While we focus on the United States banking industry, given its primacy in global finance, our findings have implications for the banking profession across the globe. We interpret these findings to provide insights on institutional work related to professions and draw broader theoretical implications for the literature.

### **Introduction**

The global financial crisis that marked the first decade of the 21<sup>st</sup> century has brought attention to the institutional structures underlying most modern capitalist societies (Davis, 2009; Kotz, 2009). This attention has also spilled over to certain professions that were seen as closely intertwined with the existing institutional systems. The banking profession, in particular, has been at the center of investigations into the crisis, given the large-scale bankruptcies and restructurings of major banks that have caught the attention of experts (Crotty, 2009) as well as the general public (Taibbi, 2009).

In this paper, we initiate an examination of the banking profession during the financial crisis. Media accounts indicate that the banking profession became one of the primary targets during the crisis, with several questions being raised about its role as a key institution underlying the major events of the crisis. As the profession came under attack in



the public realm, the chief executive officers (CEOs) of major banks, in their role as representatives of the profession, became the center of attention. Various stakeholders targeted these bank CEOs in their commentaries, and the CEOs also provided their own accounts to the public through quotes in the media. These commentaries are rich in rhetoric: Bank CEOs referred to themselves as bankers “doing God’s work”, were praised for being “consummate professionals” or “leaders”, and were also critiqued using a variety of terms, such as “lame-duck”, “arrogant”, and even accused of being outright fraudsters and liars. In order to systematically analyze these accounts in the public realm and delineate their theoretical implications, we draw upon recent theoretical developments in neo-institutional theory, referred to as the *institutional work* literature (see Lawrence and Suddaby, 2006; Lawrence et al., 2009).

Institutional work refers to the creation, maintenance and disruption of institutions by various individuals and organizations through purposive action (Lawrence and Suddaby, 2006, p. 215). In particular, rhetoric, or more generally, purposive use of language, serves as a form of institutional work that deserves more research attention (Lawrence and Suddaby, 2006, p. 239; Suddaby, 2010). Further, the key role of professions in institutional maintenance and change, including the maintenance and change of the profession itself, has been highlighted as particularly important (Scott, 2008, p. 219) and yet remains underexplored in the literature (Hwang and Powell, 2009; Lawrence et al., 2009).

These theoretical developments are particularly relevant to our focus on the banking profession during the financial crisis. On one hand, the profession became one of the primary targets of rhetoric aimed at institutional change in the broader finance industry. On the other hand, the profession attempted to use rhetoric to maintain the norms and rules related to it and thereby preserve its existing key role in the finance industry and modern finance-based societies (Davis, 2009). This context thus provides a unique opportunity to observe institutional work undertaken by key actors related to the banking profession. Banking has been considered a profession in prior literature, given that bankers are bound by common norms, rules and associated training (Borsodi, 1977; Green, 1979; Seal and Croft, 1997).

Our paper contributes to the growing literature on institutional work, particularly to the emerging strand that highlights connections between professions and institutional maintenance and change (Hwang and Powell, 2009; Lawrence and Suddaby, 2006; Lounsbury, 2002; Scott, 2008). We also contribute to the stream of research that examines responses of actors facing pressures for institutional change (Barnett and King, 2008; Maguire and Hardy, 2009; Suchman, 1995), particularly where several connected actors, such as the constituents in a specific profession, are investigated in an integrated manner (Desai, 2011; Hoffman, 1999).

The rest of our paper proceeds as follows. First, we briefly discuss the context of banks during the financial crisis. Second, we describe our data, analysis technique, and results. Finally, we interpret our findings and discuss their implications.

### **Banks and the Financial Crisis**

The global financial crisis has been attributed to causes deeply connected to the banking industry, particularly the sub-prime loans and related practices, such as credit default swaps and collateral debt obligations (Crotty, 2009). The start of large-scale mortgage defaults in 2007 in the United States provided the trigger for dramatic events in the banking industry. These events included the bankruptcy of Lehman Brothers; the buyouts of Bear Sterns and Merrill Lynch by JPMorgan Chase and Bank of America, respectively; the bankruptcy and buyout of Washington Mutual by Bank of America; the change in structure of investment banks Goldman Sachs and Morgan Stanley to deposit holding banks in order to allow their bailout by government funds; and the bailout of Citigroup by government funds. The events at these banks in the United States created global ripples, given that modern banking activities are global in nature and impact industry and governments across the world. In Table 1, we present a timeline of events related to major United States banks, along with names of bank CEOs who had tenure during these events. For further details, see for example, Reuters (2010) and CNN (2008).

*Table I. Timeline of Major Bank Events and Bank CEO Tenures during the Crisis*

<i>Major Bank</i>	<i>Key Crisis Event(s)</i>	<i>CEO Tenures</i>
<i>Lehman Brothers</i>	<i>Bankruptcy (Sep 15, 2008)</i>	<i>Richard Fuld (1994 - May 15, 2009)</i>
<i>JPMorgan Chase</i>	<i>Acquired Bear Sterns (Mar 17, 2008)</i>	<i>James Dimon (Dec 31, 2005 – Present)</i>
<i>Bear Sterns</i>	<i>Acquired by JPMorgan Chase (Mar 17, 2008)</i>	<i>James Cayne (1993 - Jan 7, 2008)  Alan Schwartz (Jan 8, 2008 – Present)</i>
<i>Bank of America</i>	<i>Acquired Merrill Lynch (Sept 15, 2008)</i>	<i>Kenneth Lewis (2001 - Dec 31, 2009)</i>
<i>Merrill Lynch</i>	<i>Acquired by Bank of America (Sept 15, 2008)</i>	<i>John Thain (Nov 14, 2007 - Jan 22, 2009)</i>
<i>Goldman Sachs</i>	<i>Converted to deposit holding bank to accept government bailout (Sept</i>	<i>Lloyd Blankfein (May 31, 2006 - Present)</i>

	21, 2008)	
<i>Morgan Stanley</i>	<i>Converted to deposit holding bank to accept government bailout (Sept 21, 2008)</i>	<i>John Mack (June 30, 2005 - Jan 1, 2010)</i>
<i>Citigroup</i>	<i>Bailed out by government funds (Nov 24, 2008)</i>	<i>Vikram Pandit (Dec 11, 2007 - Present)</i>
<i>Washington Mutual</i>	<i>Declared Bankruptcy and acquired by JPMorgan Chase (Sep 25-26, 2008)</i>	<i>Kerry Killinger (1990 - Sep 8, 2008)</i>
<i>Wells Fargo</i>	<i>Acquired Wachovia (October 11-12, 2008)</i>	<i>John Stumpf (June 27, 2007 - Present)</i>

*Sources: FDIC and various media reports available online*

Taken together, these events in the banking industry brought attention onto the banking profession in a manner that was unprecedented in recent memory. For example, the Financial Crisis Inquiry Commission was set up by the United States Congress to examine the causes of the financial crisis, and bank CEOs were a prominent set of constituents publicly cross-examined.

## Methods

As the banking profession became the focus of public attention, the media published several statements made by bank CEOs and various stakeholders. These statements constitute a source of public data for the analysis of rhetorical forms of institutional work related to the banking profession. Media as a source of data for analyzing actor positions has been well established in the literature (Krippendorff, 2004). Further, rhetorical analysis has been suggested as useful for institutional theory research (Green Jr. et al., 2009; Suddaby, 2010; Zbaracki, 1998), including research that focuses on the role of professions from an institutional perspective (Suddaby and Greenwood, 2005; Greenwood and Suddaby, 2006). Finally, analysis of rhetoric has been particularly relevant for understanding institutional elements during crisis situations (Desai, 2011; Hoffman, 1999; Zilber, 2007).

## Data

We considered several events for fixing our data collection time-frame and finally settled on the start of public hearings by the Financial Crisis Inquiry Commission (FCIC) as a defining event in terms of collection of rhetoric. The FCIC defines itself as “a bipartisan commission that has been given a critical non-partisan mission – to examine the causes of the

financial crisis that has gripped the country and to report our findings to the Congress, the President, and the American people” (FCIC, 2010).

We chose an 18-month period, January 13, 2009 – July 13, 2010, for our data collection. The FCIC commission started its public hearings on January 13, 2010, in recognition of the fact that, by then, the issues surrounding the crisis had escalated into a major public concern through various reports and commentaries in the media. We considered a time period stretching to January 13, 2009, i.e. one year preceding the first FCIC public hearing, as it allowed us to collect the rhetoric building up to the FCIC hearings. We extended the time period to July 13, 2010, to allow us to capture the key concerns voiced in the public realm during the critical first six months of the hearings.

Our study considered those bank CEOs whose tenure included the key decisions made by their bank during the financial crisis, around 2007-2009. In order to ensure we did not miss any relevant rhetoric, we also collected quotes of CEOs who had been primary decision-makers during the crisis but who had since then relinquished the CEO position. For example, John Thain was CEO of Merrill Lynch when the key decision regarding its buyout by Bank of America was made. Though Thain subsequently resigned in 2009, he continued to be a focus of, and a source of, Merrill Lynch-related rhetoric during the crisis.

For the time-frame mentioned above, we conducted searches using the Factiva database for media articles, using each CEO's first and last name as keywords. Specifically, we looked for media articles that included either quotes by the CEOs or by any other stakeholders on the banking profession. In collecting the articles, we cast a wide net that included major publications such as *The Wall Street Journal*, *Financial Times*, *The Economist*, and *Fortune*, along with any other media outlets if we were able to find quotes that met our relevance criteria. In this manner, we found 116 relevant media articles.

We read through the media articles and identified 239 direct quotes by the CEOs and 182 quotes by various stakeholders. These were later reduced to 196 and 150 quotes respectively, through omitting quotes that were repetitions or were not relevant to the discussion on banking profession and financial crisis.

### **Analysis and Results**

We analyzed our data in the following manner. We read through each article with a focus on the quotes, referring to the additional information in the article to provide context. We then followed a bottom-up approach to categorize the data, rather than imposing any top-down categories. We first marked the quotes through keywords that identified key issues, such as “banker skills,” “bank CEO concerns,” “lack of transparency,” etc. We then collated these quotes into logically connected, higher-order categories. Each quote was thus coded into categories and sub-categories by identifying thematic distinctions (Krippendorff, 2004, p. 107) based on the most salient persuasive appeals (*pisteis*) used in each quote (Suddaby and Greenwood, 2005). Coding in each category or sub-category was non-forced, i.e. a quote

could be assigned to multiple thematic categories if there was sufficient ground for considering that it fit into more than one category.

The coding was performed by two raters who had previous experience with such coding, and who were also familiar with institutional analysis and the financial crisis. The first rater independently coded all quotes. To assess inter-rater reliability, the second rater independently coded about 20 percent of the quotes by bank CEOs and 25 percent of the quotes by stakeholders (Suddaby and Greenwood, 2005). We calculated Krippendorff's alpha (Krippendorff, 2004; Hayes and Krippendorff, 2007) and found it to be 0.88 for coding of the quotes by bank CEOs and 0.93 for the quotes by stakeholders. These values of the alpha are fairly high and are acceptable; they are also expected, given that the raters had previous experience of thematic coding on common projects related to the current phenomena (Krippendorff, 2004).

We discuss the overall findings of our content analysis below, and to fully convey the richness of our results, we also share specific quotes as illustrations. We ensure that at least one quote from each category or sub-category is presented (identified by *italic* font in parentheses). Later, in the interpretation and discussion section, these findings are used to identify the main rhetorical strategies employed during the crisis.

### **Bank CEO Rhetoric**

For quotes by the bank CEOs, we identified three main thematic categories: "Assurance," "Blame" and "Care." The Assurance category included quotes by the CEOs that were made to highlight positive aspects of any entity directly connected with the banking profession. We identified five such entities and coded these as a sub-category, "Assurance Focus": *self* (bank CEO), *bank employees*, *bank*, *banking industry*, and *transacting bank*. "Transacting bank" referred to a bank other than the CEO's bank that was involved in a merger or acquisition with the CEO's bank during the financial crisis. We also noted that these assurances referred to positives of the entities across a wide time frame, and created a sub-category, "Assurance Time-Period," to identify whether the assurance was given using positives in the *past* or *present* or making predictions for the *future*.

Our second main category, Blame, consisted of quotes in which the bank CEO assigned blame towards some entity for what went wrong during the crisis. To generate more nuanced insights, we created a sub-category, "Blame Focus," to capture the direction of the blame, i.e. whether it was directed towards a constituent *internal* to the banking profession - *self* (bank CEO), *bank employees*, *bank*, and *banking industry*; or towards tangible and intangible entities *external* to the profession - *government*, *economy*, *market*, *speculation*, *society*, *media*, *other-specific*, and *non-specific*. The "other-specific" category included a set of miscellaneous parties such as lawyers, hedge funds, short-sellers, etc. The "non-specific" category included quotes where the CEO deflected blame away from internal constituents in a general manner, without pointing to any specific external party.

We identified a third main category, “Care,” for quotes in which the CEOs claimed that their profession was serving various stakeholders. Given our focus on the banking profession, we considered *self* (bank CEO), *bank employees*, *bank*, and *banking industry* as *internal* stakeholders. The *external* stakeholders included *clients*, *shareholders*, *financial system*, *economy*, *society*, and *country*.

Bank CEOs directed most of their rhetoric towards providing Assurance by highlighting positive aspects of internal constituents and by placing Blame on external constituents, in about equal measure (75 and 79 quotes, respectively). There was, however, also a substantial effort by CEOs to portray their roles as involving Care toward external constituents (37 quotes). Perhaps not surprisingly, Blame directed towards internal constituents was the least frequently observed response (23 quotes) (see Table 2).

In providing Assurance, the CEOs relied mostly on highlighting past or present aspects (26 and 20 quotes, respectively) of their bank. For example, Alan Schwartz referred to certain positives that his bank, Bear Sterns, had held in the past (*Assurance: Bank: Past*):

“Different assets have different levels of risk and should have different amounts of capital held against those assets. By those measures, which I think are the measures we were most looked at by most agencies and regulators, Bear Stearns had very strong capital ratios.”

Similarly, Kenneth Lewis asserted that Bank of America was already in positive territory and in a position to repay the government’s Troubled Asset Relief Program (TARP) funds accepted to bail out the bank during the crisis (*Assurance: Bank: Present*):

“Bank of America is well positioned to meet the continuing challenges of the economy and markets. The Merrill Lynch and Countrywide integrations are on track and returning value already. We are in position to begin to repay the federal government's TARP investments.”

The third largest group of Assurance quotes (16) referred to future potential of banks, as in the prediction by Vikram Pandit, Citigroup (*Assurance: Bank: Future*):

“After the financial crisis ebbs, Citigroup will generate industry-leading returns.”

In contrast to the Assurance for banks across all three time-periods, CEOs mostly focused on the past when it came to providing assurances about themselves (14 quotes). For example, Richard Fuld reflected on how he did whatever was possible prior to Lehman Brothers’ bankruptcy (*Assurance: Self: Past*):

Table II. Bank CEOs Rhetoric

Rhetorical Strategy	No. of Quotes	Direction of Rhetoric														
		Self (21)			Bank Employees (7)			Bank (63)			Banking Industry (1)			Transacting Bank (4)		
Assurance	75	Past	Present	Future	Past	Present	Future	Past	Present	Future	Past	Present	Future	Past	Present	Future
		14	5	2	4	3	0	26	20	16	1	0	0	1	2	1
Blame	99	Internal (23)					External (79)									
		Self	Bank Employees	Bank	Banking Industry	Government	Economy	Market	Speculation	Society	Media	Specific-Other				
		8	2	9	6	27	3	11	8	6	3	34				
Care	40	Internal (22)					External (34)									
		Self	Bank Employees	Bank	Shareholders	Banking Industry	Clients	Financial System	Economy	Society	Country					
		0	1	14	5	2	10	6	5	7	4					

Note: Total counts across sub-categories exceed the counts in some categories due to non-forced coding.

“Not that anyone on this committee cares about this, but I wake up every single night thinking, ‘What could I have done differently? What could I have said? What should I have done?’ And I come back to this: at the time I made those decisions, I made those decisions with the information I had. I can look at you and say this is a pain that will stay with me the rest of my life.”

The largest group that received Blame from bank CEOs was a miscellaneous set comprising ratings agencies, hedge funds, short-sellers, mortgages brokers, etc. (Other-Specific: 34 quotes). For example, James Cayne, Schwartz’s predecessor at Bear Sterns, used interesting imagery to portray the hawkishness of external constituents and his bank as a victim (*Blame: External: Other-Specific*):

“I have tried to avoid conspiracies, rumours. I heard the same rumours everybody heard, that hedge funds . . . ganged up . . . and that was all part of a picture of a big, fat goose walking down a lane, that’s about to get eaten up alive.”

Perhaps surprisingly, given the government bailouts of major banks, government and its agencies came in for the second largest share of Blame (27 quotes). The Treasury and Federal Reserve were typically criticized, along with some blame for the Securities and Exchange Commission (SEC) and other regulators. Some of the grievances related to perceptions of unfair treatment. For example, Kerry Kissinger of Washington Mutual lamented (*Blame: External: Government*) his company’s bankruptcy:

“I believe that Washington Mutual’s seizure was unnecessary and the company should have been given a chance to work its way through the crisis. I also believe it was unfair that Washington Mutual was not given the benefits extended to and actions taken on behalf of other financial services companies within days of Washington Mutual’s seizure.”

In cases where government bodies had played a role, bank CEOs still found plenty to complain about. For example, referring to Bank of America’s takeover of Merrill Lynch, supported by the government, Kenneth Lewis suggested that the government bodies coerced him to act in an unprofessional manner (*Blame: External: Government*),

According to testimony Mr. Lewis provided to New York’s attorney general in February, the Bank of America CEO felt ‘forced’ by Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke to go through with the Merrill deal despite mounting losses and his reservations about the deal.

and also pointed to the lack of follow-through on the part of government bodies:

“I recall a statement by Mr. Bernanke, that ‘We view you as strong and having acted appropriately in difficult circumstances, that we’ll make sure you continue that way’. [Bernanke] even went so far as to say, ‘We want to do something that when the public hears about it your stock goes up.’ That didn’t happen.”



Interestingly, perhaps betraying an inability to find enough specific parties to blame, the CEOs also prominently blamed intangible entities (Market, Speculation and Society receiving 11, 8 and 6 quotes, respectively), as illustrated by Alan Schwartz's comment (*Blame: External: Market, Speculation*):

"We, like many other financial institutions, relied on the belief that the market for highly rated tranches of structured securities, including those supported by Fannie Mae and Freddie Mac mortgages, would remain liquid, but when the markets for those securities became frozen, it left the firm susceptible to rumor and speculation."

Lloyd Blankfein of Goldman Sachs went so far as to blame the public due to their ignorance in understanding highly complex issues and hinted at the media's complicity in perpetuating this ignorance (*Blame: External: Society, Media*):

Goldman's businesses "serve a real purpose" but people "can be confused" by what is in the "pop press from time to time."

Perhaps recognizing that they were under public scrutiny, the CEOs made several attempts to highlight that they and their profession served constituencies other than themselves. Not surprisingly, no CEO suggested that their decisions were made with their own individual interests in mind (*Care: Self* = 0 quotes). Similarly, serving the interest of bank employees or the industry was also not highlighted (1 and 2 quotes, respectively). Acting in the interest of the bank itself was most often mentioned under the Care category (14 quotes). In these cases, the bank took on a life of its own as an entity to be preserved and cared about, as in this excerpt by John Thain (*Care: Bank*):

"I have received thousands of e-mails saying, 'Thank you for saving our company.'" And yet [Thain] admitted that the decision to sell Merrill Lynch – a 94-year-old institution that was always 'bullish on America' – had been painful. "This was a great job. This was a great franchise. Emotionally, it was huge responsibility."

Clients emerged as the second largest group that bank CEOs said they cared about (10 quotes), as exemplified by John Stumpf's comment (*Care: Client*),

"And it's mostly about making sure that we are not confused and no one in the Company is confused about what we are here to do every morning. We are here to serve customers. That's the reason we get up in the morning."

and by Lloyd Blankfein's attempt to erase stereotypes of fat-cat bankers:

"We are not lounging around in our sunglasses, basking in our certain future. We stay very close to our clients."

However, the CEOs went well beyond their bank, clients and shareholders and also engaged in rhetoric suggesting their commitment to higher goals, such as the overall financial system, economy, society and country. Taken together, these "higher goals" quotes were the largest group in the Care category (22

quotes). It is perhaps a sign of the times that CEOs had to make very deliberate efforts to highlight such care, as illustrated by Vikram Pandit (*Care: Economy, Society, Country*):

Mr. Pandit still acknowledges “a significant responsibility” on Citi’s part to help be “an integral part of the American recovery.” He cited Citi’s efforts to help American homeowners and credit-card holders who are having trouble making their payments.

Similarly, Lloyd Blankfein went to great lengths in taking up a position as defender of the profession, arguing that the profession had a higher purpose (*Care: Clients, Society*):

“I know I could slit my wrists and people would cheer. We’re very important. We help companies to grow by helping them to raise capital. Companies that grow create wealth. This, in turn, allows people to have jobs that create more growth and more wealth. It’s a virtuous cycle...We have a social purpose.” He is, he says, just a banker “doing God’s work.”

### **Stakeholder Rhetoric**

We identified three main thematic categories for quotes by various stakeholders based on whether the statements were “Supportive,” “Critical” or “Neutral” towards bank CEOs, their management or other constituents of the banking profession. We identified five sub-categories for the Supportive category, based on differing logics used for the support. Positive Characteristics referred to quotes that praised characteristics of the bank CEO or management, such as experience, skills, talents, etc. Another sub-category comprised statements that praised some aspect of the bank in question, such as its history or its current or future performance, and then reflected this onto the bank CEO or management, suggesting their role in these positive aspects of the bank; we termed this sub-category, Bank Performance. A third group of quotes provided support by highlighting the difficult circumstances and conditions in which the bankers found themselves, thereby absolving them of blame; we termed this sub-category, Circumstances. An interesting fourth sub-category of support emerged from quotes that suggested the CEO or management had provided a valuable service towards something larger than their own bank or industry, and we termed these as Helped System. Finally, in the fifth sub-category, we placed quotes that clearly showed support but did not provide any specific reasons and were thereby Non-Specific Support.

The Critical category similarly provided more sub-categories on closer inspection. Several statements critiqued characteristics of the bank CEOs or management and referred to issues such as poor management style, lack of skills, lack of experience, etc.; we classified these as Negative Characteristics. A second group of statements highlighted problems with practices, including issues such as lack of transparency, problems with transactions, etc.; we termed these Practices. A third sub-category emerged from quotes that brought up the issue of responsibility, obligation and duty, typically suggesting how the CEO or management had failed in this regard; we grouped these quotes under Responsibility. Finally, we

classified all quotes that were critical but did not provide specific reasons under the sub-category Non-Specific Critical.

We classified the various stakeholders into categories and sub-categories to allow us to see finer patterns in stakeholder rhetoric. Within internal stakeholders, we included bank employees (both current and former employees), members of the boards of directors, shareholders and competitor banks. External stakeholders comprised non-bank finance industry actors, academics, policy-makers (including government representatives and officials), regulatory officials, and other non-bank actors such as lawyers, media and investors.

Our stakeholder rhetoric results are presented in Table 3. Aggregate findings for all stakeholders are presented in bold font, while aggregates for internal and external stakeholders are presented in bold and italic font. Stakeholders mostly took clear sides, leaving little ground for neutrality (12 quotes), and with criticism far outweighing support (89 and 50 quotes, respectively). Positive or negative characteristics of bank CEOs and their team were brought up in equal measure for support or critique (23 and 22 quotes, respectively). However, the largest set of criticism shied away from direct focus on the people involved and instead pointed out problems with practices (45 quotes). The third largest set of criticism was expressed in general terms, without singling out a particular person or issue (Non-Specific: 18 quotes). Highlighting lapses in responsibility, with direct references to how the bankers had failed in their duty or obligation, was the least noted criticism (13 quotes). Interestingly, even during the crisis time, and reflecting the pattern observed in CEO rhetoric, references to bank performance in order to support bankers remained a frequently employed approach (16 quotes). In addition, some stakeholders extended support but were not able to, or chose not to, provide specifics (Non-Specific: 9 quotes); very few suggested that CEOs and their team did well considering the circumstances they faced (3 quotes); and a few actually suggested that the bankers had helped the wider “system” during the crisis (5 quotes).

While support from external stakeholders was, surprisingly, somewhat higher than that from internal ones (29 and 21 quotes, respectively), the external stakeholders clearly led in criticism, with almost twice the number of quotes than internal stakeholders (58 and 31, respectively).

Amongst the internal stakeholders, ex-employees were the largest critical group (20 quotes), mostly focusing on problems with practices (12 quotes) and bank CEOs (8 quotes). For example, Brad Hintz pointed towards how certain practices led to Lehman’s problems (*Critical: Practices*),

“It was a series of small steps – rising leverage, retention of risky positions, delay of raising capital and reliance on ‘hot money’ for financing – that one by one took Lehman to the end of the plank.”

and Lawrence McDonald highlighted the CEO’s shortcomings (*Critical: Negative Characteristic*):

“Fuld has a bunker mentality. He blamed the markets, blamed the short-sellers. The truth is, qualified people warned him several times and he wouldn’t listen,” there was still “a lot of anger in the community out there” toward Fuld.

In contrast, current employees were supportive as well as critical (6 and 5 quotes, respectively), e.g. Larry Di Rita portrayed her CEO in a positive manner (*Supportive: Positive Characteristic*):

“[Kenneth Lewis] has discussed these matters on several occasions now. The venues and the questions vary, but the information he has provided has been consistent, truthful and fully responsive.”

The strongest support for bank CEOs from internal constituents came from their Boards of Directors (7 quotes), who had hardly anything critical to say, as illustrated by Richard Parsons’ praise of Citigroup’s CEO (*Supportive: Positive Characteristic*):

“Vikram continues to enjoy the support of the board. When you sit with him and go through the strategy . . . you’ve got to be impressed with the thoughtfulness and the correctness.”

Table III. Stakeholder Rhetoric

Stakeholder Category	Rhetoric Type											
	Supportive						Critical					Neutral
	Total	Positive Char	Bank Performance	Circumstances	Helped System	Non-Specific	Total	Negative Char	Practices	Responsibility	Non-specific	Total
All Stakeholders	50	23	16	3	5	9	89	22	45	13	18	12
Internal Stakeholders	21	11	10	1	1	1	31	13	16	3	3	7
Current Employees	6	4	2	1	1	0	5	2	0	0	1	4
Ex-Employees	5	2	3	0	0	0	20	8	12	1	1	1
Board of Directors	7	4	3	0	0	1	1	0	0	1	0	1
Shareholders	3	1	2	0	0	0	5	3	4	1	1	1
Banking Industry Actors	3	3	0	0	0	0	2	0	1	0	1	3
External Stakeholders	29	12	6	2	4	10	58	9	29	10	15	5
Non-Bank Finance Industry Actors	7	3	2	1	1	1	6	1	2	0	3	3
Other Non-Bank Actors	7	3	2	1	1	1	6	1	2	0	3	1
Academic	3	1	1	0	1	0	4	1	0	1	2	0
Policy Maker	3	1	0	1	0	1	32	3	18	7	7	0
Regulatory Body	1	0	0	0	0	1	3	2	1	0	0	0

Note: Total counts across sub-categories exceed the counts in some categories due to non-forced coding.

Surprisingly, shareholders did not contribute much rhetoric (9 quotes), but they did have a few critical comments, e.g. John Moore Sr. critiqued Bank of America' practices from a shareholder's perspective (*Critical: Practices*):

"As a shareholder, without disclosure and transparency, it is extremely difficult to make a reasonable investment decision."

Amongst external stakeholders, the largest set of criticism came from policy-makers (32 quotes) but mostly avoided referring directly to the bank CEOs' shortcomings (Negative Characteristics: only 3 quotes). Instead, the bulk of criticism took the form of highlighting problems with practices in a non-personalized manner (18 quotes). For example, even severe-sounding criticism from FCIC Vice Chairman, Bill Thomas (member, House of Representatives) for Bear Sterns pointed to problems in practices (*Critical: Practices*):

"You had no fall back, to your fault, I think, no undergirding structure. To me it seems like it was based on trust of others more than a model where you relied on what you had."

Similarly, Senator Carl Levin pointed to problems at Washington Mutual without emphasis on the individuals involved (*Critical: Practices*):

"Washington Mutual engaged in lending practices that created a mortgage time bomb. Because volume and speed were king, loan quality fell by the wayside."

Criticism from policy-makers also appeared muted at times and avoided pointing to specific problems, as in Senator John McCain's comment (*Critical: Non-Specific*):

"I don't know if Goldman Sachs has done anything illegal, [but] from the reading of these e-mails . . . there's no doubt their behavior was unethical, and the American people will render a judgment as well as the courts."

Surprisingly few comments from policy-makers pointed towards the CEOs' lack of responsibility and duty, but those that did were typically quite emotive and scathing in their attacks, e.g. Rep. Anna Eshoo's attack on Richard Fuld (*Critical: Responsibility*):

"It's no consolation to all the people you've hurt that you have to live with that." She then blurted out, "Why did you sell your house in Florida to your wife for only a few hundred dollars while the company was collapsing?"

The few positive quotes (3) by policy-makers stood out as oddities (*Supportive: Positive Characteristic*), such as this quote from Barak Obama:

"First of all, I know both those guys. They're very savvy businessmen. And I, like most of the American people, don't begrudge people success or wealth. That's part of the free market system."

The comments that competitors, i.e. bank industry actors, had for each other were very few (3) but were in a unique vein, pointing out interesting personality characteristics, as in John Mack's comment (*Supportive: Positive Characteristic*):

"Lloyd [Blankfein] is smart, really engaged, high-energy, funny and quick - very quick"

Amongst stakeholders external to the banking profession, non-bank finance industry actors were about evenly distributed in support and critique (10 and 8 quotes, respectively), possibly reflecting their connections with the profession. Their support for bank CEOs was quite ingenious at times, as in this comment by the head of a large private equity firm (not named) (*Supportive: Circumstances*):

"Nobody has lived through what he [John Mack] has lived through as a major CEO on Wall Street. Nobody has endured all that punishment for as long as he has. You get special points for doing that."

Other non-bank actors were equally distributed across support and criticism (12 and 11 quotes, respectively), though here again most of the criticism focused on practices (7 quotes). For example, Warren Buffett suggested that Kenneth Lewis had saved the financial system, though he also criticized specific actions taken during the crisis (*Supportive: Helped System; Critical: Practices*):

Lewis "inadvertently saved" the global financial system by averting a collapse of Merrill that would have compounded the shock of Lehman Brothers' bankruptcy. But, Buffett queried the wisdom of paying \$50bn for a brokerage flirting with bankruptcy: "Why pay 'x' for Merrill on Sunday when you could have had it for pennies on Monday?"

Academics provided a few quotes (7) that were about equally distributed in criticism and support. Edward Kane's comment provides an interesting example of how bank performance was praised in order to reflect positively on the bank CEOs themselves (*Supportive: Bank Performance*):

"Mr. [Kenneth] Lewis made a few mistakes and is having to fall on his sword for them. But he also helped to make Bank of America become one of the country's and world's great banks, and as time goes on, I would predict that he will look like a better banker than he does at this moment."

While regulatory bodies were not frequently quoted (4 quotes), they were mostly critical, as seen from Ben Bernanke's reference to transparency issues (*Critical: Practices*):

"According to the bankruptcy examiner, Lehman staff did not report these transactions even to the company's board."

The details presented above provide a broad idea of the rhetoric we observed related to the banking profession during the crisis. These findings help us identify the main rhetorical strategies used for institutional work, as discussed in the next section.

## Interpretation and Discussion

To interpret the patterns of rhetoric in theoretical terms, we draw on the literature on professions and institutions, recognizing that professions can be considered as institutions (Muzio, Brock and Suddaby, 2010) and at the same time, that professionals play key roles as actors engaged in the maintenance or change of institutions (Hwang and Powell, 2009; Scott, 2008). From this perspective, the banking profession could be considered an institution, and bank CEOs, along with relevant stakeholders, comprise actors engaged in institutional work targeted towards the banking profession (Lawrence et al., 2009). The rhetoric employed by these actors thus represents a rhetorical form of institutional work, whereby the actors engage in the maintenance or change of the banking profession as an institution (Lawrence et al., 2009; Suddaby and Greenwood, 2005; Suddaby, 2010).

To provide a finer understanding of the institutional work for the banking profession, we interpret the various types of rhetoric we observed in terms of the typology of institutional work defined by Lawrence and Suddaby (2006), i.e. institutional creation, disruption and maintenance. Since our focused time-frame and public data did not allow us to observe finer distinctions between institutional creation and disruption, we combined these categories together as institutional change. Our findings reveal four main rhetorical strategies of institutional maintenance and four main strategies of institutional change (see Figure 1). For simplicity, we refer to the strategies that occurred most frequently as primary strategies and to those that occurred less frequently as secondary strategies.

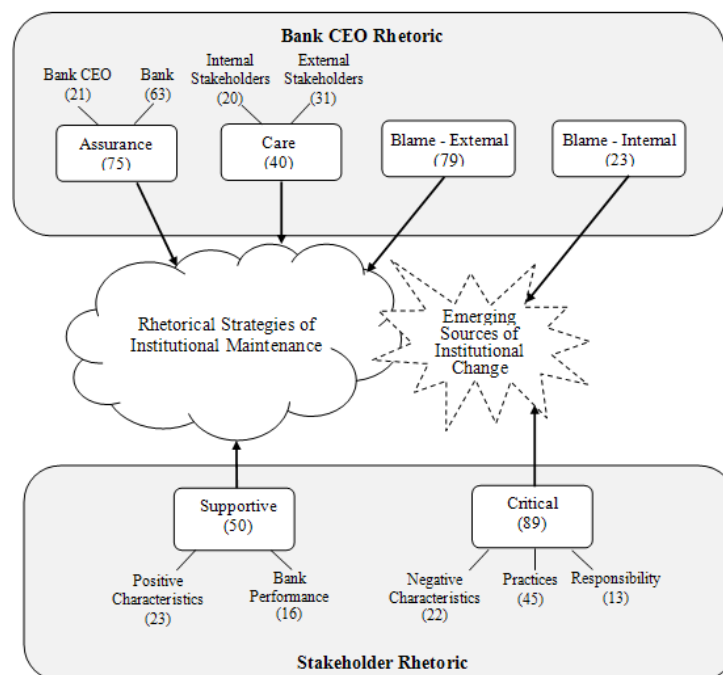
We observed two primary rhetorical strategies of institutional maintenance, *external blame* and *assurances based on profession's firms (i.e. banks)*. The first strategy involved placing blame on external constituents. The placement of blame on constituents outside the banking profession served to alleviate concerns that anything was wrong within the profession and instead directed critical scrutiny elsewhere. This shift in critical attention could help ensure that existing norms related to the banking profession were not challenged, and could thereby serve as a strategy for institutional maintenance. The representatives of the profession, bank CEOs, were the actors who employed this strategy. We also note the similarity of this finding with research by other scholars on rhetoric used by CEOs in the context of the financial crisis (Hargie et al., 2010). Though we did not explicitly attempt to code for classical rhetorical strategies in a top-down manner, we note that this strategy is similar to the classical rhetorical strategy of *pathos* (emotive appeals) (Suddaby and Greenwood, 2005).

The second primary rhetorical strategy employed for institutional maintenance involved highlighting the positives of the bank and reflecting these onto the bank CEOs and management. In other words, a logical appeal was made, suggesting that if the bank had any



positives, these were due to the representatives of the profession. Through showing these actors in a positive light, such rhetoric could alleviate concerns about the banking profession and avoid challenges to its rules and norms. This strategy could thus help in institutional maintenance of the profession. Both bank CEOs and various internal and external stakeholders engaged in this strategy. We note some similarities between this strategy and the classical rhetorical strategy of *logos* (appeals to logic) (Suddaby and Greenwood, 2005).

Figure 1. Rhetorical Strategies of Institutional Maintenance and Change for the Banking Profession During the Financial Crisis



In addition, we observed two secondary strategies for institutional maintenance, *assurances based on representatives of the profession* and *care for stakeholders*. The first strategy involved providing assurances about bank CEOs and their team by highlighting their positive characteristics, such as skills, experience and personality. Through portraying these actors as experts who were worthy of public confidence, such rhetoric could help to avoid challenges to the profession and thereby serve as a strategy for institutional maintenance of the profession. For example, highlighting that the bankers were not really at fault would imply that the rules and norms that formed the basis of the profession were adequate and changes to these rules in the form of regulative restrictions were not necessary. We note that this was the most direct strategy employed as it sought to directly build confidence in the professionals. This strategy was employed by the bank CEOs and various internal and external stakeholders, and is very similar to the classical rhetorical strategy of *ethos* (appeals on the basis of character) (Suddaby and Greenwood, 2005).

The final rhetorical strategy for institutional maintenance provided an interesting mix of logic and emotions: appeals were made based on arguments that the banks as entities were worth caring about and that the banking profession cared about a wide set of constituents and had a purpose in society. Through suggestions that bankers were fulfilling important roles in society, questions about the role of bankers could be alleviated and challenges to their existing norms and rules could be avoided. Such rhetoric was likely an attempt to preempt institutional change that seemed imminent, given the government bailouts of banks and subsequent recognition of the need to reduce moral hazard (as bankers were seen as pocketing profits in good times and relying on taxpayers in bad times). Though these appeals had an overall reliance on logic i.e. *logos*, at times there were also shades of *pathos*, particularly when references were made to the profession's role in contributing towards more abstract external stakeholders, such as society and country. This strategy was employed by bank CEOs.

Taken together, the four rhetorical strategies described above contributed towards institutional maintenance in a variety of ways. Interestingly, the primary strategies could be seen as "indirect," in that they did not involve directly providing support for the profession but rather focused on external parties, in the first case to direct blame towards others, and in the second case to direct appreciation towards the bankers. These indirect approaches could also suggest the difficulties in institutional work towards maintenance of a profession going through a crisis (Desai, 2011). Direct assurances about the bankers and their roles in society were likely harder to express in the midst of a crisis, and also carried the possibility of being ineffective due to counter-rhetoric that was concurrently focused on the negatives of bankers. Faced with limited options, actors likely resorted to indirect approaches for institutional maintenance.

In contrast to the large-scale use of rhetorical strategies for institutional maintenance, the strategies for institutional change were employed less frequently. The primary rhetorical strategy directed towards institutional change involved questioning the practices prevalent in the banking profession by raising issues such as lack of transparency, lack of due diligence, prevalence of high leverage, etc. While this strategy might not have helped to create new norms or rules in the short-term, through challenging existing practices, it could highlight the need for change in the future, thereby serving as an emerging source of institutional change in the profession. The appeals here relied mostly on logical issues and were similar to the classical rhetorical strategy of *logos*. This strategy was mostly employed by external stakeholders.

We note that this primary strategy for institutional change did not take direct aim at the professionals but rather at the practices in the profession. We believe that this has mixed implications for institutional change in the profession. On one hand, targeting practices could be construed as directing change efforts towards broader issues related to the profession

instead of focusing simply on a few professionals. However, given that professions involve not just business practices but also ethical and moral precepts that are rooted in the professionals (Brint, 1994; Brock, Powell and Hinings, 1999), the shift of attention to practices, and thus away from the behavior of professionals during the crisis, also helps to avoid concerns on moral and ethical issues within the profession. This has wider implications for the literature on professions and institutions. Institutional work directed at changes in professions is likely to take various forms, and theoretical refinements of such work might be necessary. We believe that institutional work directed towards change in practices, such as the one we observe here on a large scale, could be considered distinct from work aimed at deeper changes in cultural-cognitive aspects, including morals, ethics and beliefs.

Amongst the three secondary strategies for institutional change, the first one involved the apportioning of blame by the profession's representatives towards internal constituents, including themselves, the bank and the banking industry. This rhetorical strategy was unique in that it was the only evidence of acceptance by the profession's representatives that all was not well within the profession, and change was possibly needed. However, taken within the context of the overall rhetoric, the instances where bank CEOs personally accepted blame were very few, which raises serious doubts about the possibility of internally led change in the profession. This strategy had some shades of both *logos* and *pathos*, but the few acceptances of blame were couched in muted language rather than presented as outright apologies. We did not observe a single instance where a bank CEO categorically accepted blame and apologized. We believe this was surprising, as apologies could also serve as a valid and effective reparation strategy (Hargie et al., 2010). This lack of introspection could reflect deeper cultural elements within the banking profession (Ho, 2009), such as overconfidence about the appropriateness of existing norms and rules in the profession and a general lack of reflexivity. We believe this finding has broader implications for the emerging literature on professions and institutional change. It is likely that institutional work by professionals directed towards change in their own profession is difficult and rare, yet crucial in order for actual change to take place, and thus deserves further theoretical and empirical attention.

The remaining two secondary strategies that could lead towards institutional change in the profession involve highlighting the faults and shortcomings of the bankers and also pointing towards the lack of responsibility displayed by them during the crisis. The appeals here comprised a form of *ethos* for the former strategy, i.e. criticism on the basis of negative characteristics, and *pathos* for the latter strategy that included some scathing emotional remarks about the personal abdication of responsibility by the CEOs. Criticism directed at the bankers could provide several avenues for change in the profession. These could include regulations to curb the risky behaviors of bankers through restructuring compensation packages, decreasing leverage across the banking industry through increased capital requirements, etc. While these two strategies provided a more direct means of criticizing the

professionals, their limited occurrence raises important questions for the literature on professions and institutional work. We believe institutional work strategies aimed directly at the characteristics of professionals – and particularly those castigating them on lack of responsibility, duty and obligation – have the potential to target deeper cultural-cognitive aspects in the profession related to morals and ethics. However, *how* the responsibility issues are raised provides finer distinctions. We observed mostly emotional personal attacks (*pathos*) rather than arguments logically connecting the bankers' lack of responsibility to their failings as professionals. Dramatic personal attacks, such as those made by some policy-makers towards bank CEOs, could be a means to serve other constituencies (such as the general public) by showing that some action is being taken. However, these undercut the possibility of longer-term moral and ethical reform in the profession, due to the lack of making logical connections between the negatives of these bankers to their failure as trusted *professionals* serving a key role in society.

The four strategies of institutional change thus constitute different types of institutional work. We believe that in the context of professions, institutional work related to change in practices could be distinct from work related to moral and ethical aspects. The limited occurrence of the latter and its focus on emotive aspects suggests that changes in moral and ethical aspects, rooted in cultural-cognitive elements, are likely to be more difficult. In this aspect, professions provide an interesting context to explore the path dependence and incremental nature of institutional change that is related to cultural-cognitive elements (Scott, 2001; North, 1990).

In summary, we observe the dominance of rhetorical strategies aimed at institutional maintenance of the banking profession. Representatives of the banking profession and supportive stakeholders alike engaged in this maintenance, primarily through blaming parties external to the profession and reflecting the positives of the banks onto the bankers. Secondary maintenance was provided through the bankers showing care about various constituents in order to justify the role of bankers in society and also through some stakeholders directly praising bankers. In contrast, rhetorical strategies directed towards institutional change were less frequently observed, were primarily concerned with changes in practices, and were mostly originated by actors external to the profession. Secondary sources of institutional change included some acceptance of internal blame for the profession by bankers, as well as direct criticism of bankers' characteristics and their lack of responsibility by stakeholders. However, institutional change in moral and ethical aspects of the profession, particularly internally led change, appeared difficult.

Our study has broader implications for the emerging literature on institutional work and professions. Our findings demonstrate that rhetorical strategies comprise an important form of institutional work related to professions, and that professionals themselves are also an important source of this institutional work (Lawrence and Suddaby, 2006; Scott, 2008).

Given that professions today are a major source of regulation and control (Cooper & Robson, 2006), a varied set of stakeholders are likely to concern themselves with most professions. Studies on professions thus need to take into account both the work performed by professionals as institutional agents and also the work of a variety of actors who see themselves as relevant stakeholders to the profession. We suggest that in such contexts, developing a list of self-defined stakeholders is more accurate, such as the one we developed from the rhetoric data, to ensure that any actor that considers themselves a stakeholder is included.

Further, the existence of a variety of stakeholders implies that professions cater to diverse audiences and present themselves as serving multiple constituencies. This raises the issue of the identities of some professions being in a state of flux and drawing legitimacy from logics that might differ based on the audience or change over time (Brock, et al., 1999; Brint, 1994; Lounsbury, 2007). For example, it appears that the banking profession was caught in a form of identity crisis during the financial crisis, and its professionals accordingly sought support by relying on multiple logics, which ranged from highlighting bank performance to rambling attempts at explaining how bankers served a social purpose. Some professions are thus likely to face forms of “institutional war” at times, particularly during crises, when members of their institutional field would “compete over the definition of issues and the form of institutions that will guide organizational behavior” (Hoffman, 1999, p. 352).

Institutional wars related to professions are likely to provide unique theoretical and empirical opportunities for the study of institutional work. As observed in our findings, the processes of institutional maintenance and institutional change do not occur in isolation from each other but can coexist and fight for dominance (Hoffman, 1999; Maguire, Hardy, and Lawrence, 2004; Maguire and Hardy, 2009). In particular, rhetoric can be used to foster institutional change (Greenwood and Suddaby, 2006; Hoffman, 1999; Phillips et al., 2004) and can also be used to maintain existing institutional arrangements (Desai, 2011; Maguire and Hardy, 2009) related to professions. Our findings suggest that in professions, institutional change is likely to be more difficult than institutional maintenance due to several factors. First, many professionals themselves are likely to be adept at securing their own interests, since their roles often involve developing and maintaining institutional elements (Cooper and Robson, 2006). Professionals can thus turn these skills towards institutional maintenance of their own profession, particularly when facing threats due to crises. We observed this aspect in the large amount of rhetoric by bank CEOs directed towards institutional maintenance of the banking profession. Second, professions are likely to be more closely bonded than other collective entities, such as industries or organizational fields, since professionals are more interconnected to each other through common norms and belief systems (Suddaby and Greenwood, 2006; Ruef and Scott, 1998). They are thus likely to act collectively to maintain existing rules and norms. Our findings revealed this aspect as we observed bank CEOs stand up for the profession as whole, for example, in instances where the profession’s social

purpose was highlighted, and also in the lack of criticism of any one bank CEO by another. Third, given their collective immersion in specific norms and rules, and their close personal ties, professionals could develop deep cultural-cognitive biases that could limit their ability to be reflexive about their own roles. We observed this in our findings on the very limited categorical acceptance of blame by the bank CEOs for events related to the financial crisis, guided possibly by deep beliefs that whatever they did was acceptable. Fourth, given their close-knit nature, professions are likely to develop practices across their constituents that are very similar, such as the use of high leverage across most major banks. Changing these highly homogenized practices, particularly through reliance on internally led efforts, is likely to be very difficult. This aspect was observed in the rhetoric on practices wherein the similarity of practices across the banking profession was evident. Change then, is more likely to come from external stakeholders but is clearly difficult to achieve, given the ability, incentives and cultural-cognitive biases inherent in professionals towards the institutional maintenance of their own profession.

The institutional work we observed is ongoing and likely to continue in the aftermath of the global financial crisis. For example, the new international standards related to Basel-III were under development and were the subject of sharp debates amongst bankers and stakeholders. Several practices such as proprietary trading desks and over-the-counter derivatives were undergoing change as new regulations in the Dodd-Frank Act were set to roll out in 2011. Consistent with the rhetoric we observed in which bankers attempted to show care for various stakeholders, Goldman Sachs underwent a self-conducted review of practices aimed at providing assurance to clients and other stakeholders. On another front, and signaling the need for drawing support from a variety of stakeholders, the bank also conducted a historically unique advertising campaign aimed at the general public to highlight its positive role in society. Compensation, particularly bonuses, and conflicts of interest continued to be debated in the business press. Perhaps the most interesting evidence for the continued crisis in the profession is indicated by media reports that the banking industry's pre-crisis favor amongst graduates (i.e. as a profession to be aspired for) has waned considerably, with some suggesting that this is indeed better for society (Johnson, 2010).

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## AN INTERNATIONAL BANKING STUDY ON THE INFLUENCE OF DEMOGRAPHIC VARIABLES ON RELATIONSHIP MARKETING

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### Abstract

The purpose of this study was to use a self-developed questionnaire to conduct a study among banking clients and bank managers to identify the influence of demographic variables on relationship banking. Primary data has been collected from respondents in South Africa, Canada and the United Kingdom (UK). Convenient sampling was used to select the sample which consisted of 637 banking clients and 67 bank managers. The research instruments to be tested were two similarly structured questionnaires in the form of a 7-point Likert-type scale, one distributed to banking clients and the other to bank managers. Quantitative statistical data analysis was conducted by using the computer programme Statistica Version 9. Descriptive statistics were computed and the reliability of the research instrument was assessed by means of Cronbach Alpha reliability coefficients. A confirmatory factor analysis (CFA) considered validity and linear modelling was performed. The empirical results show that, in addition to the personalisation of banking products and/or services and the fees charged by banks, various demographic characteristics of respondents also influence banks' relationship marketing. This study is of significant value to South African retail banks to consider the relationship marketing strategies of successful banks in Canada and the UK. This study also adds value to the field of relationship marketing as a valid and reliable measuring instrument is developed for future relationship marketing research. The research offers practical strategies to banks on how to personalise offerings, develop fair fee structures and relate to different categories of clients differently. These implemented strategies will ultimately improve bank-client relationships.

**Keywords:** banks, relationship marketing

### Introduction and problem statement

Service firms are important contributors to the economy of any country (Bruhn and Georgi, 2006:11). It is expected that service firms will grow extensively in the future. In South Africa service firms are also major participants towards the growth of the economy. According to Appel (2008), the contribution of the services sector to South Africa's Gross Domestic Product (GDP) stands at a high 74%. This figure was a mere 45.6% in 1980, which increased to 65.9% in 2000 (South Africa, 2003). These increased figures show how services industries'

contribution to the country's economy has increased. Due to this influence many new service firms are entering industries or existing service firms diversify into new markets and industries. This results in fierce competition among service firms.

The development and importance of service industries is also evident in global banking industries. Retail banks are key service sector role players, especially in competitive banking industries in developing countries, for example South Africa, as well as in developed countries such as Canada and the UK (South Africa Yearbook, 2008/09:230; Figueira, Nellis and Parker, 2007:38; Metcalfe, 2003). At the end of December 2007, 33 banking institutions were registered with the Office of the Registrar of Banks in South Africa. The country's banking industry is dominated by four major banking groups holding 85.1% of the total assets of the banking industry at the end of 2007. (South Africa Yearbook, 2008/09:230). The four banking groups are Amalgamated Banks of South Africa (ABSA) Group Limited; FirstRand Holdings Limited (FNB); Nedcor Limited (Nedbank) and Standard Bank Investment Corporation Limited (Standard Bank). These banks, being participants of the country's financial services industry, contribute approximately 20% of South Africa's GDP (Profiles Stock Exchange Handbook, February – May 2010). In 2007 the South African banking industry employed 139 149 people (South Africa Yearbook, 2008/09:229-230). Therefore, the efficiency of South Africa's financial system, including its banks, is of importance because of banks' contribution to the country's employment rate and financial stability (Competition in South African Banking, 2004:4). However, the stability of these banking groups is challenged as they compete to increase market share and improve bank-client relationships.

South Africa's competitive banks, and banks in other developing countries, need to focus on improving bank-client relationships (thus relationship marketing) in order to maintain clients. However, the relationship marketing of banks may be influenced by different bank-related variables as well as demographic aspects of clients.

Prior relationship marketing research in banks was more theoretical, with the focus on the benefits of proper client relationships. Previous research fails to offer practical banking strategies to enhance relationship marketing efforts. The primary objective of this study was to identify the variables, specifically the demographic variables, influencing relationship marketing in banks, both from banking clients' and bank managers' viewpoints in South Africa, Canada and the UK. The study was based in South Africa, whereas Canada and the UK were selected as study areas because research has shown that these two countries' banks are on the forefront with regard to relationship marketing (Ptak, 2001). Therefore, the problem statement of this study is two-fold as presented by the following questions: Which variables influence relationship marketing in banks? Which demographic variables influence clients' perceptions on banks' relationship marketing?

## Purpose and Objectives

Following the introduction and problem statement above, it can be stated that the primary objective of this study was to use a self-developed questionnaire to conduct an international study among banking clients and bank managers to identify the influence of selected variables, including demographic variables, on banks' relationship marketing.

In order to assess the variables influencing banks' relationship marketing, the following secondary objectives were pursued:

- to investigate literature on South Africa, Canadian and UK banks;
- to investigate literature on variables possibly influencing relationship marketing;
- to perform an empirical investigation among international banking clients and bank managers; and
- to give recommendations to banks on how to improve their bank-client relationships.

## Literature Overview

Based on the objectives stated above, a literature overview was conducted concerning banks in South Africa, Canada and the UK as well as variables possibly influencing relationship marketing in banks.

According to Appel (2008), the financial services industry, which includes banks, has been identified as one of the two most significant contributors to growth in South Africa's service sector, the other being construction. As mentioned before, the highly competitive South African banking industry is dominated by ABSA, FNB, Nedbank and Standard Bank. Financial service firms listed on the Johannesburg Securities Exchange (JSE), the stock exchange of South Africa, represented more than 16% of the total market capitalisation in 2009; the four major banking groups alone accounted for 8.91% of the total market capitalisation in 2009 and employing approximately 122 000 people. (Profiles Stock Exchange Handbook, February – May 2010). With the four major banks controlling over 85% of the banking industry, this South African industry operates as an oligopoly, which makes it highly competitive with participants experiencing various challenges.

Challenges faced by South African banks include operating in the global business environment, overcoming devaluations of banks' shares, countering government intervention and implementing banking technology. Banks' partnerships with other firms, competition for the "un-banked" segment of the population, changing client behaviour, and enquires about fees are additional challenges. (Metcalf, 2009; Whitfield, 2009:47; Harris, 2008:13; Okeahalam, 2008:1131; Whitfield, 2008:20; Nyamakanga, 2007).

However, despite these challenges, the four major banking groups in South Africa aim to increase their number of accounts and clients, by 22% by the year 2012 (Metcalf, 2009:8). Clearly relationship marketing is important for South African banks and it would be useful to

consider the relationship marketing efforts of successful international banks to gain knowledge on practical relationship marketing strategies.

The Canadian banking industry consists of 14 local banks, 33 foreign bank subsidiaries and 20 foreign bank branches (Canada's Banks, 2002). Canada's banking system is mature, sophisticated and highly competitive. Canadian banks are often regarded as leaders in the field of relationship marketing. Since 1997, The Royal Bank of Canada (RBC), Canada's largest bank, has implemented many successful relationship marketing strategies (Ptak, 2001:38), while serving over 10 million clients internationally (Khirallah, 2001:2). It would be to South African banks' advantage to consider and adopt relationship marketing strategies practised by Canadian banks.

UK banks provide services globally and the industry is dominated by a small number of large banks. Figueira *et al.*, (2007:38) mention that UK banks are often regarded as highly efficient and competitive banks. As one South African bank, ABSA, is 58.8% owned by a major UK-based bank, Barclays (Mittner, 2009:24), it is necessary to consider, with the purpose of implementing, the effective relationship marketing strategies of UK banks.

Swartz and Iacobucci (2000:96) state that much focus in marketing is on the concept of developing relationships with clients. Law, Lau and Wong (2003:55) indicate that many financial service providers, including banks, have transformed their firms to strengthen their relationships with clients. The importance of relationship marketing in banks is evident, as Howcroft, Hower and Durkin (2003) state that the nature of the financial industry's complicated, risky and long-term products and services leads to clients having high involvement relationships with their financial service providers. According to Donaldson and O'Toole (2007:150) a firm-client relationship consists of several non-accidental interactions occurring over time. Therefore, relationship marketing is defined by Grönroos (1994:4-20) as the firm strategy which aims to profitably identify and establish, maintain and enhance, and, when necessary, terminate relationships with clients. If well-executed, relationship marketing may lead to many benefits for firms, including banks, and their clients. Quality firm-client relationships consist of bonds, commitment, satisfaction, benevolence and trust between two parties (Rauyruen and Miller, 2007; Bennett and Barkensjo, 2003; Roberts, Varki and Brodie, 2003; Naude and Buttle, 2000). Swartz and Iacobucci (2000:328) also indicate that clients receive specific benefits from firms which focus on relationship marketing. From a firm's viewpoint, the rationale for implementing relationship marketing strategies is that it improves customer service, enhances customer satisfaction and increases customer loyalty and customer retention (Bergeron, Roy and Fallu, 2008; Eid, 2007:1021; Wilmshurst and Mackay, 2002:346). Baron and Harris (2003:161) also mention that relationship marketing can lead to lower marketing costs and positive word-of-mouth recommendations.

However, despite these advantages offered by relationship marketing, Payant (2004:7) determined that approximately 50% of banks are not satisfied with the returns they receive on

their investments in relationship marketing. This indicates some shortcomings in banks' relationship marketing strategies, which may be due to bank-related variables and clients' demographic variables, influencing relationship marketing.

The literature review on relationship marketing led to the identification of specific bank-related aspects as variables which can possibly influence banks' relationship marketing. Seven bank-related aspects were selected as variables possibly influencing relationship marketing, namely communication, knowledgeability, personalisation, empowerment, ethics, fees and technology. However, for the purpose of this paper, only the findings on the most important variables, as suggested by the empirical findings, will be reported on, namely personalisation and fees.

According to Berndt, Herbst and Roux (2004:36), personalisation in banks occurs when banking products and/or services are adapted in unique ways to the preferences of clients. The importance of personalisation in banks is evident as Jackson (2003:71) states that the only aspect differentiating a bank from its competitors is its personalisation of offerings. A bank's fees refer to its charges or costs to clients for the bank services delivered for example, transaction and administration fees.

As this study's purpose is to investigate the possible influence of two selected variables on the relationship marketing of banks in South Africa, Canada and the UK, it is important to conduct an empirical investigation from the perspectives of both banking clients and bank managers, through the use of a self-developed measuring instrument.

From the literature overview above, it is evident that the focus on relationship marketing can be useful for banks and those in South Africa can possibly adopt relationship marketing strategies as used by banks in Canada and the UK. Therefore, the empirical investigation of this study aims to provide insight into clients' and managers' viewpoints on relationship marketing in international banks in order to improve the delivery of banking services to clients and as a whole improve bank-client relationships.

## **Research Methodology**

To attain this study's primary objective the positivistic as well as the phenomenological research paradigms were used in this study, in order to complement each other. The positivistic paradigm was used to test the clients' perceptions by analysing data quantitatively, whereas the phenomenological research paradigm was used to gain more insight into the managers' perceptions.

Both primary and secondary resources were used in the study. Secondary sources, including books, articles, academic journals and websites, were used to collect information on banks in South Africa, Canada and the UK as well as relationship marketing aspects. The primary research was conducted by means of an empirical study. Primary data has been collected from banking clients as well as bank managers of banks in all three specified

countries. The 637 banking clients and 67 bank managers were selected by means of convenience sampling.

The research instruments were two similarly structured questionnaires, one distributed to banking clients and the other to bank managers. These questionnaires were self-developed and self-administered. The empirical investigation was conducted in English. The literature overview assisted in designing the items in section A and statements revolved around the two selected variables possibly influencing the relationship marketing of banks. Section A used a seven-point Likert-type scale ranging from 'strongly disagree' (1) to 'strongly agree' (7). Section B gathered demographical data of the respondents (banking clients and bank managers). The face validity of the measuring instrument was subjectively decided as experts in the fields of services marketing and relationship marketing as well as bank managers assisted with the questionnaires' designs.

The computer programs Microsoft Excel and Statistica (Version 9) were used and statistical data analyses were performed in four phases as the following statistics were calculated: descriptive statistics, also with the use of analysis of variance (ANOVA) and analysis of covariance (ANCOVA), Cronbach alpha coefficients, linear modelling and descriptive statistics specifically on the bank manager' results.

Descriptive statistics aim to provide an overall summary of a large amount of data (Struwig and Stead, 2001:158) and therefore, during the first phase of data analysis, descriptive statistics were calculated to summarise the sample data distribution. Secondly, to evaluate the construct validity and internal reliability and consistency of the measuring instrument items, a confirmatory factor analysis (CFA) was performed and Cronbach alpha coefficients were computed. A Cronbach alpha coefficient should be greater than 0.70 (Hair, Babin, Money and Samouel, 2003:172). A measuring instrument and its items are more reliable if the Cronbach alpha coefficients are higher than 0.7. In the third data analysis phase linear modelling was performed to identify the influence of the selected variables on the relationship marketing of banks. Finally, descriptive statistics were computed for the bank manager' results.

## **Empirica Results**

From the four phased statistical data analysis, the following section elaborates on the empirical findings of the study. First, findings from the descriptive statistics are described. Secondly, the reliability of the measuring instrument is tested through the calculation of Cronbach alpha coefficients, where after the results from the linear modelling are provided. Lastly, the results from the bank manager' analysis are discussed.

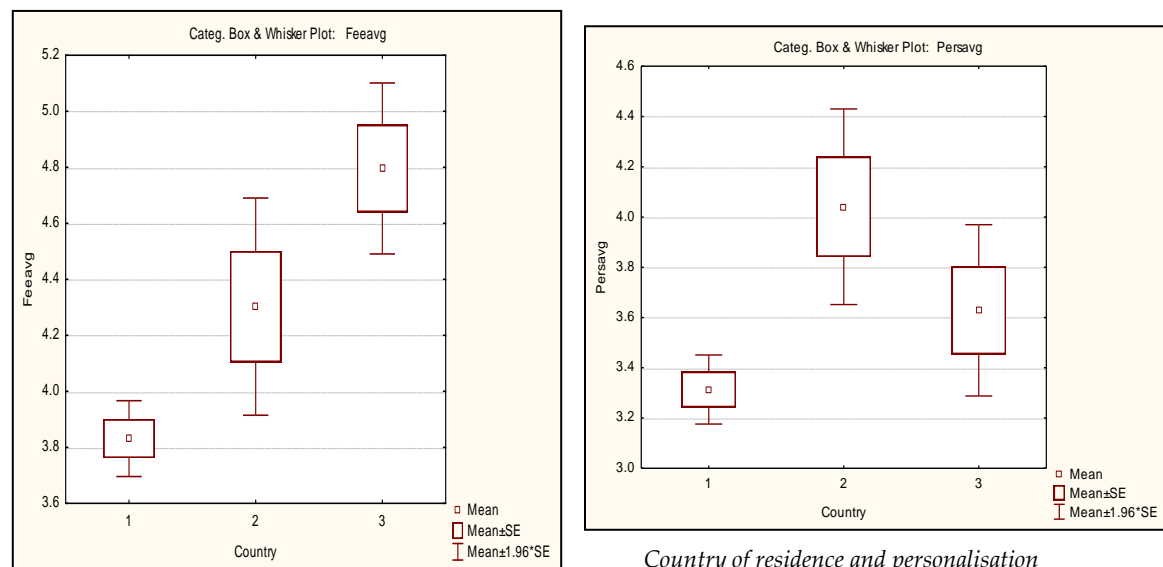
### **Descriptive statistics**

With regard to the descriptive statistics, significant findings related to the demographic variables, namely the country of residence, population group and education level of banking client respondents. ANOVA was used to determine the influence of the demographic

variables on the dependent variable, relationship marketing. This was followed with ANCOVA as the variables personalisation and fees were included in the analysis.

It was important to identify whether respondents' country of residence exert an effect on the perceptions clients have regarding the two selected variables possibly influencing the relationship marketing of banks. Figure 1 illustrates these findings by presenting box plots that show how clients' country of residence influences their perceptions regarding banks' fees and personalisation efforts.

*Figure 1: Country of residence and its influence on perceptions on fees and personalisation*



*Country of residence and personalisation*

*Country 1: South Africa*

*Country 2: Canada*

*Country 3: UK*

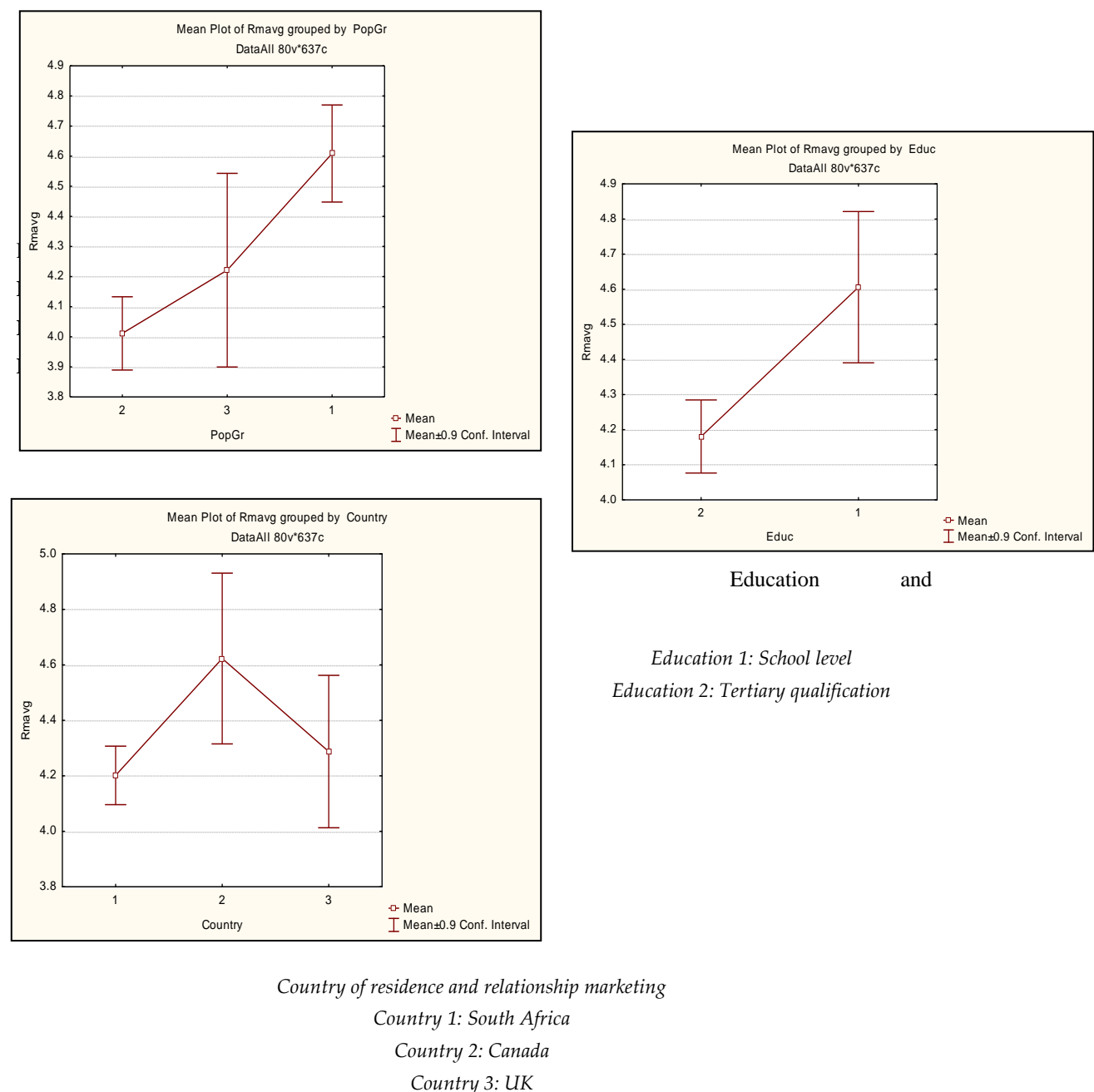
The mean scores for personalisation is significantly higher if banking clients are from Canada (4.04) than if banking clients are from South Africa (3.31). In addition, the analysis showed that the mean scores for fees are significantly higher if banking clients are from the UK (4.80) than if respondents are South African banking clients (3.83). Generally, this indicates that banking clients are more positive regarding the personalisation strategies of Canadian banks than South Africans are about the personalisation efforts of South African banks. In addition, banking clients in the UK are more satisfied with the fee structures of UK banks than South Africans are about those of South African banks.

In addition, ANOVA and ANCOVA were performed to establish whether the demographic characteristics of respondents exert an influence on the perceptions clients have regarding the relationship marketing of their banks.

The gender and age of banking client respondents exerted no significant influence on the relationship marketing of banks at the 0.05 level of significance. However, the ANOVA and ANCOVA analyses revealed that the demographic characteristics population group, education level and country of residence exerted an influence on the perceptions clients have regarding banks' relationship marketing.

Figure 2 depicts box plots showing that the population group, education level and country of residence of respondents exerted an influence on the perceptions clients have regarding banks' relationship marketing.

Figure 2: Demographic characteristics and the influences on relationship marketing





A *post hoc* Bonferroni test revealed that at the 0.01 level of significance ( $p=0.000002$ ), the mean score for the relationship marketing of a bank is significantly higher if banking clients are African (5.06) than if banking clients are from the European population group (4.51). The *post hoc* Bonferroni test also showed at the 0.01 level of significance ( $p=0.006632$ ) that the mean score for the relationship marketing of a bank is significantly lower if banking clients are educated with a tertiary qualification (4.52) than if banking clients are not educated with a qualification beyond secondary school level (4.88). In terms of country comparisons, the Fisher LSD estimate showed a significant difference between the relationship marketing responses of South African and Canadian banking clients ( $p=0.035949$ ). This finding suggests that Canadian banking clients are more positive regarding their banks' relationship marketing efforts than South African banking clients are regarding their banks' relationship marketing efforts.

### Reliability of the measuring instrument

The results illustrating the internal reliability of the measuring instrument, as measured by the Cronbach alpha coefficients, are shown in Table 1.

Table 1: Cronbach alpha coefficients

<i>Factors</i>	<i>Cronbach alpha</i>
<i>Personalisation</i>	<i>0.894</i>
<i>Fees</i>	<i>0.909</i>
<i>Relationship marketing</i>	<i>0.948</i>

As evident from the table above, all the factors obtained Cronbach alpha coefficient scores above the recommended 0.70. As the Cronbach alpha coefficients indicate the reliability of the questionnaire items and the complete measuring instrument, it can be said that the measuring instrument is reliable and can be used for future studies. Relationship marketing had a high Cronbach alpha of 0.948, thus the items measuring relationship marketing can be regarded as reliable. The most reliable factor thought to influence relationship marketing was fees with a Cronbach alpha coefficient of 0.909.

### Linear modelling of bank-related variables

Table 2 illustrates the results from the linear modelling performed to identify whether the two selected variables influence relationship marketing in banks.

Table 2: Linear modelling results

<i>Factors</i>	<i>Estimate</i>	<i>p-value</i>
<i>Personalisation</i>	0.279	***
<i>Fees</i>	0.625	***

\*\*\* $p$ -value<0.001

The p-values for both variables personalisation and fees are significant at the 1% level. This provides support to the claim that both variables have an influence on banks' relationship marketing. Given that both parameter estimates are positive, this indicates that both personalisation and fees have positive relationships with the dependent variable, relationship marketing. This can be interpreted in the following way: if banks' personalisation efforts increase and improve and if their fee increases are fully justified, their client relationships would improve. The size of the estimate indicates which variable has the greatest influence. The empirical results of the study indicate that banking fees has the largest influence on relationship marketing.

Considering the above empirical results, one can conclude that both personalisation and fees have an impact on improving banks' client relationships. In addition, banks should be knowledgeable that clients' country of residence, population group and education level may influence their perceptions on banks' relationship marketing efforts.

#### **Bank managers' survey results**

As mentioned, the survey results of the bank managers' responses were analysed by considering the means of the variables as well as general comments provided by managers.

Generally, bank managers were very positive towards the current banking services that their bank employers provide to clients. This can be seen by looking at the means of the selected variables in Table 3.

Table 3: Means from bank managers

<i>Factors</i>	<i>Means</i>
<i>Personalisation</i>	5.161
<i>Fees</i>	5.144
<i>Relationship marketing</i>	5.222

The means in the table above indicate that the managers strongly agreed (a mean value of approximately 5) that their banks' personalisation efforts and fees are acceptable to clients. In addition, with a mean of 5.22 for relationship marketing, bank managers stated that their banks' relationship marketing efforts are currently satisfactory. However, selected issues that bank managers mentioned as concerns for their bank's service delivery are: bank employees should address clients by their first names (relating to personalisation), banks should attract

new clients with special fees (relating to fees) and banks should decrease switching costs to attract more clients (referring to positive relationship marketing strategies).

### **Contribution of the Study**

This study has been of significant value to South African banks to consider the relationship marketing strategies of Canadian and UK banks, as these banks are well known for their successful relationship marketing efforts. In particular, this study indicates that banks should adapt relationship marketing strategies for different groups or categories of clients, based on demographic variables.

The international nature of the study makes it unique and the study differs from previous research as it identifies selected bank-related and demographic variables influencing relationship marketing in banks while considering the viewpoints of both banking clients and bank managers.

Thus, it is foreseen that this study will contribute to the services marketing discipline through the provision of theoretical and empirical knowledge on relationship marketing in international banking industries, but specifically in South Africa and other developing countries. If contextualised, this study's valid and reliable measuring instrument can also be used in future relationship marketing studies in other industries.

### **Conclusions and Managerial Implications**

This study's main aim was achieved as the influence of bank-related and clients' demographic variables on banks' relationship marketing efforts was identified. The study provides insight into the relationship marketing of banks in South Africa, Canada and the UK. More specifically, the study provided insight into variables influencing banks' relationship marketing based on the viewpoints of both banking clients and bank managers. The empirical findings of this study have established that the personalisation of banking products and/or services and the fair structure of fees are focus areas for banks aiming to improve their client relationships. In addition, it was evident from the empirical findings that demographic variables, such as clients' country of residence, population group and education level, influence clients' perceptions regarding banks' relationship marketing. The empirical investigation led to a number of recommendations which can be provided to banks with regard to their relationship marketing and the variables influencing their efforts to improve relationships with banking clients. Strategies related to banks' personalisation efforts, fees and relationship marketing efforts towards different groups or categories of clients are highlighted, and a detailed discussion of these strategies is hereby provided.

Banks should personalise their offerings by means of coaching employees to address profitable clients by their first names to ensure that clients feel valued. Banks should adapt banking products and/or services to fit the needs of individual clients. In addition, banks should create special banking offers or packages for valued clients to promote personalisation

and mutually beneficial bank-client relationships. Special events, for example a personal financial planning seminar, should be offered to valued clients. As it was evident from the country comparisons, South African banks in particular can adopt personalisation strategies from Canadian banks. For example, in terms of personalisation, Canadian banks offer personalised greetings on automated teller machines (ATMs), use ATMs to automatically select clients' preferred language and offer special banking arrangements for new country residents.

Fees charges to clients should be justified by banks. Clients should be knowledgeable on the fees to be charged, the amounts, when it is to be charged and for which banking products and/or services. Fee structures should be clearly communicated by banks to their clients and adapted fee structures for specific categories of clients, for example retired clients, should be explained and justified, for example the reasons for annual fee increases. Specifically, the empirical results showed that South African banks can learn from UK banks' fee structures. UK banks offer special fee benefits to loyal clients and often implement 'recovering' or lower fees on accounts, for example credit card account payments when identifying clients who struggle financially.

To specifically improve relationship marketing banks should:

- offer a variety of and newly designed banking products and/or services to clients;
- ensure that managers are available for face-to-face appointments with clients; and
- build strong client relationships through effective communication with clients.

Concerning the demographic characteristics of banking clients, banks should be aware that clients of European ancestry and those with higher educational qualifications may regard relationship marketing strategies of a lower standard than other clients. Following these conclusions, it is recommended that banks need to focus on their service delivery to European and educated clients, as it may be more difficult to maintain bank-client relationships with these clients, to ensure that they are satisfied with the bank's services and that they will maintain a positive relationship with the bank. For example, educated clients might read more, ask more questions or have more queries regarding bank matters. Therefore, banks should ensure detailed sources of communication when interacting with educated clients. Based on the findings concerning the country of residence of clients, South African banking clients had less favourable or positive perceptions regarding their banks' relationship marketing. Thus, it is important for South African banks to promote and deliver on their relationship marketing promises. This would possibly instil positive images of South African banks' relationship marketing. For example, the assistance offered to clients by Relationship Bankers of banking institutions could be a focus of marketing campaigns.

The mean scores obtained from the bank managers' results show that managers strongly agreed that their banks' personalisation efforts and fees are acceptable to clients. However, a

study by Rootman (2011) indicates that clients do not share this same view. Therefore, it is important that banks align their managers' viewpoints concerning relationship marketing with the views of their clients. Thus, those banking aspects important to clients to maintain bank-client relationships should also be the focus of banks' managers. This way the offerings of banks would be satisfactory to clients and ensure stronger bank-client relationships.

The effective implementation of these mentioned strategies could lead to banks' improved relationship marketing and this may lead to higher customer satisfaction levels, more successful banks and a stronger economy.

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## THE USE OF E-TECHNOLOGY IN THE REPUBLIC OF CROATIA

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### Abstract

The process of transition comprises those European countries that have underwent a change from socialism to capitalism in the last 25 years. One of those countries is the Republic of Croatia. The role of Internet, which with its democratic nature contributes to this process, is certainly significant. Internet has become a medium implemented in various spheres of society.

In this paper we will revise how and to what extent do Croatian citizens use e-technology and compare those indicators to the ones in the EU. By means of a survey conducted on a random pattern we will determine the level of using individual elements of e-technology such as: e-government, e-banking, e-business, e-health. The aim of this research is to determine how much and when the examinees use the Internet and e-technology. To what extent is the Internet used for e-banking, to what extent for e-trade, and to what extent in judiciary and state administration. The research was conducted with examinees that had the opportunity of using the Internet daily. Results gathered by survey were processed and compared with EU figures using various statistical methods.

**Keywords:** Internet, technology, education, banking, trade, Croatia

### Introduction

Croatia is one of the European countries which have in the last quarter of the twentieth century underwent a transition from socialistic to capitalistic social system. This process of change in fact constitutes a transition that includes political as well as economic elements which contribute to the transition to neoliberal economy. That process brings both positive and negative effects in the political, socio-economic and socio-cultural spheres of life. One of the most important elements brought on by the process of transition is the growth of democracy and freedom of choice.

An unrelated, but simultaneous occurrence with the process of transition is a sudden increase in the implementation of Internet in everyday life. In this period Internet, so far a medium of complex utilization as a scientific tool, becomes an easy to use and cheap medium, available to general population. Strong implementation of the Internet lead to changes of

civilisation norms and cultures of living and brought new sociological phenomena which would never have existed without such a liberal, cheap and anonymous communication infrastructure. There is not a country in the world in which there is such freedom and human rights as there is on the Internet, but in the same time there is not a country in the world governed by such an uncontrollable, unregulated and anarchistic environment, as is the case with Internet. The Internet is based on three essential features: (1) spontaneity in the network development, which resulted in its uncontrollability, (2) the fundamental philosophy of its manifestation which manifested itself as a client-server architecture, (3) standardization of service, that is the services given by individual, individually and collectively, subjects via Internet. (Panian, 2002.) When investigating the relevance of Internet for the development of civil society, it constitutes one of the elements in the process of transition, as found in two extremely important elements: (1) free access to information on the Internet based on the economic possibilities of using the Internet and (2) civil freedom which incorporates freedom of expression and human rights when using this medium (Panian, 2002).

Thus it is unusually important in today's global society with great differences between the rich and the poor countries, as well as different priorities, but with a common goal of promoting social justice and equality, that all sectors, private, business and governmental, are actively included in the ICT process of making decisions. (Mijić, 2011)

Advantages that are offered in the development of an individual country by ICT refer to all parts of society, however it should be noticed that poor countries will in the future, due to the decreased possibilities of using these technologies, get even more behind wealthier countries, which have used access to information and the strong implementation of the Internet in all parts of society, especially economy, to create additional values and an improvement in the overall quality of life.

A medium this available, cheap and uncontrollable has offered the possibility of implementation in different areas, principally in the business of various economical entities which use it as means of promotion as well as distribution of their products to potential consumers. We therefore find the implementation of Internet within industrial production, that uses it as a promotional-distributive channel, in the sectors of banking, communication, tourism as well as education, health care systems and other areas of life.

### **Statistical Data on The Usage of The Internet in Croatia and EU 25**

According to e-Europe 2005[1] : Benchmarking indicators of monitoring the development of the informational society consist of: (1) Internet indicators, (2) modern public institutions on the Internet, (3) dynamic business environment, (4) safe informational infrastructure and (5) broadband connections.



This paper will examine the elements of dynamics in the business environment and modern public institutions on the Internet in the Republic of Croatia as relevant elements of development of the informational society.

Internet indicators include access and use of the Internet in parts of citizenry and the business sector, as well as the costs of access. In Croatia according to Gfk [2] research conducted on a representative pattern in 2011, 58% of citizens used the Internet, approximately 2.000.000 citizens over 15 years of age respectively. According to Eurostat's data in 2009, 50% of all Croatian households and 68% of the households in EU 25 have access to the Internet. According to the data of the Croatian Bureau Of Statistics [3] for the year 2010, 95% of Croatian companies have access to the Internet, while 97% use computers in business, same as the share of companies which own and use a computer in business in EU 25.

According to the Croatian Bureau Of Statistics 73% of all Internet users in Croatia use it daily, which makes almost 1,5 million citizens. According to Eurostat's data from 2009, 44% of the total population of Croatia used the Internet regularly, while in the EU 64% of the citizens used the Internet regularly. The purposes of using the Internet vary from fun and information to shopping and selling products and services.

*Table 1, The purpose of using the Internet in Croatian citizens*

PURPOSE	%
<i>Sending / receiving e-mails</i>	71
<i>Information on daily events</i>	64
<i>Searching for information on products / services</i>	60
<i>Using social networks</i>	57
<i>Information on health and nutrition</i>	38
<i>Online games, movies, music</i>	37
<i>Writing messages (news groups, forums, chat)</i>	34
<i>Uploading text, images – data exchange</i>	30
<i>Downloading programs, applications</i>	27
<i>E-banking</i>	25
<i>Looking for employment, sending offers</i>	23
<i>Searching for information on education etc.</i>	23
<i>Online radio / television</i>	21
<i>Tourist information</i>	18
<i>Online telephoning</i>	15

Source: [www.gfk.hr](http://www.gfk.hr) 20/04/2011

Modern public online services are usually divided on e-administration, e-education and e-health. It is precisely the use of these forms that contributes democratic openness and improves civil society in a country. The development of e-administration is measured through monitoring the level of availability of certain services intended for citizens and the

economy. According to the data given by the Croatian Bureau Of Statistics 63% of Croatian companies used the services of e-administration in the year 2010. E-health is one of the elements of democratic development especially manifested in the public creation of waiting lists and providing health related information for the citizens. In the social sciences, discussions of patients' use of home based e-health tools have concentrated on how health care service-initiated technologies govern patient identities and place new expectations on the patients, e.g. to act as "diagnostic agents" and take on responsibilities for tasks traditionally ascribed to health care professionals (Andreassen, 2011.). According to Eurostat's data 22,5% of Croatian citizens used the Internet to find health care information, while in the EU 25 33,9% of citizens used the Internet for the same purpose. When looking on the percentage of public services fully available online, there are 76% of such in the EU 25, and only 35% in Croatia.

As the main source of daily information 19% of Croatian citizens state the Internet as the primary medium. According to the data of the Croatian Bureau Of Statistics, 61% of Croatian companies have a web site in 2010.

E-business can be defined as the exchange of goods, services, and information and/or ideas using an electronic medium (for two good overviews of E-business, see Electronic commerce (E-commerce), including Web-based commerce, mobile commerce (M-commerce) and ubiquitous commerce (U-commerce), is based not only on developments pertaining to the Internet compound, but also on prior technological and organizational innovations arising from the combination of telecommunications and organizational computing (Zwass, 2003.). 67% of all companies in the EU 25 and 50% of all companies in Croatia have Internet access. The share of Internet commerce in the countries of EU 25 in the year 2007 was 4,2%, while that share in Croatia the same year was only 2,1%. Internet trade (e-trade) in Croatia is in a steady increase and according to the data given by the Croatian Bureau Of Statistics in the year 2010, 32% of companies purchase via Internet and 24% sell via Internet.

The banking and financial industry is transforming itself in unpredictable ways (Crane and Bodie, 1996), powered in an important way by advances in information technology (Holland and Westwood, 2001). Since the 1980s, commercial banking has continuously innovated through technology-enhanced products and services, such as multi-function ATM, tele-banking, electronic transfers, and electronic cash cards (Haghighi, Divandari and Keimasi; 2010.) In Croatia 85% of all companies used e-banking in 2010.

## **Research Methodology**

Basic quantity data on the use of certain elements of e-business are available in the general statistical data. The aim of this paper is to define the type and level of using the Internet services by the citizens of Croatia, location of access to the Internet, as well as reasons of more significant use of certain services. The research was conducted beginning Academic year 2009/10 on the sample of 72 examinees in Zadar with 30%, that is 22 members of the male sex

and 70%, that is 51 members of the female sex. The survey included students (63%) and other citizens (37%). The examinees were given an anonymous structured questionnaire with thirty one questions to which they answered by circling one of the offered answers. The results were processed using Microsoft Excel and Statistic methods of descriptive statistics.

Finally the results of the research will be compared to the data from Eurostat and the Croatian Bureau Of Statistics.

## Results and Discussion

Of 72 examinees 48,1% don't have any work experience, 46,5% worked part-time and only 5,4% work full-time. 19% of the examinees don't use computers at neither home nor at work, while 81% of the examinees use computers daily both at home and at work. The results are in accordance with the statistics of Croatian Bureau of Statistics.

Table 1 shows the results of the analysis of the answers on the question of Internet and computer usage. The offered answers are in form of a scale 1 to 7, where 1 signifies I don't use, and 7 means I use more than once a day.

*Table 1, Analysis of Computer Use*

Variables	Valid N	Mean	Minimum	Maximum	Std.Dev.
CHECKING E-MAIL	70	4,171429	1,000000	7,000000	2,186731
SURFING OF INTERNET	72	5,666667	1,000000	7,000000	1,853819
E-SHOPPING	72	1,444444	1,000000	4,000000	1,019328
E-BANKING	72	1,472222	1,000000	6,000000	1,266833
E-LEARNING	72	1,388889	1,000000	6,000000	0,986643
BLOGGING	72	1,500000	1,000000	5,000000	1,125893
FORUMS	72	2,194444	1,000000	6,000000	1,773321
FUN	72	3,500000	1,000000	7,000000	2,220202
OTHER	72	7,861111	1,000000	101,0000	15,95791

Looking at the results we notice that the survey participants use the computer most of all for surfing the Internet, then for checking e-mails, fun and access to forums. Participants use e-banking, e-shopping and e-learning very little. A large number of participants never heard of e-government (72,3%). Considerably more participants are familiar with the term e-health (66,7%) probably because they use the services of e-prescriptions and making doctor's appointments over the Internet. The number of participants familiar with the term e-banking is even larger (80,6%), and 27,8% of the participants would like to get education through e-learning. 75% of the survey participants use the services of e-banking, although a total of 80,6% are familiar with the term. The difference probably occurs because some of the participants are students and do not have their own bank accounts yet. Table 2 shows the results of the analysis of the answer to the question on using e-banking (average value, lowest

and highest grades and deviations from the average grade) in the purposes of household bills, personal finances, payment of loans, currency conversion, company business, other.

*Table 2, The Analysis of Using E-Banking in the Purposes of.*

Variables	Valid N	Mean	Minimum	Maximum	Std.Dev.
HOUSEHOLD BILLS	70	2,02857	1,00000	7,00000	1,99253
PERSONAL FINANCES	68	2,11764	1,00000	7,00000	2,05542
PAYMENT OF LOANS	66	1,36363	1,00000	7,00000	1,44260
CURRENCY CONVERS	66	1,39393	1,00000	7,00000	1,44519
COMPANY BUSINESS	66	1,57575	1,00000	7,00000	1,62727
OTHER	64	2,15625	1,00000	7,00000	2,19825

By analyzing the data from the table, we notice that e-banking is rarely used, and when it is used, that is for the purposes of paying household bills and taking care of personal finances. We were interested to find out what are the advantages of e-banking, e-administration and e-health. Participants rated the listed advantages on a scale from 1 to 7 where 1 signified it is not an advantage, and 7 absolute advantage. In the following tables average grades, lowest and highest grades of a certain advantage and deviations from the average grade are processed.

*Table 3, Advantages of e-banking*

Variables	Valid N	Mean	Minimum	Maximum	Std.Dev.
SAFETY OF BUSINESS AC	68	4,29411	1,00000	7,00000	2,23312
SPEED OF BUSINESS ACT	70	5,80000	1,00000	7,00000	1,78236
COMFORT OF BUSINESS	70	5,80000	1,00000	7,00000	1,78236
24 h AVAILABILITY	70	6,02857	1,00000	7,00000	1,65915
PROTECTION OF PRIVAC	68	5,23529	1,00000	7,00000	1,92483

*Table 4, Advantages of e-administration*

Variables	Valid N	Mean	Minimum	Maximum	Std.Dev.
SAFETY OF BUSINESS AC	62	4,77419	1,00000	7,00000	2,31473
SPEED OF BUSINESS ACT	62	5,54838	1,00000	7,00000	1,89630
COMFORT OF BUSINESS	62	5,74193	1,00000	7,00000	1,88118
24 h AVAILABILITY	62	5,61290	1,00000	7,00000	1,97820
PROTECTION OF PRIVAC	62	5,61290	1,00000	7,00000	1,85856

Table 5, Advantages of e-health care

Variables	Valid N	Mean	Minimum	Maximum	Std.Dev.
SAFETY OF BUSINESS ACTIVITY	62	5,51612	1,00000	7,00000	1,98140
SPEED OF BUSINESS ACTIVITY	62	5,96774	3,00000	7,00000	1,54673
COMFORT OF BUSINESS ACTIVITY	62	5,80645	1,00000	7,00000	1,78186
24 h AVAILABILITY OF SERVICE	62	5,58064	1,00000	7,00000	1,84256
PROTECTION OF PRIVACY	60	5,03333	1,00000	7,00000	2,17042

We notice that the main advantages of e-banking, e-administration and e-health are quick business activity, comfort of doing business from home and 24 hour availability of service. All participants noticed all listed advantages of these services and graded them highly. Let us now analyze the disadvantages of e-banking, e-administration and e-health care. The data is shown in tables 6, 7 and 8.

Table 6, Disadvantages of e-banking

Variables	Valid N	Mean	Minimum	Maximum	Std.Dev.
LACK OF SAFETY OF BUSINESS ACTIVITY	60	4,76666	1,00000	7,00000	2,56023
LOW SPEED OF BUSINESS ACTIVITY	60	4,06666	1,00000	7,00000	2,67991
COMFORT OF BUSINESS ACTIVITY	60	2,06666	1,00000	7,00000	2,01575
UNAVAILABILITY OF SERVICE	60	3,06666	1,00000	7,00000	2,55028
PROTECTION OF PRIVACY	56	2,17857	1,00000	7,00000	1,76951

Table 7, Disadvantages of e-administration

Variables	Valid N	Mean	Minimum	Maximum	Std.Dev.
LACK OF SAFETY OF BUSINESS ACTIVITY	60	4,30000	1,00000	7,00000	2,57958
LOW SPEED OF BUSINESS ACTIVITY	60	4,23333	1,00000	7,00000	2,57344
COMFORT OF BUSINESS ACTIVITY	60	1,76666	1,00000	7,00000	1,41860
UNAVAILABILITY OF SERVICE	60	4,10000	1,00000	7,00000	2,78433
PROTECTION OF PRIVACY	60	1,86666	1,00000	6,00000	1,55647

Table 8, Disadvantages of e-health

Variables	Valid N	Mean	Minimum	Maximum	Std.Dev.
LACK OF SAFETY OF BUSINESS ACTIVITY	60	4,76666	1,00000	7,00000	2,47952
LOW SPEED OF BUSINESS ACTIVITY	58	4,34482	1,00000	7,00000	2,65271
COMFORT OF BUSINESS ACTIVITY	58	1,96551	1,00000	7,00000	1,48637
UNAVAILABILITY OF SERVICE	58	4,27586	1,00000	7,00000	2,52561
PROTECTION OF PRIVACY	58	2,13793	1,00000	6,00000	1,62705

By analyzing the tables above, we notice that the examinees indicated unsafe business activity, slow business activity and unavailability of service as the biggest disadvantages.

We can conclude that examinees have unpleasant experiences with the slowness of offered services and that in order for more of them to use e-banking, e-administration and e-health, there should be an appropriate software assistance that would give users confidence to do this kind of business activity.

## Conclusion

Due to the process of transition in Croatia there is a sudden increase of information technology and Internet use. The aim of the paper was to define the type and level of use of online services of Croatian citizens, as well as the reasons for more significant use of certain services. We can conclude that in our country there is a high percentage of computer and Internet users, however our research on a chosen sample indicates that examinees still use the Internet and computer mostly for surfing the web, checking e-mail and fun, and are not sufficiently informed of the advantages of e-business and poorly use various forms of e-business. Given that investment in e-business, other than advantages for the user, also means a long term saving for employers, there should be more effort in the marketing of e-business, safety and availability of e-businesses such as e-banking, e-administration and e-health. Finally, the users should be educated on all the advantages of e-business and some currently present fears and doubts on e-business should be overcome.

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## DEVELOPING A STRATEGIC ALLIANCE: CASE STUDY OF PERUVIAN PHARMACEUTICAL LABORATORY

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### Abstract

The case seeks to identify some of the issues encountered in the development and growth of a family-owned firm in the pharmaceutical business in Lima, Peru. Having overcome the initial challenges of its establishment, the company has become a visible and viable competitor in the Peruvian market and is poised to expand in cross border markets by exploring the prospect of a strategic alliance with a suitable pharmaceutical firm or a chain store in these markets. Senior management must evaluate the issues associated with an alliance that entails manufacturing for foreign companies.

**Keywords:** Brands, patents, lines of credit, outsourcing, horizontal sales, chains, third-country manufacturing, strategic alliances.

### Introduction

Sofia Pernarella, an MBA student at ESAN University, Lima, Peru, was preoccupied with employment prospects upon completion of her studies when her advisor called her to his office to inform her of a six-month internship opportunity with a local pharmaceutical firm. He was quick to point out that it was a paid internship and that this opportunity could develop into a permanent position with the firm if the senior management was satisfied with her performance.

Sofia lost no time in following through and arranging for an interview with the designated company executive. A week later she started work at the Pharmaceutical Laboratory of Peru (in spanish Laboratorio Farmaceutico Peruano or LAFAPE) and went through a month-long rotational training to gain insights into the company's operations and scope of activities. As she wondered on her next assignment, Sofia received a call from the office of the Chief Executive Officer (CEO), Mr. Fausto Libayro, who expressed the interest to meet with her. Apprehensive as to the nature of the meeting, she quickly felt at ease when Mr. Libayro asked her about her impressions of the company and listened to her very attentively. In the course of the meeting he encouraged her to undertake a thorough review of the company operations and make recommendations on its development prospects. She agreed to have the report ready in a month's time and make a presentation of the key issues.

Cognizant that this report could result in her full time employment with the firm, Sofia reflected on the need to look for information and combine data from three different sources. She felt appropriate to first familiarize herself with the pertinent literature on the international expansion of manufacturing enterprises and any leads that this venue offered for the company's potential development. Next she sensed the need to compile information about the state of the pharmaceutical industry in Peru and its relative importance for the country. The literature on international expansion and the domestic trends of the pharmaceutical industry provided, Sofia felt, the appropriate framework for discussion of the company's background and operations, financial performance, and objectives. Hence the sequence of the sections below.

### **The Internationalization Process in Literature**

The development and growth of multinational corporations in response to the dynamics of a changing and increasingly competitive international environment, have given rise to a body of theory that addresses different aspects of this subject. This is to be expected considering prevailing differences in the extent, form and pattern of firms' international operations, and the variations in company-specific characteristics, products produced, and markets served.

One of the theories (Eiteman et al., 2010) that sought to explain the internationalization impetus of a firm, refers to this development as the *globalization process*. It describes this process as a progression in business activity entailing structural and managerial changes and challenging experiences for the firm. This theory identifies three distinct phases in this sequential process--the domestic phase, the international trade phase and the multinational phase. In the *domestic phase*, the firm (usually a family-owned business) builds its operations slowly as it tries to develop a competitive advantage. Its manufacturing and service inputs originate in local sources, and its product sales are directed to local customers. Transactions are denominated in local currency and the credit quality of all suppliers and customers is determined on the basis of domestic guidelines. Existence of a competitive home market can enhance a firm's visibility and viability and sharpen its competitive advantage. Expansion drive to take advantage of opportunities in foreign markets, or comparative advantages of particular locations, would thrust the firm into the *international trade phase*. Import of inputs from foreign sources and export of products and services to foreign buyers are typical of this stage and entail increased challenges for the firm's financial management. First, foreign currency payments and receipts expose the firm to currency fluctuations and consequently to foreign exchange risk. Second, differences in foreign business practices and legal systems render more difficult the evaluation of the credit quality of foreign buyers and sellers and hence the management of credit risk. As firms learn more about foreign market conditions, payment conventions and financial institutions, they feel more confident in increasing their physical presence abroad. At this stage the company progresses to the next phase, the



*multinational phase*. A variety of strategic alternatives are associated with this phase including the undertaking of foreign direct investments (FDI) and control of assets abroad.

The OLI paradigm (Buckley and Casson, 1976; Dunning, 1977) explains why multinational enterprises choose direct investment (wholly owned subsidiaries) to other alternative modes of entry in foreign markets (e.g., licensing, joint ventures, management contracts, and exporting). The paradigm identifies three important considerations for a firm's foreign direct investment to be successful--"O" or ownership of firm-specific competitive advantage in the home market that can be transferred abroad; "L" or (selection of suitable) location that will allow the firm to exploit its competitive advantage; "I" or internalization, maintaining effective control of the competitive advantage abroad by transferring it within the firm's own organization.

Ownership of assets and companies in foreign countries create a high profile for a multinational enterprise and consequently it exposes its FDI to political risk--political events that can undermine the economic viability and performance of the firm in these countries. Political risk can range from seizure of property (expropriation) to goal conflict between a multinational and its host government (governance risk) and limitations on the transfer funds out of the host country (blocked funds).

### **The Pharmaceutical Industry in Peru**

With a population in excess of 30 million, Peru is establishing itself as one of the best performing economies in Latin America. While the 1990s stand out for the introduction of market-oriented economic reforms and privatizations that initiated the transformation of the country, economic policy from the turn of the century onward concentrated on the pursuit of sustained growth and macroeconomic stability. The country's economic performance in recent years is evidenced by its current record which includes one of the lowest inflation rates in the region and a gross domestic product (GDP) growth which is expected to attain an increase of 5.1 percent in real terms in 2011. With economic prosperity overly concentrated in Lima and other major centers, urban demand for improved healthcare and pharmaceutical products, has increased significantly. This development has contributed, in turn, to increased regulatory oversight to ensure against drug counterfeiting and piracy.

The pharmaceutical market in Peru at year-end 2010 amounted to a little over \$750 million which represented a fourfold expansion over the corresponding 1995 figure. Given current country projections for sustained economic growth between 2011 and 2016, the size of the pharmaceutical market will continue to expand throughout this period. Industry forecasts estimate market growth to remain in the same range, between 17 to 20 percent per year. Clearly, if one considers that the rural communities have yet to experience the benefits of improved healthcare, market prospects will increase further over time.

Lima, being the capital of Peru, has a sizeable urban population and concentration of economic prosperity, and accounts for 60 percent of the total market for pharmaceutical products. Overall, the national market is made up of three component parts, horizontal sales, chains, and institutional.

- **Horizontal Sales:** This market is made up of private clinics and pharmacies served by distributors (Distribuidora QS and Distribuidora AS). Spot sales amount approximately to 14,000 (stores, sales points).
- **Chains:** As implied, this market is made up of different chains operating in the Peruvian market. Some of the more important chains in this category are: Drogueria los Andes, Arcangel, Boticas y Salud, Mi Farma, FASA, BTL, America Salud, Norfarma, Boticas y Salud, and Cadena Nacional de Medicinas
- **Institutional:** This market is made up of Peruvian State agencies such as Social Security (ESSALUD) and the Health Ministry (MINSA). Accounting for about 30 percent of the total, this market underwent important changes in 2006 when the government agencies switched out of the brand products into the generic drug market. This move resulted from the government need to cope with the pharmaceutical needs of a rising population. Procurement of this market is provided by pharmaceutical firms.

### Company Background and Operations

In the summer of 2002, Mr. Fausto Libayro, prompted by his pharmacist father, established in Lima, Peru, a family company owned jointly by himself, his father and his sister. The objective of the firm was to engage in the sale of pharmaceutical products both under its own brands as well as generic. He named the business Commercial Labo Medical Products (in Spanish Comercializadora Labo Medical or LABO). Once the company was formed he sought to comply with industry regulation by registering its brands with DIGEMID, the Peruvian drug control entity that is equivalent to the Federal Drug Administration (FDA) in the United States.

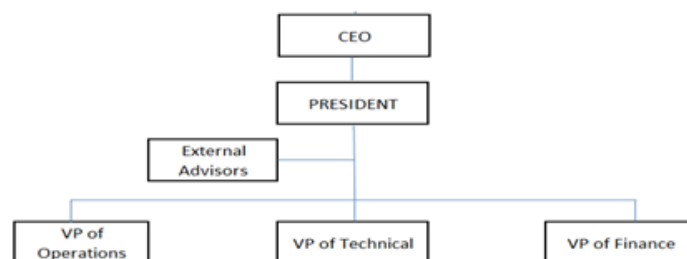
Initially the company strategy was to expand the scope of its activities by manufacturing pharmaceutical products for the account of different laboratories, both Peruvian and foreign, that were authorized by DIGEMID as third-party manufacturers. The targeted products ranged from such items as pills and syrups to ointments and creams.

The company's senior management consisted of Fausto himself and his older sister Macarena. Although they both had completed their undergraduate studies and had earned their MBA degrees from ESAN University, their professional interests diverged. Fausto was more focused in financial management while his sister was more experienced in the development of new business. As a result, Fausto addressed the company's financial aspects and oversaw operations while Macarena dealt with the expansion of existing products and markets and the entry into new ones.

The company had completed four years in operation when some important developments appeared to challenge its management and company strategy. In 2004 Peru initiated negotiations for a Free Trade Agreement with the United States<sup>1</sup> which it signed in April 2006. The agreement extended to U.S. exporters of pharmaceutical products greater market opportunities in Peru and afforded pharmaceutical companies favorable intellectual property rights on patented drugs. These provisions on brands and patents raised important concerns for the continued competitiveness of the company. These concerns preoccupied the owners who decided to address them by creating a new startup through investment in a manufacturing pharmaceutical laboratory. The new firm would manufacture both LABO products and those of other domestic and regional firms thus positioning itself to take advantage of the government overtures to sign free trade agreements with other countries and turn Peru into a regional operational hub.

It was against this background of developments that LAFAPE was created. The company's organizational structure, depicted in Figure 1, included three units--Technical (dealing with chemical issues), Operations, and Finance--each headed by a vice president with significant experience in the respective field. Aside from Macarena Libayro who was a LABO executive prior to assuming the company's presidency, the other administrators were hired after a careful search in the pharmaceutical industry both at home and abroad. Although the new hires were local nationals with some 30 years of experience in their respective fields, the company recognized the need to hire in the future foreign candidates to benefit from their knowledge of foreign markets. The new administrative team and their respective units were as follows: Cristian Tambor was placed in charge of the Technical unit, Guillermo Roma took over Operations, and Cesar Dewing Finance. The company's CEO position was given to the father in an honorary recognition of his reputation and experience in the field.

*Figure 1 Organizational Chart*



Once the new venture was legally established, the company's senior management set out to meet with the Peruvian banks that LABO had maintained a working relationship to apprise them of LAFAPE and the need for credit facilities to finance its operations. LABO's

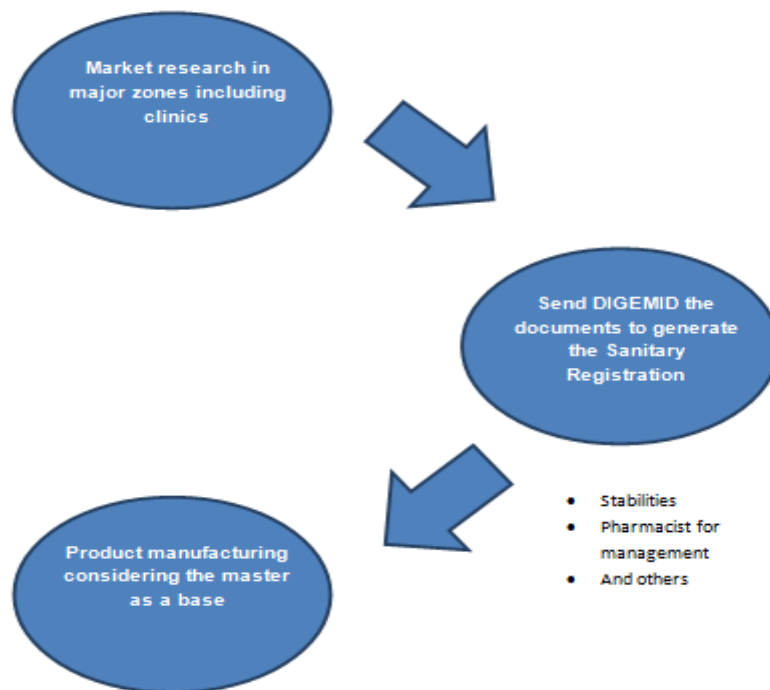
credit facilities with Peruvian banks are identified in Table 1. As seen in this table, the company had lines of credit with four institutions, totaling \$860,000.

*Table 1 Available Lines of Credit to LABO*

<i><b>Banking Institution</b></i>	<i><b>Amount of Credit Facility</b></i>
<i>PCB</i>	<i>\$350,000</i>
<i>Banco AVBB</i>	<i>250,000</i>
<i>Banco Canada</i>	<i>140,000</i>
<i>Banco Comercial</i>	<i>120,000</i>
<i>Total</i>	<i>\$860,000</i>

LAFAPE assumed immediately the manufacturing of LABO's 85 brand and 40 generic products, and sought to take on any other business originating from Peruvian, Latin American and global companies. For a pharmaceutical company to operate in Peru and manufacture products (medicines) for third parties, it ought to be accredited with Good Manufacturing Practices (BPM, for its name in spanish Buenas Practicas de Manufactura). BPM accreditation included GSP, that is, Good Storage Practices (BPA, for its name in spanish Buenas Prácticas de Almacenaje). LAFAPE satisfied the requirements for these designations and was now also in the process to qualify for ISO (International Organization of Standardization<sup>2</sup>) 9001: 2008 (quality) and ISO 14000 certification (environment) .

Both the brand and generic products manufactured by LAFAPE enjoy a diverse market. The process to identify and size the market for each of these products has been a challenging process as it needs to take account of individuals who are end consumers and a variety of different entities (e.g., clinics and hospitals). Figure 2 identifies the process to establish the size of the market and its effect on product manufacturing.

*Figure 2 Determining market size and its effect on product manufacturing*

Over time LAFAPE has introduced cutting-edge technology which has increased its production efficiency. Its manufacturing activity has grown to include approximately 250 products while its current capacity amounts to about 500. Table 2 highlights plant capacity by production line and corresponding monthly output. This growth momentum has prompted relocation of the company's offices to the LAFAPE facility in the Lurin business center, a suburb of Lima.

*Table 2 Plant capacity*

<i>Production Line</i>	<i>Amount per Month</i>	<i>Turns used</i>	<i>Maximun Turns</i>
<i>Liquids</i>	<i>250,000 bottles of 60ml</i>	<i>1 turn</i>	<i>2 to 12 hours 3 to 8 hours</i>
<i>Tablets, capsules and pills</i>	<i>30,000,000 Small</i>	<i>1 turn</i>	<i>2 to 12 hours 3 to 8 hours</i>
<i>Tablets, capsules and pills</i>	<i>20,000,000 Medium</i>	<i>1 turn</i>	<i>2 to 12 hours 3 to 8 hours</i>
<i>Creams</i>	<i>150,000 Tube of 60 gr</i>	<i>1 turn</i>	<i>2 to 12 hours 3 to 8 hours</i>

The company buys its raw materials from a number of foreign sources. Inputs are identified in each master or layout or manufacturing log, which is specific to each product. The main countries, where raw materials or active ingredients (generic substances) are bought from include China, India, Germany and the United States.

In the early years of its operation, LABO had pursued the practice of outsourcing several of its assembly lines. This practice however contributed to the emergence of laboratories that registered their own products and evolved into LAFAPE competitors. Some of the more important such competitors include:

- Medco
- Induchemical
- Carrion
- Cipa

LAFAPE is active in the country's three main pharmaceutical markets--Horizontal Sales, Chains and Institutional. In the Chains category, LAFAPE serves the three large business: Drogueria los Andes, Arcangel, and Boticas y Salud.

### **Financial Performance**

LABO and LAFAPE performance has grown significantly in the few last years. Although in the initial stage of its establishment LAFAPE had faced some financial difficulties these were effectively addressed and allowed the company to pursue a sustained growth momentum. The problems arose when the company fell behind payment of a land leasing instalment. This situation led one of the local banks to consider the termination of the credit facility it had extended to the company. Fausto lost no time in hiring a financing and restructuring consultant to address this problem. Improvement in the management of the company's cash cycle combined with a revised land and machinery lease agreement rectified the issue and averted any bank action that would have undermined the operations of LAFAPE.

LAFAPE sales policy has been 90 percent credit and 10 percent cash in an effort to build market share. The accounts receivable turnover is about 120 days. When clients send in their purchase orders, there is an inventory check and if the product is in stock it is dispatched to the client in no more than 7 calendar days. If the product is not in stock, the order is sent to the production facility for manufacturing. Manufacturing time schedules vary between 15 and 90 days, depending on the availability of raw material stocks.

Raw material supply accounts for almost 50 percent of production cost. Purchases are made on a 90 days credit. Past the payment due date, purchases are financed by the local banks for a maximum of a 60-day term. There are three main sources of raw materials procurement--Asia, America and Europe. Asia accounts for almost 50 percent of procurement while America and Europe for approximately 25 percent each.

The financial performance of both LABO and LAFAPE for the period 2008-2011 is depicted in the balance sheet and income statements cited in Tables 3,4,5 and 6. Expressed in Nuevo Soles, the national currency of the country, these statements were audited by the local office of a major U.S. accounting firm.

**Table 3 LABO Medical**  
Income Statement, 2008-2011

	Amounts in Nuevo Soles				Common-size statement			
	2011 April	2010 Dec	2009 Dec	2008 Dec	2011 Dec	2010 Dec	2009 Dec	2008 Dec
Sales	4,366,525.79	12,167,146.80	10,021,151.26	7,054,502.00				
Discounts	0.00	0.00	0.00	0.00	0.0%	0.0%	0.0%	0.0%
Net sales	4,366,525.79	12,167,146.80	10,021,151.26	7,054,502.00	100.0%	100.0%	100.0%	100.0%
Cost of good sold	2,429,082.42	6,159,382.35	4,681,861.00	1,812,462.00	55.6%	50.6%	46.7%	25.7%
<b>Gross Profit</b>	<b>1,937,443.37</b>	<b>6,007,764.45</b>	<b>5,339,290.26</b>	<b>5,242,040.00</b>	<b>44.4%</b>	<b>49.4%</b>	<b>53.3%</b>	<b>74.3%</b>
Operating expenses								
Administrative expenses	632,934.36	1,891,609.05	1,858,337.47	1,830,920.00	14.5%	15.5%	18.6%	26.0%
Sales expenses	778,026.98	2,399,996.23	2,195,493.89	2,196,508.00	17.8%	19.7%	21.9%	31.1%
<b>Operating Income</b>	<b>526,482.03</b>	<b>1,716,159.17</b>	<b>1,275,458.90</b>	<b>1,214,612.00</b>	<b>12.1%</b>	<b>14.1%</b>	<b>12.7%</b>	<b>17.2%</b>
Interest expenses	244,620.71	1,102,370.82	1,915,723.57	748,689.00	5.6%	9.1%	19.1%	10.6%
Interest income	1,240.46	383,772.76	1,081,612.48	9,610.00	0.0%	3.2%	10.8%	0.1%
Other income	79,830.00	639,191.54	277,992.48	1,277,977.00	1.8%	5.3%	2.8%	18.1%
Other expenses	0.00	297,030.79	43,781.72	16,720.00	0.0%	2.4%	0.4%	0.2%
<b>Earnings Before Taxes (EBT)</b>	<b>362,931.78</b>	<b>1,339,721.86</b>	<b>675,558.57</b>	<b>1,736,790.00</b>	<b>8.3%</b>	<b>11.0%</b>	<b>6.7%</b>	<b>24.6%</b>
Employee participation	0.00	113,886.73	62,822.11					
Legal reserves	0.00	0.00	39,607.00					
Taxes	108,879.53	392,909.23	216,736.29	521,037.00	2.5%	3.2%	2.2%	7.4%
<b>Net Income</b>	<b>254,052.25</b>	<b>832,925.90</b>	<b>356,393.17</b>	<b>1,215,753.00</b>	<b>5.8%</b>	<b>6.8%</b>	<b>3.6%</b>	<b>17.2%</b>

Source: Data provided by the LAFAPE management.

**Table 4 LABO Medical**  
Balance Sheet, 2008-2011

	Amounts in Nuevo Soles				Common-size statement			
	2011 April	2010 Dec	2009 Dec	2008 Dec	2011 Dec	2010 Dec	2009 Dec	2008 Dec
<b>Assets</b>								
<b>Current Assets</b>								
Cash	10,598.00	296,860.00	109,215.00	65,889.00	0.0%	1.4%	0.5%	0.4%
Accounts receivable	8,349,473.00	6,240,871.00	6,065,039.00	4,608,231.00	36.7%	29.2%	28.5%	27.3%
Inventories	1,002,379.00	1,554,145.00	1,265,010.00	323,434.00	4.4%	7.3%	6.0%	1.9%
Raw materials	520,773.00	0.00	1,216,180.00	2,343,737.00	2.3%	0.0%	5.7%	13.9%
Other current assets	1,493,060.00	1,517,047.00	1,789,273.00	0.00	6.6%	7.1%	8.4%	0.0%
Prepaid assets	2,329,330.00	2,185,007.00	1,600,218.00	1,205,833.00	10.2%	10.2%	7.5%	7.1%
<b>Total Current Assets</b>	<b>13,705,613.00</b>	<b>11,793,930.00</b>	<b>12,044,935.00</b>	<b>8,547,124.00</b>	<b>60.2%</b>	<b>55.2%</b>	<b>56.7%</b>	<b>50.6%</b>
<b>Non-Current Assets</b>								
Other assets	2,385,848.00	2,666,188.00	1,855,005.00	0.00	10.5%	12.5%	8.7%	0.0%
Buildings and equipment	7,813,024.00	7,777,570.00	7,922,785.00	8,585,661.00	34.3%	36.4%	37.3%	50.9%
Less accumulated depreciation	(1,144,234.00)	(858,175.00)	(568,920.00)	(253,500.00)	5.0%	4.0%	2.7%	1.5%
<b>Total Non-Current Assets</b>	<b>9,054,638.00</b>	<b>9,585,583.00</b>	<b>9,208,870.00</b>	<b>8,332,161.00</b>	<b>39.8%</b>	<b>44.8%</b>	<b>43.3%</b>	<b>49.4%</b>
<b>Total Assets</b>	<b>22,760,251.00</b>	<b>21,379,513.00</b>	<b>21,253,805.00</b>	<b>16,879,285.00</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
<b>Liabilities and Stockholders' Equity</b>								
<b>Current Liabilities</b>								
Bank loans	12,340,072.00	8,157,787.00	7,413,859.00	3,294,782.00	54.2%	38.2%	34.9%	19.5%
Taxes	307,316.00	245,451.00	256,576.00	536,957.00	1.4%	1.1%	1.2%	3.2%
Salaries and wages	138,029.00	104,897.00	76,121.00	89,696.00	0.6%	0.5%	0.4%	0.5%
Accounts payable	1,002,967.00	3,129,458.00	3,218,769.00	1,933,346.00	4.4%	14.6%	15.1%	11.5%
Other current liabilities	0.00	0.00	214,420.00	40,644.00	0.0%	0.0%	1.0%	0.2%
<b>Total Current Liabilities</b>	<b>13,788,384.00</b>	<b>11,637,593.00</b>	<b>11,179,745.00</b>	<b>5,895,425.00</b>	<b>60.6%</b>	<b>54.4%</b>	<b>52.6%</b>	<b>34.9%</b>
<b>Non-Current Liabilities</b>								
Long term loans	3,076,041.00	4,209,027.00	5,546,458.00	6,752,212.00	13.5%	19.7%	26.1%	40.0%
Shareholders' debt	0.00	1,268,690.00	1,096,321.00	545,844.00	0.0%	5.9%	5.2%	3.2%
<b>Total Non-Current Liabilities</b>	<b>3,076,041.00</b>	<b>5,477,717.00</b>	<b>6,642,779.00</b>	<b>7,298,056.00</b>	<b>13.5%</b>	<b>25.6%</b>	<b>31.3%</b>	<b>43.2%</b>
<b>Total Liabilities</b>	<b>16,864,425.00</b>	<b>17,115,310.00</b>	<b>17,822,524.00</b>	<b>13,193,481.00</b>	<b>74.1%</b>	<b>80.1%</b>	<b>83.9%</b>	<b>78.2%</b>
<b>Equity</b>								
Shareholders' equity	3,294,727.00	3,294,727.00	2,902,226.00	2,229,216.00	14.5%	15.4%	13.7%	13.2%
Additional capital	1,268,690.00	0.00	0.00	0.00	5.6%	0.0%	0.0%	0.0%
Legal reserves	219,844.00	136,550.00	136,551.00	65,754.00	1.0%	0.6%	0.6%	0.4%
Accumulated net income	749,633.00	832,926.00	36,109.00	175,081.00	3.3%	3.9%	0.2%	1.0%
Net income	362,932.00	0.00	356,393.00	1,215,753.00	1.6%	0.0%	1.7%	7.2%
<b>Total Equity</b>	<b>5,895,826.00</b>	<b>4,264,203.00</b>	<b>3,431,279.00</b>	<b>3,685,804.00</b>	<b>25.9%</b>	<b>19.9%</b>	<b>16.1%</b>	<b>21.8%</b>
<b>Total Liabilities and Equity</b>	<b>22,760,251.00</b>	<b>21,379,513.00</b>	<b>21,253,803.00</b>	<b>16,879,285.00</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Source: Data provided by the LAFAPE management.



**Table 5** LAFAPE  
Income Statement, 2008-2011

	Amounts in Nuevo Soles				Common-size statement			
	2011 April	2010 Dec	2009 Dec	2008 Dec	2011 Dec	2010 Dec	2009 Dec	2008 Dec
Sales	2,876,886.05	9,864,551.36	6,276,153.86	183,301.00				
Discounts	0.00	0.00	0.00	0.00	0.0%	0.0%	0.0%	0.0%
Net sales	2,876,886.05	9,864,551.36	6,276,153.86	183,301.00	100.0%	100.0%	100.0%	100.0%
Cost of good sold	1,985,339.06	6,973,916.15	3,154,403.54	68,210.00	69.0%	70.7%	50.3%	37.2%
<b>Gross Profit</b>	<b>891,546.99</b>	<b>2,890,635.21</b>	<b>3,121,750.32</b>	<b>115,091.00</b>	<b>31.0%</b>	<b>29.3%</b>	<b>49.7%</b>	<b>62.8%</b>
Operating expenses								
Administrative expenses	235,294.60	541,091.92	1,103,242.83	37,353.00	8.2%	5.5%	17.6%	20.4%
Sales expenses	22,314.75	0.00	1,043,732.97	21,909.00	0.8%	0.0%	16.6%	12.0%
<b>Operating Income</b>	<b>633,937.64</b>	<b>2,349,543.29</b>	<b>974,774.52</b>	<b>55,829.00</b>	<b>22.0%</b>	<b>23.8%</b>	<b>15.5%</b>	<b>30.5%</b>
Interest expenses	118,439.97	979,546.12	197,695.66	1,358.00	4.1%	9.9%	3.1%	0.7%
Interest income	0.00	76,795.16	107,475.98	747.00	0.0%	0.8%	1.7%	0.4%
Other income	6,013.27	57,880.05	48.06	0.00	0.2%	0.6%	0.0%	0.0%
Other expenses	0.00	106,650.70	12,661.94	0.00	0.0%	1.1%	0.2%	0.0%
<b>Earnings Before Taxes (EBT)</b>	<b>521,510.94</b>	<b>1,398,021.68</b>	<b>871,940.96</b>	<b>55,218.00</b>	<b>18.1%</b>	<b>14.2%</b>	<b>13.9%</b>	<b>30.1%</b>
Employee participation	0.00	148,886.77	92,518.25					
Legal reserves	0.00	0.00	53,623.00					
Taxes	156,453.28	401,994.27	249,799.28	16,565.00	5.4%	4.1%	4.0%	9.0%
<b>Net Income</b>	<b>365,057.66</b>	<b>847,140.64</b>	<b>476,000.43</b>	<b>38,653.00</b>	<b>12.7%</b>	<b>8.6%</b>	<b>7.6%</b>	<b>21.1%</b>

Source: Data provided by the LAFAPE management.

**Table 6 LAFAPE**  
Balance Sheet, 2008-2011

	Amounts in Nuevo Soles				Common-size statement			
	2011 April	2010 Dec	2009 Dec	2008 Dec	2011 Dec	2010 Dec	2009 Dec	2008 Dec
<b>Assets</b>								
<b>Current Assets</b>								
Cash	446,385.00	7,820.00	4,573.00	5,721.00	5.9%	0.1%	0.1%	0.3%
Accounts receivable	2,379,205.00	3,079,335.00	1,993,259.00	218,128.00	31.5%	38.8%	48.6%	12.7%
Inventories	2,746,986.00	3,062,075.00	1,270,279.00	212,926.00	36.4%	38.6%	31.0%	12.4%
Raw materials	0.00	0.00	0.00	0.00	0.0%	0.0%	0.0%	0.0%
Other current assets	20,851.00	16,645.00	135,879.00	0.00	0.3%	0.2%	3.3%	0.0%
Prepaid assets	348,110.00	262,574.00	133,114.00	47,767.00	4.6%	3.3%	3.2%	2.8%
<b>Total Current Assets</b>	<b>5,941,537.00</b>	<b>6,428,449.00</b>	<b>3,537,104.00</b>	<b>484,542.00</b>	<b>78.8%</b>	<b>81.1%</b>	<b>86.3%</b>	<b>28.2%</b>
<b>Non-Current Assets</b>								
Other assets	0.00	131,990.00	1,365.00	44,224.00	0.0%	1.7%	0.0%	2.6%
Buildings and equipment	1,734,431.00	1,471,468.00	596,995.00	1,187,602.00	23.0%	18.6%	14.6%	69.2%
Less accumulated depreciation	(134,131.00)	(101,704.00)	(36,121.00)	0.00	1.8%	1.3%	0.9%	0.0%
<b>Total Non-Current Assets</b>	<b>1,600,300.00</b>	<b>1,501,754.00</b>	<b>562,239.00</b>	<b>1,231,826.00</b>	<b>21.2%</b>	<b>18.9%</b>	<b>13.7%</b>	<b>71.8%</b>
<b>Total Assets</b>	<b>7,541,837.00</b>	<b>7,930,203.00</b>	<b>4,099,343.00</b>	<b>1,716,368.00</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
<b>Liabilities and Stockholders' Equity</b>								
<b>Current Liabilities</b>								
Bank loans	3,579,379.00	2,589,949.00	1,422,250.00	60.00	47.5%	32.7%	34.7%	0.0%
Taxes	7,093.00	301,677.00	370,709.00	0.00	0.1%	3.8%	9.0%	0.0%
Salaries and wages	228,085.00	0.00	177,889.00	0.00	3.0%	0.0%	4.3%	0.0%
Accounts payable	1,300,922.00	2,298,758.00	1,323,240.00	305,044.00	17.2%	29.0%	32.3%	17.8%
Other current liabilities	0.00	0.00	26,295.00	0.00	0.0%	0.0%	0.6%	0.0%
<b>Total Current Liabilities</b>	<b>5,115,479.00</b>	<b>5,190,384.00</b>	<b>3,320,383.00</b>	<b>305,104.00</b>	<b>67.8%</b>	<b>65.5%</b>	<b>81.0%</b>	<b>17.8%</b>
<b>Non-Current Liabilities</b>								
Long term loans	305,087.00	924,690.00	26,339.00	1,187,602.00	4.0%	11.7%	0.6%	69.2%
Shareholders' debt	0.00	0.00	0.00	0.00	0.0%	0.0%	0.0%	0.0%
<b>Total Non-Current Liabilities</b>	<b>305,087.00</b>	<b>924,690.00</b>	<b>26,339.00</b>	<b>1,187,602.00</b>	<b>4.0%</b>	<b>11.7%</b>	<b>0.6%</b>	<b>69.2%</b>
<b>Total Liabilities</b>	<b>5,420,566.00</b>	<b>6,115,074.00</b>	<b>3,346,722.00</b>	<b>1,492,706.00</b>	<b>71.9%</b>	<b>77.1%</b>	<b>81.6%</b>	<b>87.0%</b>
<b>Equity</b>								
Shareholders' equity	695,100.00	695,100.00	219,100.00	185,000.00	9.2%	8.8%	5.3%	10.8%
Additional capital	0.00	215,369.00	0.00	0.00	0.0%	2.7%	0.0%	0.0%
Legal reserves	142,234.00	57,520.00	57,520.00	0.00	1.9%	0.7%	1.4%	0.0%
Accumulated net income	762,427.00	0.00	476,000.00	0.00	10.1%	0.0%	11.6%	0.0%
Net income	521,511.00	847,140.00	0.00	38,653.00	6.9%	10.7%	0.0%	2.3%
<b>Total Equity</b>	<b>2,121,272.00</b>	<b>1,815,129.00</b>	<b>752,620.00</b>	<b>223,653.00</b>	<b>28.1%</b>	<b>22.9%</b>	<b>18.4%</b>	<b>13.0%</b>
<b>Total Liabilities and Equity</b>	<b>7,541,838.00</b>	<b>7,930,203.00</b>	<b>4,099,342.00</b>	<b>1,716,359.00</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

*Note:* Official Soles/U.S. Dollar exchange rates for the dates of the financial statements in Tables 3 through 6 may be secured National Superintendency of Tax Administration (Superintendencia Nacional de Administración Tributaria or Sunat, Peru).<sup>1</sup>

*Source:* Data provided by the LAFAPE management.

Of the LABO financial statements cited above it is worth noting that commercial activities generated revenues at year-end 2010 in the amount of 12 million Nuevos Soles (Table 3) which represented a 72.47 percent increase over the corresponding year-end 2008 figure. The manufacturing performance of LAFAPE during the same period of time, contributed to an asset base at year-end 2010 of 7.9 million Nuevos Soles (Table 6) which represented a 362 percent increase over the year-end 2008 figure. Company revenues for the same period increased by 5,282 percent resulting to a year-end 2010 net income of 0.847 million Nuevos Soles (Table 5), a rate of return on equity of 46.67 percent.

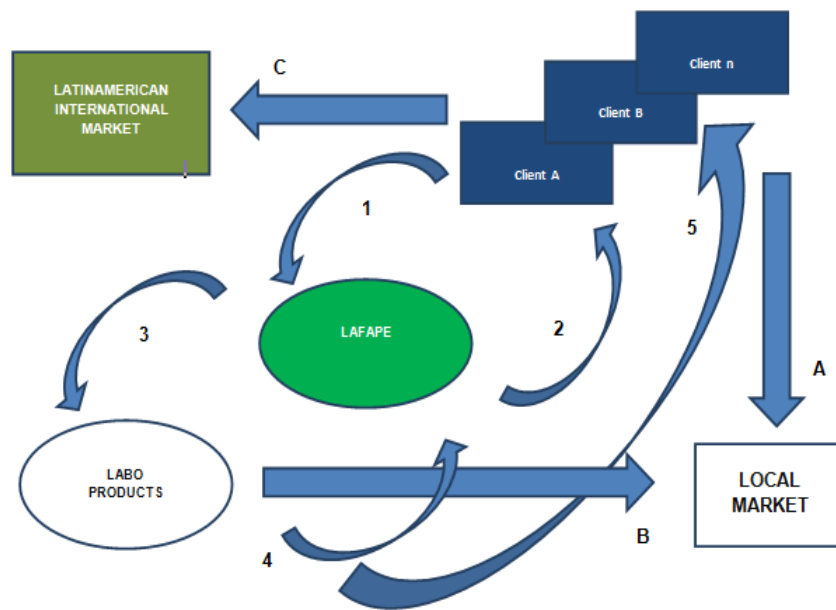
## Company Objectives

LAFAPE seeks to position itself not only as a major pharmaceutical firm in Peru but also in Latin America. The venue considered for attaining this objective is that of a strategic alliance. The term strategic alliance conveys a different meaning in different instances. In one form of cross-border strategic alliance, two firms exchange a share of ownership with one another--viewed as stable and friendly hands--to defend against a possible takeover. In a more comprehensive format this arrangement , in addition to exchanging stock, enables the establishment of a separate venture to develop and manufacture a product or service (e.g., this practice may be encountered in high tech industries where the cost of research and development is high and timely introduction of improvements is important). Another level might include joint marketing and servicing agreements in which a partner represents the other in certain markets.

For LAFAPE, the strategic alliance would be the vehicle to extend manufacturing capacity to foreign pharmaceutical companies, chains and other related clients. Although initially established to manufacture LABO products, LAFAPE has been authorized by DIGEMID, effective year-end 2009, to engage in third-party manufacturing for foreign pharmaceutical companies.

The free trade agreements that the Peruvian government is reviewing and signing, in the framework of the globalization trend, is creating major opportunities for the firm's growth potential. To capitalize on these opportunities LAFAPE would require additional credit lines to finance its working capital needs. Additionally, the firm would need to re-evaluate its credit strategy and currency exposure because of the resulting increase in sales to the "main chains." These clients invariably demand low product cost and high quality, which LAFAPE can easily meet. The company's installed capacity is up to date and in excellent condition. Its machinery is just three years of age and its useful life is 10 to 15 years. Appropriate preventative and corrective maintenance of the machinery would contribute to cost savings and enable the company to maintain its competitive edge.

Both LABO and LAFAPE complement each other with the former focusing on the marketing of its products to chains and directly (horizontal), while LAFAPE produces not only the "LABO" products, but also products for several chains and other laboratories. Figure 3 identifies this operational complementarity.

*Figure 3 LABO/LAFAPE operational complementarity*

The complementarity in the relationships of the two companies can permit the company to export its “services” to foreign laboratories (import the raw materials, produce the products and export them to foreign clients). Regional collaboration would result to important savings for the international clients, since Lima has maritime ports and an airport that offers easy and quick access to markets in regional proximity, such as Quito in Ecuador, Bogota in Colombia, and La Paz in Bolivia. Figure 4 shows the regional proximity of these markets and the respective potential for the participants in a strategic alliance.

*Figure 4 Proximity to foreign markets in the region*

Timely delivery of client orders would require expedient access to raw materials. Having expedient suppliers will improve not only delivery schedules but would also reduce costs and contribute to company competitiveness and increased visibility in international markets. This is especially important considering that the company's objective is direct product sales and manufacturing for third parties.

Table 7 identifies select important suppliers the company intends to contact through attendance to annual conferences in different countries. Their competitive pricing and delivery efficiency would translate into important financial benefits in the procurement of raw materials.

*Table 7 Select key suppliers of raw materials internationally*

- 
- Catalent, largest global CMO with a long-term supplier relationship with Wyeth
  - Lonza, key Swiss supplier in emerging markets (including China and India) with biopharmaceutical manufacturing capabilities
  - Boehringer Ingelheim, major firm offering extensive and well developed services
  - BASF, vendor of a full suite of pharmaceutical manufacturing services
  - Fareva, rapidly growing firm by purchasing facilities from pharma companies
  - Wockhardt, major India pharmaceutical and CRAMS company growing through acquisitions
  - DSM, significant operator in the United States, Europe and China. Owns the PER.C6 cell line and licenses it to various partners
  - Evonic, purchased remaining shares of its JV in China
  - Patheon, relationships with all of the top 20 pharma companies
  - Jubilant, Indian contract and research manufacturing company acquiring Canadian and US facilities
- 

*Source: Data provided by the LAFAPE management.*

## Drafting the Report

Sofia spent sometime thinking about the format and structure of her report. Although the company's growth momentum has been impressive she realizes that continued breakthroughs in the field of medical research will keep expanding the company's pharmaceutical prospects. In fact, Sofia thought, there are pharmaceutical product lines that the company can continue developing, such as heart, gastric and retroviral drugs. As several thoughts run through her mind she settled to address the basic issues by drafting a three part report along the following lines.

1. Present the major strengths and weaknesses of the company using bullet statements or phrases. She felt that at least three but no more than five statements in each case would be adequate.
2. Identify the company's key priorities (short and/or long term) and discuss the strategy to attain them.

3. Determine the issues associated with the establishment of a strategic alliance that entails manufacturing for foreign companies?

Sofia felt confident that this format would enable her to perform her assignment in a complete fashion and address any questions asked by the senior management.

#### End Notes

1 Free Trade Agreement -

<http://www.tlcperu-eeuu.gob.pe/index.php?ncategoria1=101&ncategoria2=133>

2 <http://www.iso.org/iso/home.html>

3 SUNAT web site - <http://www.sunat.gob.pe/cl-at-ittipcam/tcS01Alias>

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## ORGANIZATIONAL JUSTICE AND PERFORMANCE: APPRAISAL AND FAIRNESS

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### Abstract

In a changing economic climate, characterised by pressures to improve productivity and reduce costs, performance management has a more central role in helping to ensure competitive advantage. Appraisals have become an almost universal feature of modern organizations and it is essential that they are perceived as fair if they are to bring about commitment to discretionary effort, which is increasingly a key feature in gaining competitive advantage. This paper uses the concept of organizational justice to explore the outcomes, procedures and implementation of appraisal in contemporary organizations. It draws on a range of theoretical frameworks from both philosophy and social science, examines current practices and experiences and looks at future trends. Empirical research includes a ten year longitudinal study of practising managers and ethnography, questionnaires and interviews. It concludes that appraisal frequently creates both actual and perceived injustice in organizations and a tension between managing performance and encouraging engagement, which is dependent on perceptions of fairness.

**Keywords:** organizational justice, performance, appraisal, fairness

### Introduction

As organizations have developed more formal strategic processes, there has been some movement towards integration of organizational strategy with a more strategic approach from Human Resource Management. This has involved many organizations in the introduction of formal performance systems, frequently characterised by appraisals or performance reviews.

As the prevalence of performance appraisal has grown so its importance in shaping employee perceptions of justice has become more important. Outcomes and processes which are perceived as unfair in an organization will result in a workforce whose contribution through enthusiasm and “going the extra mile” is not fully achieved.

Organizational Justice is concerned with: the fairness by which the benefits and burdens of an Organization are allocated; the fairness of the process by which decisions are made and; the fairness of interpersonal treatment and information (Greenberg 1987,1990; Folger and Bies, 1989; Beugre 1998;).

Organizational Justice is a useful concept through which to examine the outcomes and processes of performance appraisal. It is core to the central psychological contract and to employee engagement and discretionary effort. It is also helpful if new developments in performance appraisal can be examined through this lens.

## **Aims**

This paper begins with an overview of the development of concepts of organizational justice, owing much to philosophers such as Plato to Rawls and moving on to the more recent contributions of social science. There is an examination of recent developments in appraisal from an organizational justice perspective and a statement of relevant research questions. The paper describes empirical work carried out by the authors, presents the findings from these studies and draws conclusions which are related back to other work and provides suggestions for future focus.

## **Literature**

### **Organizational justice**

Although social scientists have explored concepts of justice for over 60 years, it was not until the 1980s that the workplace became a focus for what has become known as organizational justice (Greenberg, 1987). Theorists have made a distinction between distributive justice – the fairness of outcomes- and procedural justice – the fairness of process to achieve these outcomes. More recently there has been a theoretical separation within procedural justice between how decisions are made and how they are implemented and communicated. This has led to a third category, that of interactional justice (Bies, 2001) which is sometimes subdivided into interpersonal justice- how people are treated and informational justice - how people are informed about why outcomes are distributed as they are and why particular procedures are used. Notions of distributive justice are grounded in political theory (Marx, 1969), they have also found applications in criminology to explain deviant behaviour (Lea and Young, 1996). Organizational justice began as Greenberg (1990:400) points out “to test principles of justice in general social interaction, not organizations in particular”. The early focus of Organizational Justice was in distributive justice grounded in the contributions of Homans (1961) and Adams (1963), whose equity theory suggested that workers compare their own input/output ratios with that of others. A corollary of this was that both behaviours and attitudes changed where there were disparities as workers attempted to achieve equilibrium.

Models of ethical outcomes go back considerably further. Aristotle considered justice to be people receiving that which they deserved. In the 18th Century Bentham(1789 ) considered the outcomes of utilitarianism/fairness to be happiness. Later commentators consider linkages of happiness to both work and personal performance (Blanchflower and Oswald, 2011).Stakeholder theory considers the ‘ sustaining corporation’ making a positive



contribution to human wellbeing (Clifton and Amran, 2011;123-124.). Deontological models consider rightness to be crucial and justice to be a reward in itself. Utilitarianism cites the importance of healthy, respectful and supportive organizational culture and fair treatment, security and recognition (Ashkanasy, 2011:25).

### **Appraisal**

Appraisal systems can result in unfair or inequitable distributions of organizational rewards and punishments. It is useful to begin with the purpose of appraisal. It is customary to distinguish between two different purposes of appraisal; administrative and developmental. Administrative appraisal is usually part of a performance management system and can result in increased pay and other rewards such as promotion, career opportunities or actions to remedy disciplinary or capability issues, perhaps resulting in dismissal. Developmental appraisal is related to enhancing individual performance and usually sits uneasily within a formal system. However, it can often result in differential access to organizational resources such as education and training.

If the outcomes of appraisal are considered unfair then it might explain the attitudinal and behavioural outcomes predicted by Adams, including reduction of effort and a lack of engagement. Where disparities are large it is expected that responses will be proportionally great.

Outcomes of appraisal may be perceived as unfair even when the procedures are objective. Where procedures are perceived as unfair, however, there is little hope of outcomes being perceived as fair. Much of the research into appraisal systems has focused on procedural aspects such as the reliability and validity of performance measurement, stakeholder involvement and providing feedback.

Folger and Bies (1989) identify seven procedural elements important to managers. These are:

- giving adequate consideration to employees' viewpoints
- suppressing bias
- applying decision-making criteria consistently across employees
- providing timely feedback to employees after the decision
- providing justification for the decision
- being truthful in communication
- treating employees with courtesy and civility

They are a useful guide to examine findings of research into appraisal.

### **Appraisal and performance management**

Since the late 1950s research into appraisal systems has shown repeatedly that schemes which link interviews with remuneration are at best unhelpful and at worst counterproductive (Maier, 1958; O'Neill, 1995; Oliver, 1996 and Prowse and Prowse, 2009). No evidence currently exists from any controlled study in the UK or USA to show that long-term improvements in the quality of performance result from appraisal-based extrinsic rewards. Nonetheless, providing information for remuneration purposes continued to be one of the major objectives of appraisal, along with objective setting and training needs analysis for employee development purposes (CIPD, 2009.)

A survey by IRS (1994) showed that managers ranked in descending order 'identifying training needs', 'improving individual/ corporate performance', 'encouraging manager-subordinate dialogue', 'bringing about cultural change' and 'succession planning and identifying individual potential.' These were all more important than 'assessing performance to determine individual performance-related pay' which was ranked as last in order of importance. These findings are reflected in more recent studies (Armstrong and Baron, 2005; CIPD, 2009.) Even when pay is removed from the equation, the remaining reasons for introducing performance appraisals are conflicting rather than congruent. American research indicates that appraisals are used for multiple purposes in addition to the above; these include promotions, lay-offs, transfers and terminations (Thomas and Bretz, 1994; Smith et al, 1996).

The diversity of reasons for using appraisal are reflected in the variety of assessment measures, which are employed. These can be classified as: traits, behaviours and outcomes (Marchington and Wilkinson, 1996). Traits such as commitment, reliability and conscientiousness have traditionally been measured by graphic rating scales. Behaviour has been measured through behaviourally anchored rating scales (BARS) and, more recently, through competence-based assessment. Outcomes have been appraised through management by objectives (MBO) or by direct measurement of output, sales, quality or other quantifiable criterion. There has been a tendency for more mechanistic systems to be used for manual workers (IRS, 1994).

Historically, line managers have carried out appraisals. Surveys (Smith et al, 1996; Wiese and Buckley, 1998 and CIPD, 2009) document the introduction of self-appraisal, peer appraisal, 360 degree appraisal and balanced scorecard approaches, to provide a wider perspective on performance. There is also evidence that many organisations are linking appraisal more closely to employee development and separating this from decisions about levels of pay (Armstrong and Baron, 1998). There are few reported instances of group or team appraisal. However, there is evidence of the evolution of e-appraisal carried out in a small number of organizations and in some instances there is an element of self appraisal (Payne et al, 2009.)

There is clearly a link between the methods in use, the reasons why appraisal is employed and the underlying philosophies of management. There has been a shift away from subjective judgements of desirable traits towards a multi-faceted review of process behaviour and outcomes and a collaborative approach to establishing objectives and analysing development needs (Neeley, 1998; Bennett, 2006.) This has been mirrored by a declining emphasis on linking appraisal to reward and a growth in employee development activities, through personal development plans (PDPs) and continuous professional development (CPD).

It may be thought that this shift in both the expressed purposes of appraisal and the methods employed signals a fundamental change in the underlying philosophies of human resource management, which inform the appraisal process. At face value the trend seems to support this interpretation. The values of utilitarian instrumentalism, typified by the Michigan school (Fombrun et al, 1984) appear to have given way to the Harvard approach of developmental humanism (Beer and Spector, 1985). Concepts of ideology, politics and power are replaced by ideas of empowerment, commitment, culture and consensus. There seems to be a congruence between espoused theory ('people are our greatest asset', 'we are a learning organisation') and theory in use. Yet, the approach taken may be subtler but, nonetheless, still instrumental.

It is clear that many organizations have taken a more strategic approach to human resource management and see performance management as fulfilling a pivotal integrative role in relating employee resourcing, reward, relations and development practices to strategic objectives (CIPD, 2009). However, the extent to which this strategic emphasis reflects a change in values remains largely unanswered and perceptions of fairness are not fully considered in a climate where discretionary effort is critical to success.

## **Research Focus**

The recent downturn in economic activity has placed a premium on effective performance and the harnessing of discretionary effort for competitive advantage. At the same time the growth of scandals in the world of business has driven a pervasive interest in ethics and corporate social responsibility. This has been particularly true of university MBA programmes. Although there has been a continued interest in employee well-being (Baptiste, 2008)) this has not usually been linked to ideas of organizational justice. The connection between performance management, ethics and fairness has not been adequately explored. The focus of our research was on whether employee perceptions of the fairness of appraisal have an impact on the effectiveness of performance management systems. The questions which interested us were framed in the context of organizational justice, business ethics and improving performance for competitive advantage.

Do appraisals contribute to disparities in organizational rewards and burdens?

Do employees perceive outcomes and procedures as fair and ethical?

Is there a tension between control and commitment and how does this influence the effectiveness of performance management?

## Methodology

A mixed methods approach was used with documentary analysis, formal and informal interviews, questionnaires and observation as primary tools. Literature reviews were carried out to establish comparable current research findings and theoretical frameworks. The initial research started off in all cases with an exploratory phase using informal interviews followed by content analysis to identify emerging trends and patterns.

The information came from three main samples.

Sample one was a longitudinal study and comprised of over 100 managers engaged on management development programmes at two higher educational institutions over a period of ten years. The sample was also a convenience sample representing both the public and private sectors. There was a 100% response rates from these participants due to personal and prolonged contact with each participant. All participants in this sample were interviewed informally and also completed a postal questionnaire.

Samples two and three were taken simultaneously from two large service and manufacturing organizations and comprised of a purposive diagonal ethnographic survey of 40 employees followed by a postal questionnaire sent to all employees and completed by 500. Response rates were 30% from organization A and 16% from organization B. All participants were based in the United Kingdom and were in full time employment.

All participants in sample one (100 persons), and all those from samples two and three who had taken part in the ethnographic survey (40 persons) completed a semi-structured account of how appraisals and performance management took place in their organization. They were also asked to give their own perceptions of the effectiveness and appropriateness of any of the systems and outcomes they had experienced. Content analysis then took place and identified themes and linkages were used to design questionnaires with categories that could be interrogated by a mixture of quantitative and qualitative means. The emphasis of the questionnaires was to test the tools, systems, procedures and outcomes of appraisal and the participant's perception of linkages to individual performance, motivation and organizational effectiveness.

Significance testing was undertaken by means of Chi-Squared (Bhattachary and Johnson, 1977). The purpose of this was to examine whether there were any significant differences between responses from different organizations, sectors, occupations, length of service and gender.

## Findings

### Ethnographic survey findings

Several themes emerge from the ethnographic survey; that were common to both organizations. The common themes were a distrust of appraisal and performance related pay and a belief that there was an inequity of treatment between high and low producers centring on arbitrary standards of discipline. A large proportion of those interviewed were cynical about appraisal and although they believed that in an ideal world it could be a useful and positive experience, in reality it was often “just going through the motions” and was not carried out in a fair and systematic way. Many expressed a belief that appraisal was often about “whether your face fitted” and that there had been abuse “I am certain of it”. There was a fear that appraisal may be used for redundancy but this was not as widespread as concerns regarding subjectivity. Most participants were strongly against being rated for performance related pay even some that received it. The differences between organizations were not significant although participants from organization A although critical of some aspects of personal development, acknowledged the existence of a system that was having some impact and the majority saw it as a positive experience with some benefits, although a few did think it raised too many expectations. Improvements in training and support were also mentioned as were beliefs in the value of team working. The Personnel Section in both organizations came in for criticism for not understanding the nature of the job and not appearing to care for the workforce in general.

Some participants in organization B were highly critical of the lack of training and training opportunities and some participants commented about these being given as rewards and withheld as punishments.

### Union views

Both organizations in the survey had strong union memberships representing over 75% of the workforce. Union officers from both organizations were interviewed using the same semi-structured format experienced by other participants.

There was a strongly held view from Union officers at both organizations that there were hidden agendas for the use of appraisal as other purposes evidenced from the use of yearly reviews by one of the organizations creating a matrix for redundancy purposes.

Appraisal: “nothing happens.” It was not taken seriously and was open to abuse. “It was never going to be objective.” There seemed to be no system or structure. The union were not optimistic that this could ever happen.

Appraisal was also described as “management driven.” They were not always carried out. Appraisal was seen as a control mechanism and not always a developmental mechanism. “If someone is perceived not to have met the requirements of their appraisal they can be taken down the disciplinary route and have been done so.”

"We are aware of individuals not being treated perhaps as fairly as others. It depends on the manager's style and some are more subjective than others."

However, personal development initiatives were seen in principle as positive but often "does not work. Again there was a perception of inequity operating for some at the personal discretion of managers.

### **Questionnaire findings**

Data was interrogated to see if there were any groups that were unrepresented by the survey. No groups were unrepresented. The information was based on up-to-date personnel print outs from both organisations.

Almost 75% of those who responded had experienced some form of formal appraisal at their present organisation and many had also experienced appraisal in their previous organization.

39% of those from organization A and 44% of those from organization B felt that appraisal had not helped their job performance along with many who do not appear to know (13% and 21%.)

43% organization A respondents believed that appraisals had helped improve their job performance.

31% organization B respondents held the same belief.

It would seem that although some participants do think appraisal can help improve individual performance the majority felt that it did not help them improve their job performance with many not knowing if it did.

Over 30% of respondents in both organizations felt strongly that appraisal was carried out with favouritism and 25% claimed not to know if there was favouritism or not. This has important implications for organizational justice and ethical workplace practice in terms of the large numbers of respondents in this sample that do not trust the system or do not know if they can trust the system.

These findings were reinforced by similar findings from our longitudinal study.

There was no mathematical significance of frequency indicated by these results.

Respondents were asked to comment on anything not included in the questionnaire concerning appraisal, performance- related pay or company culture that they felt was important.

The comments that most commonly emerged from the questionnaires and combined with those from our participants in the longitudinal study were noted and cross-checked by means of the author and a secretarial supporter making independent notes of recurring sentiments. These were selected independently and then cross-checked. Quotes that best typified

responses were then selected. This approach was taken to increase the likelihood of obtaining typical responses and cross-checking and calibration occurred to ensure better standards of inter-judge reliability.

A selection of these comments included:

“There are no regular meetings to monitor progress”

“The better you are at your job the more work is pushed on you”

“Too subjective based on a manager’s perceptions”

“Very subjective and there are no specific objectives”

“There is too much favouritism in the company between supervisors, managers and the Leading Mechanic’s and mechanics.” (sic)

“PR pay will only be effective if individuals have the back up of the company in terms of training, advice and edification.”

“Appraisals are not carried out on everyone; we need rules and proper guidance.”

There was no statistical significance in expected frequency between organizations. These participants were found to be a representative sample consistent with the profiles supplied by both organizations in the form of personnel and departmental records. The findings of the questionnaire showed a marked consistency between organizations and also consistency between gender, occupation and length of service in the majority of cases. This allowed for generalisability in many areas.

### **Longitudinal Study Sample**

There was a constant and almost universal concern about “fairness” from all participants in both the study of two organizations and the longitudinal study. There was no shift in emphasis over a ten year period up to and including 2009.

“I suppose you could say our appraisal is the personal development interview but we don’t seem to link this to practice.”

It is time consuming, there is favouritism.....and no rewards for high performers”

“We link performance related pay to appraisal but it is not fair.”

“It’s a joke.”

What’s the point, we are making people redundant and it is not the poor performers who are going.”

Content analysis showed a marked emphasis on the tension between the espoused theory of fairness and perceptions of inequality, inconsistency and subjectivity

### Summary of Findings and Discussion

Information was volunteered freely by all participants. Employees at all levels spoke openly at both informal and formal exchanges. There were no significant differences between responses from males and females, different age groups, length of service and area of work. The most interesting thing from the researcher's viewpoint was the similarity in beliefs from a diagonal slice of the workforce taken in from organizations A and B and participants in the longitudinal study who were all managers.

There was a convincing raft of evidence from all sample groups based on anecdotes, chats, ethnographic surveys, formal interviews and questionnaires to make the following observations:

There was a strong belief in inequality of treatment between high and low producers centred on arbitrary standards of discipline. Both managers and workers found this frustrating and many spoke about fairness, equity and injustice.

There was a widespread distrust of both appraisal and performance related pay.

There was widespread confusion about performance management systems, interestingly many employees were unclear as to whether their performance was measured and if so what were the methods used to measure it.

Performance management systems were viewed as bureaucratic, costly and often a waste of time. Many workers and managers spoke at length about discretionary activity and their frustration with the organization's inability to deal effectively with disciplinary issues.

There was cynicism about appraisals and the subjectivity/competence of appraisers.

A fear/belief that appraisal was used for redundancy purposes. This belief was strongly voiced by union officers who gave examples of actual instances when they had seen this in practice. Some managers spoke of appraisal as being useful in cases of redundancy.

The majority of persons had experienced some form of appraisal in their present organizations and a significant proportion had experienced it in previous organizations. Whilst many perceived the notion of appraisal as being a good idea, they saw the procedure and its outcomes as being flawed. In this sense they felt that both procedural and distributive justice were unfair.

Appraisal was sporadic and not homogeneous and in many instances reflected the failure of several important elements in a manager's procedural inventory (Folger and Bies, 1989.) These flaws were seen: as not giving adequate consideration to employee's viewpoints; not applying decision making criteria consistently across employees; not providing timely feedback to employees after decisions; not providing justification for the decisions and not treating employees with courtesy and civility. In these cases interactional justice comprising of interpersonal and informational experiences was seen as negative.



Many did not believe that appraisals improved job performance.

Performance related pay was seen as being too dependent on variable outside the individual's control. This was seen as unfair by many who were unclear as to how it could consciously increase organisational performance.

Union officials stressed the difficulties of measuring activities and placing similar value on different activities. Statistics were often seen as open to manipulation and distrusted. Rewards for individuals were seen as counter to the Unions belief in equity and objectivity.

Equity was a central issue in all our research findings. It was mentioned by almost every participant and was of equal concern for both managers and employees. Perceptions of inequalities arose in many areas but most concerns occurred in the areas of discipline, payment and trust. Anecdotes, observations, interviews and questionnaires constantly referred to fairness, unfair treatment, inequity; and most involved strong emotions concerned with self-worth. Anecdotes of workers taking action to balance the perceived inequity were also related (Adams, 1963; Porter and Lawler, 1968.) There was widespread evidence of pervasive cultural beliefs holding equity as a lynchpin of working life. "I would like openness and honesty." The belief that everyone should work hard represented the normative culture of our participants. Both managers and workers spoke at length about different standards of performance management and many expressed anger and frustration concerning the procedural and distributive justice of discipline in their workplace. "Nothing happens here if people aren't pulling their weight." Trust was a concern for many participants and there were many complaints about managers and their different agendas. Some managers also spoke about the need to build and establish trust. The lack of trust may influence behaviour at appraisals and result in appraisees withholding relevant information concerning personal weaknesses and staff relationships. This has implications for the effectiveness of performance management and appraisal.

Equity and trust were found to be highly valued but it was debatable if they existed other than as espoused theory at organizational level. The notion of equity had been expected to be an important aspect of this research but the overwhelming pre-occupation of the majority of participants has provided a rich source for future research and discussion.

## Conclusions

Our research builds on previous research in the following respects:

- It places appraisal within a framework of organizational justice; perceptions of fairness are important in harnessing goodwill.
- There is little evidence of appraisal systems having a significant impact on the widening disparities between earnings within organizations. However, they can influence differential access to other rewards and benefits, and as a way to justify the allocation of tasks, which are often perceived as important.

- They are in many cases perceived as being procedurally unfair in terms of the Folger and Bies (1989) criteria. Inadequate consideration is given to employee views; there is evidence of bias, inconsistency, poorly justified feedback and a lack of honesty in the process.
- Our research confirms findings that appraisal reinforces power relationships and is often perceived as being open to abuse (Geary, 1992)
- Dissatisfaction with processes and the resulting distributive justice had a negative impact on employee perceptions of fairness and could act as a barrier to organizational effectiveness (Cook and Crossman, 2004; Greenberg, 2006.)
- It also may conflate development with control measures resulting in “privilege training rather than work based learning,” (Bennet.2006:14.)
- It ignores systems factors (Deming, 1986; Soltani et al, 2006), particularly relationships in teams and between teams and can work against the establishment of a quality culture. It often seeks to act as an agent to bolster managerial power rather than to enhance quality.
- The hostility towards appraisal comes from those carrying out appraisals as well as from those being appraised. Our research supports the case put forward by others that effective performance will not be obtained unless all dimensions of organizational justice are satisfied within the performance management system and that there is a strong argument for all stakeholders views to be incorporated in the system (Cook and Crossman, 2004; Suliman, 2007; Simmons, 2008.)
- The move by many organizations to management systems, which espouse teamwork and a shared mission, lies uneasily with an approach to performance management, which is reliant on individual appraisals. It is also ironic that many of these same organizations believe that performance related pay is congruent with a unitarist value system.

The notion that appraisal is “a bad idea and it doesn’t work” (Armstrong and Baron, 1998), held by many academics, is not always echoed by those who engage in the process.

Performance measurement is approached with caution by both appraisers and appraisees. There is a reluctance to play God (Newton and Findlay, 1996) on the part of appraisers and distrust on the part of those being appraised, arising out of marked discrepancies between rhetoric and reality. Measurement is perceived as inconsistent, subjective and political.

The introduction of Behaviourally Anchored Rating Scales, 360-degree appraisal, on-line self-assessment and competence-based appraisal may have gone some way towards improving the reliability, consistency and objectivity of performance measurement. Yet,

where appraisal attempts to fulfil the twin aims of measuring performance and developing people, a paradox still remains.

For decades adherents of the human relations movement have argued that organizations, with their emphasis on control systems, discourage the full participation of their members. This may well be detrimental to performance and could affect competitive advantage (Deming, 1986; Wiese and Buckley, 1998.) Organizational experience is often demotivating rather than empowering.

Few organizations have thought through the notion that the development of teams and individuals is a key component of corporate strategy, and embedded it in all aspects of the organisation. The idea that individuals need to be controlled dies hard. If a control philosophy permeates notions of empowerment, personal development and lifelong learning it will render both control and development ineffective.

Too often appraisal interviews attempt to achieve both aims – to control performance and develop the individual. The two are clearly incompatible. The ritual charade of measuring performance may foster a cynicism about identifying areas for personal development.

### **Contribution**

Our research clearly indicates that both managers and employees see a potential for appraisal, which is rarely achieved in practice. If the sole purpose of appraisal is to encourage personal and professional development, then the appraiser will act as counsellor, adviser and coach. This is almost universally seen as desirable and effective in gaining commitment. If, at the same time, the appraiser also acts as a judge or evaluator, then commitment degenerates into resigned compliance with widespread resentment and perceptions of inequity. Our research also confirms the findings of others most significantly in terms of reinforcing perceptions of dishonesty, mistrust, inequity and managerialism. Happiness and stakeholder interests are not addressed and appraisees are often left feeling aggrieved.

Organisations are purposive entities. They have goals and need to measure the achievement of those goals. But, weighing the calf does not fatten it. Indeed, the trauma of the measurement process may hamper development. Creating an environment where individuals can grow and develop is enhanced by appraisals designed for that purpose. Measurement of individual performance is of dubious relevance in team working environments. Judgements, about how individuals contribute to teams, are perhaps best made by teams themselves. Individual appraisal interviews are best suited to counselling and identification of development needs. Certainly, the inclusion of performance measurement clouds the process and leads to cynical beliefs about organisational value systems. If appraisal is to contribute to the achievement of an organisation's goals, then the organisation needs to be clear about why appraisal is in place and how it fits with strategy, culture and philosophy. Appraisal has to be fair and above all, it needs to be seen to be fair.

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## PORTUGUESE AND INTERNATIONAL ONLINE CONSUMERS OF WINE: A NICHE MARKET?

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### Abstract

Online retailing is growing rapidly; according to all estimates, it will account for a significant percentage of retail sales in the future. Shopping online has become part of some consumers' daily lives. For producers of wine, an online store is an important channel through which to provide product information and offer direct sales to their customers. In a hyper-fragmented industry, such as the wine industry, finding new niche markets could be a powerful tool in gaining a competitive advantage.

This paper investigates the Portuguese online consumer of wine using a survey to describe and analyse the main characteristics, buying habits, motivations, influences, and overall satisfaction of the Portuguese online consumers of wine. A comparative analysis with international online wine consumers assesses differences based on nationality.

**Keywords:** Online consumer behaviour, Portuguese and international online wine consumer, niche markets

### Introduction

Portugal is known worldwide for its Port wine, which is produced in the northern part of the country and bottled in the city of Porto. However, other quality wines are produced all over the country and their importance to the domestic economy is undeniable in terms of both domestic consumption and exports. Invited by a group of Portuguese firms (public and private) to study the competitive advantages of Portugal, Porter (1994) identified this sector as a cluster and suggested emphasizing grape quality, firms' long-term investment, professional management, and quality certification; selecting target countries (the UK and the USA); studying consumer behaviour; increasing the number of super-premium wines; and protecting the Portuguese brand to improve its competitiveness (Monitor Group, 2003).

A possible source of competitive advantage for Portuguese firms is product differentiation. Product differentiation advantages derive from the product's physical properties and attributes that customers regard as unique (Balabanis, Mueller and Melewar 2002; Nicholls et al., 2003). Wine is a highly differentiated product but it faces intense competition in the main export markets (Stricker, Sumner and Mueller, 2003). The focus of the strategy is to build competitive advantage in narrow segments of a market using differentiation characteristics

with niche suppliers, primarily catering to speciality product demands (Porter, 1985; Hassan and Katsanis, 1991; Grant, 1993).

In the wine industry, a competitive advantage requires, on the demand side, international recognition of the wine's quality (or its image or reputation) and, on the supply side, a local collective dynamic of appropriation that qualifies the wine, either by the modification of an intrinsic characteristic (such as taste) or an extrinsic characteristic (such as packaging or labelling information). The success of this strategy depends upon the market's recognition of the wine (identity, specificity), the sustainability of the competitive advantage acquired (brand name, protection of the product's origin) and the ability of firms to appropriate the rents earned.

In the past two decades, an increasing number of Portuguese firms have produced and sold high-quality wine to foreign markets. The success of these firms is greatly facilitated by regional specificities, such as soil, climate, history, geography, culture, and local know-how, all of which confers a competitive advantage on Portuguese wines. One classic example is Porto wine, which has been marketed by Portuguese firms as *sui generis*; most Porto wine originates from the Douro region, where the soil, climate, and expertise are unique. However, some Portuguese firms are evolving from this classical approach to exploring niche markets, including the online wine market, to find new consumers. Shopping online has become part of some consumers' daily lives. An online store is an important channel through which to provide product information, conduct direct sales, and expand domestic market.

Based on the results of an online survey, this paper describes the characteristics of online shoppers and buyers and analyses the profile of this niche market in order to reveal developing opportunities to potential operators. Consumers' motivations for shopping online and their attitudes regarding e-commerce are also investigated in order to reveal online shopping behaviour. This study can help Portuguese firms interpret some of the key issues behind e-commerce and to apply the experiences from operating in this niche market to other products characterised by similar conditions.

Section 1 briefly discusses the concept of niche marketing in the context of the wine industry and provides examples of new niches in the Portuguese market. Section 2 provides some empirical evidence about online consumer behaviour, while section 3 assesses the profile of the international online wine consumer, online wine-purchasing behaviour, online purchasing patterns versus offline ones, and the main influences in the decision process. Section 4 presents the research methodology used in the study. Section 5 examines the results of a Portuguese survey in terms of the profile, buying habits, motivations, influences, and overall satisfaction of online wine consumers. Finally, we discuss our findings and advance the marketing and policy implications that can be drawn from the results of the study.

## Niche Markets in the Wine Industry

Today's consumers are more selective and seek a greater variety of choices than ever. This change opens new opportunities for high-quality regional products and for a large range of small producers who want to reach niche markets. A niche is a micro-market consisting of a small group of consumers with similar characteristics or needs. Carving out a niche whose unique needs are not fulfilled requires niche marketing, which involves positioning a product into small, profitable, homogeneous market segments that have been ignored or neglected by others. This positioning is based on the integrated marketing concept and the distinctive competencies the company possesses. However, many small firms struggle, not with whether to use the integrated marketing concept, but with how to tailor the concept to fit each segment and how to make it work (Hunerberg, 1993; Dalgic and Leeuw, 2006; Cuthbert, 2008).

In the wine industry, niche markets exist (or can be created) based on unique product attributes and consumers' desires and preferences. To stay competitive, firms must know their consumers and their needs and be able to deliver products properly targeted to selected markets. To add value based on the consumer perceptions of the product, the firm can customise its products to meet consumer expectations, make new products to serve a market not well served, or improve marketing and sales by focusing on perceived quality or other service characteristics.

On the supplier side, segmentation analyses can be used to disaggregate a market into narrowly defined segments so their structural characteristics can be studied to appraise their attractiveness. The wine industry can be segmented based on many intrinsic and extrinsic wine attributes. Some of the most basic distinctions are region of origin (Alentejo, Douro, Dão) and the colour (white, red, rosé) or type of the wine (maduro, verde). A more refined distinction is based on the grapes used (domestic, foreign) or special references (harvest date) (Freitas Santos and Cadima Ribeiro, 2008). For example, in order to appeal to young consumers and women, the Portuguese firm Sogrape launched its first rosé wine variant in over sixty years in 2005 in the United Kingdom. Mateus Rosé Tempranillo is a single varietal wine that represents the culmination of over two years' investment as part of a focused effort to attract 20-35-year-old wine consumers by supplying a rosé with a colour, aroma, and taste geared specifically to them ([www.talkinretail.com](http://www.talkinretail.com)).

Another Portuguese firm, José Maria da Fonseca, recently launched Twin Vines, a new wine from the Vinho Verde region in the northern part of Portugal, which was designed specifically for the American market. Twin Vines is a lightly sparkling and refreshing dry white wine, a young and aromatic wine characterised by a low alcohol level, a good fruit-acid balance, and good value (Dentinho, 2008). Adega Cooperativa Regional de Monção, one of the largest Portuguese cooperative producers, launched its first rosé, Muralhas de Monção, which is made from a blend of indigenous local grapes. According to the president of the



cooperative, “initial responses have been very encouraging” ([www.avenuevine.com](http://www.avenuevine.com)). Even one of the oldest Port wine Portuguese producers (Croft) has complemented its portfolio of Port wines with Croft Pink, an innovative rosé Port wine ([www.theportwine.com](http://www.theportwine.com)).

On the customer side, consumer characteristics and behaviour can be a powerful source of market segmentation if customer desires and preferences can be identified. Variables such as income, education, gender, age, wine knowledge, wine involvement, consumption frequency, preferred price level, preferred alcohol level, and preferred sweetness level are only examples of basic demographic characteristics and preferences that can be explored in segmenting wine consumers (Mueller and Umberger, 2009). For example, in the United States, the Millennial, or Echo Boomer, segment could be targeted by the wine industry because it has reached the drinking age range of 21-28 and has considerable size and buying power (Thach and Olsen, 2006). Another example is the South African wine consumer, whose key segmentation variables are age, gender, income, race, and wine drinking history (Ndanga, Louw and Rooyen, 2009); in addition, the black middle class differs from the white middle class, and several segments exist within the ‘Black Diamonds’.

Research in the area of consumer behaviour has established that consumers go through a sequence of stages in making buying decisions, including problem recognition, search for information, evaluation of alternatives, purchase decision, and post-purchase evaluation (Turban, 2002; Gebauer and Ginsburg, 2003). This process is influenced by the type of purchase and the extent of involvement in the purchase decision (Venkatesan, 1987; Turban, 2002; Fahy, 2006). Consumer buying behaviour is also influenced by consumer’s internal variables, such as motivation, perception, learning capacity and memory, attitudes, personality, and self-concept), and by socio-cultural variables, such as culture, subcultures, social class, social groups, family, and personal influence). These variables influence the ways in which the consumer proceeds through a decision process related to product acquisition (Loudon and Bitta, 1988; Turban, 2002).

Based on some of these variables, Wine Intelligence (2006) identified the characteristics of five consumer groups: i) adventurous connoisseurs (high-income broadsheet readers, high frequency, high spend, high wine involvement); ii) mainstream at-homers (suburban middle-income professionals, high frequency, average spend, high wine involvement, consumption mainly at home); iii) weekly treaters (younger singletons, low frequency, above average spend, moderate wine involvement); iv) sociable bargain-hunters (prosperous empty-nesters, high frequency on-trade, low spend, and low to moderate wine involvement); and v) frugal conservatives (low-income TV viewers, low frequency, low spend, low wine involvement).

This literature review raises the following question: can online wine shops be treated as a market niche?

The attractiveness of a niche is dependent on the following criteria: i) sufficient size of the market (estimated number of potential consumers), ii) purchasing power of the targeted

consumers, iii) market growth potential, and iv) negligible interest to competitors (Shani and Chalasani, 1992). The most appropriate variables in identifying niche markets are those that yield the most distinct criteria. The products offered tend to be higher-value specialty products directed to specific markets that value the unique attributes of a product with limited volume supply.

### **Online Customer Behaviour: An Empirical Review**

The estimated number of internet users continues to grow rapidly. By the end of 2007, worldwide figures indicated that an average of one out of five people was online (ITU, 2009). In the 27 countries of the European Union, 83 percent of individuals who lived in a household with broadband access in 2009, with Portugal below the average, at 65 percent, and Sweden (95 percent), Denmark and Norway (94 percent) registering the highest percentages (Eurostat, 2010). Broadband is important as many of the most effective applications and services are available only through a high-speed internet connection.

The increasing number of online transactions has led many firms to take advantage of this new distribution channel. Automated buying profiles, networked buying clubs, and online auctions are only some of today's technologies. However, competing in this market space is very different from competing in the conventional marketplace: price comparisons are easy to do, relationships between buyer and seller are mediated by personal computer screens, and transactions are based on information about the product rather than on its physical appearance. Consumers and producers have flexible, fast, and inexpensive ways of participating in the market for products around the world; individual customers can approach the virtual marketplace in many different ways as the variety and depth of information speed up the decision-making process.

The literature has shown that technical expertise, online shopping familiarity, shopping intention (hedonic or utilitarian), time spent online, risk perception, income, age, gender, education, and product tangibility all influence the behaviour of internet shoppers (Sorce, Perotti and Widrick, 2004). These authors also tested the proposition that internet shopping behaviour is different for positive reinforcement products than for negative reinforcement products and concluded that people four times as likely to shop online for products that provide primarily positive reinforcement. For the purposes of this study, wine is considered a positive product because it generates enjoyable experiences for consumers.

A more recent review of literature (Zhou, Day and Zhang, 2007) found that online consumers tend to be more convenience-oriented, that shopping intention is adverse to perceived product risk, and that previous satisfaction has a positive effect on online shopping tendency. Other research has reported that goal-directed buying is facilitated online specifically because of convenience and accessibility, a unique and broad selection of products, the availability of accurate and comprehensive information, and the lack of sociality from salespeople, retail workers, spouses, and kids (Wolfenbarger and Gilly, 2008).

In the online environment, instilling trust in the consumer is critical because the perception of risk regarding products and transactions is very high. According to Quinton and Harridge-March (2008), there is a difference between the elements of trust that consumers use to determine whether to purchase wine online and the elements of trust they use offline.

Morgado (2003) proposed a model with customer characteristics, motivations and attitudes as predictors of purchase by Brazilian consumers and tested it with data from a survey. Results of this study showed that the socio-economic profile of online consumers was higher than that of non-consumers (buys more digital goods, is well educated in English, travels to foreign countries). The Brazilian online consumers were more oriented toward convenience/utility and used the internet for e-banking and to search information about products and services (prices and promotions). Brazilian online consumers also had a positive attitude toward the internet and were less worried about security and privacy and more willing to accept direct marketing than other consumers were. Motivational factors also played a key role in determining time spent on product searching and online shopping (Zhou, Day and Zhang, 2007).

The online wine consumer experiences some problems when attempting to purchase wine, such as the heterogeneous state laws regulating wine shipments, taxation, and age verification and the great diversity of the wine industry (Sheridan et al., 2009). Transport costs can also be an impediment for a growing diffusion of e-commerce in the international markets, as costs can attain around 40 percent of the total price per bottle of the wine (Stricker, Sumner and Mueller, 2003). Additional complexities arise because there is little similarity between selling books, CDs, suits, fruits or furniture online and selling wine (Gebauer and Ginsburg, 2003; Fahy, 2006). "Quasi-commodity products" and "look-and-feel goods" or "tactile goods" are purchased in a two-step process, and they require some hands-on experience by the user to access their quality (Gebauer and Ginsburg, 2003, p.63). During the first step, consumers select the product by its functionality or general features, based on information provided. A more refined selection based on brands or predefined intrinsic or extrinsic product cues and the shopping, itself come later.

Price competition and the importance of trust are also distinctive for online wine sales. For example, Brynjolfsson and Smith (2000) found that price dispersion (differences) among internet sellers was wider than expected. The same authors also found that one of the ironies of online selling was that, far from being a great equalizer of retailers and eliminating the need for branding, the internet heightens the importance of differences among retailers in terms of dimensions such as trust and branding. Similarly, Degeratu et al. (2000) found that, in some product categories, the importance of brands was greater online than offline, possibly because consumers use the brand name as a surrogate for the attributes for which information is missing or is costly to obtain (Degeratu et al., 2000). Thus, brands become more

relevant in the choice of sensory product attributes (e.g., tactile goods) than in the choice of non-sensory ones (e.g., commodities).

In addition, contrary to what was expected, the move to online markets did not necessarily result in market disintermediation (Stricker, Sumner and Mueller, 2003). This has been particularly true in the case of wine, where most wineries, large and small, did not choose to do direct marketing on the internet, as evidenced by the Australian, Italian and German cases (Stricker, Sumner and Mueller, 2003; Vecchio, 2009). That is, it is one thing to provide product information on the web and link consumers to traditional retailers and quite another to sell wine directly to final consumers using the online channel. As Vecchio (2009) explained, most Italian producers use their websites primarily as a sort of online catalogue and, in the worst cases, do not update the catalogue frequently.

Therefore, although the internet is often thought of as an new “world of opportunity”, following Vecchio (2009, p. 2), “the promises of the internet as a platform to reach new outlets, markets of global dimension, virtually infinite product selections, intimate customers relationships, low cost and streamlined distributions chains [...] have largely been dissatisfied”, in the wine industry, at least. However, this distribution channel does have a large business potential, part of which comes from its singular attributes and nature.

### **The International Online Wine Consumer: Results from a Survey**

While the use of the internet has been increasing in the last years in the households of the European Union, there are differences among the European countries in terms of i) internet access and online shopping, ii) attitudes by age group and country, iii) preferences regarding online acquisition of products and services, and iv) logistic and legal constraints to cross-border internet shopping (Eurostat, 2008a; 2008b).

A survey conducted online between April 24 and May 12, 2007, by Vizu (2007) was used to develop a profile of the online wine consumer and assess wine purchasing behaviour, purchasing patterns (online versus offline), and purchase influences. Based on these results the online wine consumer can be characterised as follows: 20.3 percent are heavy consumers who drink wine daily, 33.2 percent are regular but less frequent wine drinkers (weekly, monthly), and 46.5 percent, the largest segment, drink wine rarely. Moreover, nearly half (45.7 percent) of the consumers buy their own wine, while 28.2 percent receive it as a gift of friends or business acquaintances. The members of the responders’ families (e.g., spouses) are less involved in wine purchasing than the responders are.

According to the survey, the online wine market remains small (Vizu, 2007), accounting for only 17.2 percent of wine consumers, with a subset of 7.1 percent that buy wine online daily or weekly. A majority of consumers kept an interest in buying more at traditional points of sale, rather than online; only 9 percent claimed to shop for wine more often online than offline.

The three main reasons for buying wine online were convenience (easy accessibility to a shop through a click), a broad selection of wines, and lower prices. The shipping was the largest obstacle to online trade, with a combined 46 percent of respondents citing shipping cost, time, or state restrictions as reasons for not purchasing wine online. Other impediments were lack of trust in the seller, the quality of the wine, and security of the transactions made online (Vizu, 2007). These results were in line with those of previous empirical research. Security reasons were also pointed out by 30 percent of the E.U. respondents, who had the opinion that carrying on transactions over the internet was “not really safe” or was “not safe at all” (European Union Commission Representation in Portugal, 2009b). In Portugal, the figures were similar, where 23 percent felt that online shopping was “not really safe” and 12 percent considered it “not safe at all”. The level of risk avoidance, that is, the percentage of those who said they did not carry out online transactions in order to avoid financial risk was 42 percent, both in the Portuguese and in the E.U.27 countries (European Union Commission Representation in Portugal, 2009b).

An E.U. Commission report (European Union Commission Representation in Portugal, 2009a) specifically addressed the issue of logistic costs and border trade barriers and found that, even though online trade has increased markedly in recent years, several barriers still exist. This could explain why border trade in 2008 did not exceed 7 percent of all online exchanged goods in the European Union, a figure quite close to the 6 percent registered in 2006 (European Union Commission Representation in Portugal, 2009a). However, more than just the logistic infrastructure explains this poor performance. Other factors include language differences, national market regulations and taxes applied to products, and consumer confidence in the market’s operators. As a result, the European Union Commission has pursued new laws and procedures regarding this trade channel. As Viviane Reding, the European Commissary for Information Society and Media, declared, “If one wishes consumers to shop through and take full profit from digital communication technologies, we have to be able to convince them that their rights are guaranteed” (European Union Commission Representation in Portugal, 2009b).

When purchasing wine online, consumers can be influenced by many factors. Personal recommendations by friends were the most influential factor (26.4 percent), followed by restaurant experiences (13.9 percent). Experts’ wine ratings and online and print reviews/recommendations, in aggregate, had the second-largest influence on purchase behaviour. Advertisements and the opinions of retailers (online and offline) were considered of less importance (Vizu, 2007).

Most respondents spent about the same amount of money per purchase, whether they shopped for wine online or offline. When there was a difference in spending, twice as many spent less money per purchase online than offline. This gap shrinks on a per bottle basis. There was no dominant online channel for wine purchases. Winery web sites were slightly

preferred over other sites (17.9 percent), such as online wine clubs (10.8 percent) or online wine shops (11.8 percent). The majority of online purchases were for personal consumption (13.7 percent) or gifts to offer to friends, family and acquaintances (Vizu, 2007).

Online wine shoppers searched for information via a wide variety of sources. The most important source of information was wine retailers (29.6 percent), whilst web blogs, community sites, and chat rooms were less researched. The type of online wine information most trusted by wine shoppers—by a wide margin—was user reviews and experts' ratings (73 percent). In some cases, the marketing of wine by online wine shops was made through interactive and rich media in order to boost sales by adding the excitement of virtual and video tasting (35.2 percent). Chatting with winemakers was also used to promote wine online. Celebrity endorsements hold little sway over wine shoppers, with four out of five respondents giving celebrity picks no weight in their purchase decisions (Vizu, 2007).

These results indicate two of the most important characteristics that define a niche market: a small size (no more than 24.3 percent of the survey sample indicated that they were regular online buyers) and similar needs (convenience, broad selection of wines, and low prices). To examine these results in terms of the Portuguese online wine consumer, we fielded our own survey.

## Methodology

The information previously provided regarding the profile, attitudes, and motivations of the international online consumer is surely useful in understanding the situation and prospects of the online Portuguese market. Two types of online shops exist in Portugal: the general online shop, which is an extension of the main retailing groups (Continente, Jumbo or El Corte Ingles); and the specialized online shop, which sell wines as their main business. This exploratory study examines the characteristics of the Portuguese online wine consumers and assesses their shopping behaviours and preferences. The survey was conducted in an online wine Portuguese shop during the last three months of 2009. The questionnaire contained three groups of questions: questions about demographics, such as gender, age, income, and education; questions about the use of online wine shops (buying habits, satisfaction); and questions about motivations and the factors that influence online buying behaviour. The questionnaire was delivered to regular and new customers when a transaction was processed online. Of the 82 questionnaires received, 74 were sufficiently complete to be used in the study.

A descriptive statistical analysis of the completed questionnaires helped us to put into perspective the online buying habits of the Portuguese consumer, their motivations for buying online, the main influence factors behind their decision to buy online, and their satisfaction with online wine shopping. The viability of producing a comparative analysis between the international and the Portuguese wine online consumer restricted our use of some questions, as the two surveys were used for different goals.

## **The Portuguese Online Wine Consumer: A Survey**

Internet access in Portugal is used primarily to search for health information; to read online news, newspapers, or magazines; to interact with public authorities; or to access home banking. According to 2008 data, the most common goods acquired by online shoppers were travel and holiday accommodations, clothing and sporting goods, and books, magazines and e-learning. These internet uses were ranked similarly in other European countries (Eurostat, 2008a; 2008b).

A market study conducted by Netsonda (2009) in Portugal, addressed to a panel of online shops, found that the main products and services sold through the internet were electronics and mobile phones (41.2 percent), CDs and DVDs (35.2 percent), games/play stations, informatics (26.5 percent each), and books/magazines (20.6 percent), amongst many other products and services. The Nielsen consultancy company (2010) estimated that more than 160 thousand Portuguese homes use the Internet to buy consumer goods, although such online purchases are more common in Lisbon and Porto, where 7.8 percent of the households shop on the Internet, than in rural areas. Over four percent of households in continental Portugal made online purchases of consumer goods between June 2008 and May 2009.

Data from the European Union (Eurostat, 2008a) show that e-shoppers in Portugal were no more than 10 percent of all individuals and that most belonged to the 16-74 age cohort. This figure makes a strong contrast with the E.U. average of 32 percent of population's doing online shopping, not to mention the cases of countries like Denmark, the U.K. or Sweden, where more than half of adults shop online. However, the data for Portugal represented significant progress, with the percentage of online shoppers doubling since 2004.

Similar to the general European data, the most represented age group among e-shoppers was those 25-34 years old, followed closely by those 16-24 years old and those 35-44 years old. As expected, the oldest generations showed just a residual wish (or capacity) to use this shopping channel. According to Netsonda (2008), the average general Portuguese online consumer was male (52 percent), young (70.3 percent were between 25 and 64 years old), well educated (37.5 percent had a secondary education and 49 percent had higher than secondary education), urban (small, medium and big cities represented 83.5 percent of online shoppers), living in small families (two or three members per household), with a moderate level of income (more than 60 percent earned between €10,000-€50,000 annually). In 2009, the Portuguese online consumer preferred to access the Internet from home (39 percent), while the workplace and school accounted for lower figures (20 percent and 8 percent, respectively).

Table 1 – Characteristics of the Portuguese online wine consumer

Variables	N. <sup>o</sup> (n = 74)	%
<i>Gender</i>		
Male	65	87.8
Female	9	12.2
<i>Age</i>		
16 – 29 years	8	10.8
30 – 39 years	27	36.5
40 – 49 years	32	43.2
>= 50 years	7	9.5
<i>Education</i>		
< 9 years of school	1	1.4
9 – 12 years of school	8	10.8
Higher Education	58	78.4
Post-graduation (Master's, PhD)	7	9.5
<i>Family Income (monthly)</i>		
<=1,000 Euros	1	6.8
1,001 – 3,000 Euros	27	36.5
3,001 – 5,000 Euros	34	45.9
5,001 – 7,000 Euros	6	8.1
>= 7,000 Euros	2	2.7
<i>Internet Access from:</i>		
Home	48	64.9
Work	22	29.7
School	4	5.4

The results of the Portuguese study (Table 1) show the differences between the general online consumer and the online wine consumer. The prevalence of males (87.8 percent), younger age cohorts (79.7 percent between 30 and 49 years), more educated people (78.4 percent have a higher education degree) and wealthier people (82.4 percent have an average monthly income between 1,000 and 5,000 Euros) differentiate the Portuguese online wine consumers from the online consumer of general goods. Moreover, this specific consumer tends to access the online wine shop mostly from home (64.9 percent).

The Portuguese online consumer of wine is not a heavy customer (Table 2), as the number of total transactions is relatively small (Less than ten percent have made more than fifty transactions). This explains why most visits are made on a monthly or semester basis. When a product is very specialized, as wine is, shoppers' tendency is to concentrate in one transaction, which is time-consuming to perform. This adds to the fact that shops frequently promote delivery costs according to the quantity of goods purchased, which tend to increase the total amount of the transaction (by an average of 41.9 percent, or between €101 and €150).

If we compare these results with those of Vizu's (2007) survey, considering only the consumers who buy wine online (daily, weekly, monthly, a few times a year), we see that the majority (59.5 percent) of the Portuguese consumers shop online just a few times a year, while



a large percentage of international wine online buyers make such purchases daily (almost 25 percent) or weekly (20.3 percent). Looking to these differences, we can infer that there is space for promotional campaigns conducted by the Portuguese online wine suppliers to induce the frequency of acquisition, the average amount of the orders placed, and the total number of transactions delivered. A reduction in transaction costs could also be used as a strategy to attract new consumers and create additional motivation to shop wine online.

*Table 2 – Online Portuguese wine consumers' buying habits*

<i>Variables</i>	<i>N.<sup>o</sup> (n = 74)</i>	<i>%</i>
<i>Frequency of buying wine online</i>		
<i>Week</i>	4	5.4
<i>Month</i>	26	35.1
<i>Quarter</i>	23	31.1
<i>Semester</i>	16	21.6
<i>Annual</i>	5	6.8
<i>Number of transactions</i>		
<i>Fewer than 10 transactions</i>	6	8.1
<i>11-20 transactions</i>	25	33.8
<i>21-50 transactions</i>	36	48.6
<i>More than 50 transactions</i>	7	9.5
<i>Average amount for transaction</i>		
<i>Less than €50</i>	5	6.8
<i>Between €51 and €100</i>	26	35.1
<i>Between €101 and €150</i>	31	41.9
<i>More than €150</i>	12	16.2
<i>For whom do you usually purchase wine</i>		
<i>Myself</i>	53	71.6
<i>Closer friends and family</i>	18	24.3
<i>Business and casual acquaintances</i>	3	4.1
<i>Occasion of consumption</i>		
<i>At meals</i>	47	63.5
<i>On special occasions</i>	18	24.3
<i>Occasionally</i>	9	12.2

Portuguese consumers buy wine online primary for their own consumption (71.6 percent) and less for friends or business acquaintances. If we consider only those who buy wine online, this result is similar to the one attained through the international consumer survey. This result indicates that nationality does not significantly explain the attitudinal differences found in terms of purchasing wine. Portuguese online wine buyers consume the wine predominantly at home, during the meals (63.5 percent), and on special occasions of social interaction (24.3 percent).

Table 3 shows that convenience is the main motivation for buying wine online. In fact, convenience is the only factor that no respondent included in the “less important” category, and it scores the highest statistical average of all available responses (2.78). A wide selection of wines offered by the online shops seems also to be very important for the consumer, while lower prices and promotions (with average scores of 2.35 and 2.32, respectively) follow behind. In the international survey, convenience and lower prices were among the more important motivational factors. Selection of wines by experts ranked worst in the Portuguese survey.

*Table 3 – Motivations for buying wine online*

<i>Variables</i>	<i>Less Important</i>	<i>Important</i>	<i>More Important</i>	<i>Mean (a)</i>
<i>Convenience</i>	0 (0.0)	16 (21.6)	58 (78.4)	2.78
<i>Selected wines</i>	17 (23.0)	24 (32.4)	33 (44.6)	2.22
<i>More choices of wines</i>	13 (17.6)	20 (27.0)	41 (55.4)	2.38
<i>More information about wines</i>	38 (51.4)	31 (41.9)	5 (6.8)	1.55
<i>Lower prices</i>	11 (14.9)	26 (35.1)	37 (50.0)	2.35
<i>Security in payments</i>	10 (13.5)	61 (82.4)	3 (4.1)	1.91
<i>Promotions</i>	15 (20.3)	20 (27.0)	39 (52.7)	2.32
<i>Anonymity</i>	13 (17.6)	46 (62.2)	15 (20.3)	2.03
<i>Delivery at home</i>	22 (29.7)	21 (28.4)	31 (41.9)	2.12

*Note: (a) Less Important (1), Important (2), More Important (3).*

Information about wines is ranked lowest in importance, at 1.55, so online consumers may have more knowledge about wine than the average offline consumer does. Security of payments is also of little importance in e-commerce since technology improvements in online transactions are providing consumers more security. Anonymity does not play an important role in the possibility of ordering wine online.

The e-consumer denotes that price is important (2.38), as are promotions (2.22), albeit to a lesser extent (Table 4). Loyalty to brand and/or region of origin is reported as having the most influence (2.61) on the e-shopper. The same conclusion, but for traditional retailing, was obtained by Freitas Santos and Cadima Ribeiro (2008), who found that region of origin and brand were the dominant factors in the acquisition of high-quality Portuguese wine. This factor is important regardless of the point of purchase.

Expert recommendations and online advertising have a minor influence on Portuguese purchasers of wine online, confirming the result obtained for the international online wine consumer (Vizu, 2007). These factors tend to be undervalued by the consumers, perhaps because they have sufficient knowledge of the product before purchasing online.

Table 4 – Main influences of wine e-shoppers (n = 74)

Variables	Less Important	Important	More Important	Mean (a)
Expert recommendation	45 (60.8)	20 (27.0)	9 (12.2)	1.51
Price	13 (17.6)	20 (27.0)	41 (55.4)	2.38
Past experience	9 (12.2)	36 (48.6)	29 (39.2)	2.27
Promotion	21 (28.4)	16 (21.6)	37 (50.0)	2.22
Online shop recommendation	12 (16.2)	26 (35.1)	36 (48.6)	2.32
Advertising online	58 (78.4)	12 (16.2)	4 (5.4)	1.27
Friend's recommendation	17 (23.0)	31 (41.9)	26 (35.1)	2.12
Loyalty to brand/region of origin	6 (8.1)	17 (23.0)	51 (68.9)	2.61
Experience of new wines	31 (41.9)	26 (35.1)	17 (23.0)	1.81

Note: (a) Less Important (1), Important (2), More Important (3).

The satisfaction in this specific type of online shopping (Table 5) is high, as almost 80 percent of the Portuguese online consumers of wine report being satisfied or totally satisfied with the process. Overall satisfaction, measured as the sum of the positive points (satisfy + totally satisfied), is also very good, attaining a total of 87 positive points.

Table 5 – Satisfaction with online wine shopping

Variables	N. <sup>o</sup> (n = 74)	%
Satisfaction with shopping		
Totally unsatisfied (-2)	1	1.4
Unsatisfied (-1)	5	6.8
Neither satisfied nor unsatisfied (0)	9	12.2
Satisfied (1)	31	41.9
Totally satisfied (2)	28	37.8
Total of positive points	87	
Mean	1.08	
SD	0.947	

## Conclusion

Online retailing is growing rapidly and, according to all forecasts, will account for an important percentage of retail sales in the future. The online wine market can be considered a niche because of its small size: in an international survey, only 17.2 percent of wine consumers made use of this channel, and just a subset of 10.9 percent could be considered regular online wine buyers. Our empirical research did not include information about the size of the Portuguese online wine purchasing market, but the size of the online market in Portugal was estimated at between 4.3 percent, according to Nielsen (2010) data and 10 percent, according to Eurostat (2008a) data, of the overall consumer market. In any case, this

niche remains domestic, even in the European Union, because of legal issues like age verification and because of tax differences and transportation costs.

From the available literature and the empirical evidence provided, we can conclude that wine producers and specialized retailers are beginning to succeed in using internet technologies and associated marketing techniques, even if mostly for direct marketing rather than for selling online. In any case, to be effective in the online wine market firms need to know better the characteristics of the wine e-consumer.

As our empirical study shows, this segment is composed mainly of young, male, well-educated, high-income consumers who buy wine online from home. They tend to concentrate their wine orders, so their purchases are often more than a month apart. The main reason for their purchase is personal consumption. In addition, they are motivated by convenience, a wide selection of wines, availability, and price. As decision factors, they value the origin/brand of the wine, the price, the recommendation of the online shop, and their own experience. Overall, they are very satisfied with shopping for and buying wine online.

We recommend that before defining a strategy an examination of market partners (wine firms, delivery agents), wine offerings (selection of wines), and the communication mix (promotions, advertising) should be made in order to target this niche. Qualitative market research may also be needed in order to position the online seller optimally. The identification of specific online wine consumer segments in the niche market is another step, as is identification of the critical (minimal) size of the segments that should be taken into consideration. Finally, the process of approaching the opportunity of operating in such markets should include adapting the online shop's marketing mix to the special needs of wine consumers.

For example, a strategy that targets the premium segment of online wine buyers would include retaining hard-to-find and very high-quality wines, which will differentiate the shop from the mass market of traditional retailers (hypermarkets and supermarkets). On the other hand, if an online wine shop wants to target the segment of price-oriented consumers, the shop should offer better prices than offline shops do. Some online sellers are already promoting zero delivery costs when the order exceeds a certain amount, but they need to be more selective in the marketing-mix to attract new consumers.

To the best of our knowledge, this is the first Portuguese study made of the online wine market. As a first approach, as with all first attempts, it suffers from several limitations. One limitation results from the difficulties encountered when approaching the market operators, as few online shops are available to collaborate with research. The size of the sample reflects this limitation, and a small sample size can contain bias in terms of consumer demographics. Another problem found has to do with the comparability between the two surveys from which results are taken, as they were conducted at two different times (2007 versus 2009)

using different ways of collecting the data (online versus offline), and they included questions that were not exactly the same.

Further studies are needed to assess the impact of e-commerce on traditional retailing in Portugal, particular as regards the best-selling online products, such as software, games, music, movies. Comparing online habits, motivations and influence factors behind the market success of different types of products could help online wine stores to adjust their marketing mix to the needs of consumers.

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**MEDICAL DOCTORS' PERCEPTIONS OF INFLUENCES ON PRESCRIBING  
BEHAVIOUR AND THE IMPLICATIONS FOR SALES AND STRATEGIC  
MARKETING PRACTICES IN THE PHARMACEUTICAL INDUSTRY**

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**Abstract**

To determine the influences on doctors' drug prescriptions and the implications for strategic sales and marketing practices in the pharmaceutical industry.

The paper adopts an interpretive methodological approach and analysis. Data were collected using semi-structured interviews with a regionally located group of selected doctors (n=11) in Cheshire and the Wirral, United Kingdom.

The paper identified the powerful role of macro-national government health care structures on prescription medical doctors' decision-making. It also identified the questionable and diminishing role of sales representatives for the pharmaceutical industry.

The findings showed that, in contrast to findings under earlier structures, macro-organizational bodies such as Primary Care Trusts (PCTs) were the most commonly mentioned influence on the doctor's (hereafter termed GPs') medicine prescribing behaviour alongside cost considerations and drug budgets. In relation to previous studies in the field, the participants' views on the most important influence noted that PCTs and costs were indicated as significant as were clinical judgement and autonomy, with some resentment evident about a perceived loss of autonomy by GPs. Moreover, the influence of the government's drug accreditation body, the National Institute for Clinical Excellence (NICE), also appeared to have developed while the role and influence of the pharmaceutical industry and its sales representatives seemed to have declined.

The paper provides a valuable insight into the under-researched nexus of two paradoxically well-known organizational sectors – the interface of pharmaceutical marketing in relation to GPs. With regards to limitations, the paper recognises that, due to the challenging nature of access and confidentiality issues, it is based on a necessarily small sample size. Equally, the study takes place in a sector that is notorious for its ever-shifting context driven by governmental policies and changes.

The insights generated by the paper offer highly significant insights and impacts for providing enhanced understanding for medical doctor prescribing practices,

pharmaceutical sales and marketing strategy practices against the context of the dynamic changing organizational environment constituted by governmental health regimes.

Health care is a centrally important concern in all human societies. This research helps develop understanding in relation to marketing practices and environments at the micro-level doctor prescription/sales and marketing representative interface.

While there is significant research that has been in healthcare realm this has been less the case through an organizational and marketing perspective. The paper provides a rare insight into the doctor/pharmaceutical representative interface and interaction.

**Keywords:** Strategic Marketing, Pharmaceutical Sales and Marketing.

### **Introduction and Background: Health Care Organizational Structures and Pressures on Prescribing Behaviour**

The background to this study encompasses a consideration of the sales and marketing activity of pharmaceutical industry representatives in relation to the family doctor medicine prescribing behaviour in the UK. Family doctors, in the UK context, are known as 'general practitioners' (hereafter referred to as GPs) and work within the National Health Service (NHS) framework of the United Kingdom.

It will be valuable to provide some background to the organizational structures within which GPs and pharmaceutical sales representatives are situated. When the NHS first came into existence in 1948, GPs opposed the prospect of becoming salaried employees. They retained their self-employed status but became independent contractors to the NHS. Numerous changes have been made to the contractual arrangements between the state and GPs over the years and, although there has been a considerable growth in the number salaried GPs in recent times, most GPs are still independent contractors to the NHS. Since 2004, contracts have been negotiated between Primary Care Trusts (PCTs) and general practices rather than between the Secretary of State for Health and individual GPs (Pollock, 2005). Primary Care Groups (PCGs), which subsequently became PCTs, were created between 1997 and 1999. During the period when some were still PCGs and others had completed the transition to PCTs, the organisations were known collectively as Primary Care Organisations (PCOs). Initially, PCTs had an advisory role but from 2003 they assumed responsibility for 75% of the total NHS budget including the prescription budgets of all general practices in their areas. Prior to this, local health authorities had endeavoured to persuade GPs to limit their medicine prescribing to an approved list of drugs that they considered efficacious and affordable, but had generally not controlled what GPs prescribed. PCTs currently have a fixed drug budget and have powers to ensure that their GP practices stay within it (Pollock, 2005).



This has led to a shift in the balance of power away from individual GPs to PCTs. Under the new contractual arrangements, PCTs supervise the quality aspects of GPs' work and authorise payments for the attainment of performance targets, such as managing chronic disease. Payments may amount to up to one third of a GP's practice income and this has allowed PCTs to exert considerable influence over the GPs behaviour within their boundaries (Pollock, 2005). However, with the arrival of the coalition government in 2010 this extant organizational structuring of healthcare has been subjected to review. Whilst heated debate continues over the details the government's current plan is for PCTs to be disbanded over the next two to three years. It is further planned that the commissioning of health services will be largely returned to GPs who will be encouraged to form themselves into commissioning consortia.

NICE, a mainly independent organisation with a brief to provide national guidance on the promotion of good health and the prevention and treatment of ill-health, was formed in 1999 (as the National Institute for Clinical Excellence NICE) and in 2005, the Institute was joined by the Health Development Agency. Currently, the Department of Health (DoH) commissions NICE to develop clinical guidelines for use within the NHS. Significantly, local NHS organisations (including the PCTs) are required to meet the cost of medicines and treatments contained in NICE guidelines once they have been published for three months (NICE, 2008).

Opinions as to the effectiveness of the original NICE have been divided. Wathen and Dean (2004) found that NICE guidelines in isolation had little impact on the prescribing behaviour of GPs. Scoggins et al.(2006) reported that GPs in their study found NICE guidelines to be an objective, but not a particularly useful, source of information. Tanday (2007) highlighted claims by NICE that GPs were increasingly following its advice, but also quoted a spokeswoman from the Royal College of General Practitioners who stated that around a third of PCTs fail to follow NICE guidance. In discussing criticism of NICE, Eastham (2006) pointed to its lack of true independence due to the fact that it must take its instructions from the DoH rather than decide itself which treatments to evaluate. Eastham (2006) also referred to a woman who was refused a cancer treatment by her PCT because it had not been approved by NICE. When the matter attracted extensive media interest, the Government Health Secretary, at the time, pronounced that the drug would be made available to any woman who required it, even though NICE had not been due to appraise the drug until the following August. Eastham (2006) believed that this action shattered the notion that NICE is independent, but he believed that the general consensus was that NICE is a force for good which should be reformed rather than removed.

In summary to this section of the discussion, it can be seen that the organizational context within which sales operatives in the pharmaceutical industry operate can be determined as a complex one (Daft, 2011). Moreover, it is prone to dynamic change and short-termist political

intervention. This creates a potent challenge for the pharmaceutical sales representative and their sales and marketing corporate operations and the next stage of the paper moves on to consider some of the implicit issues.

### **The Pharmaceutical Industry: Background and Sales and Marketing Context**

The pharmaceutical industry, like the NHS, is a giant both in a global sense and in terms of its importance to the UK economy. The Association of the British Pharmaceutical Industry (ABPI) is the trade organisation of the industry and represents more than 75 companies. These companies research, develop, manufacture and supply more than 80% of NHS medicines (ABPI, 2006). The ABPI pointed out that in 2004 the pharmaceutical industry invested more than £3.2 billion in research and development in the UK; a greater amount than any other sector and it also employed more scientists than any comparable part of the economy. In addition, the pharmaceutical industry employed 73,000 people and generated a further 250,000 secondary jobs. Exports in 2005 amounted to £12.2 billion, creating a trade surplus of £3.4 billion. It was claimed that the industry is consistently in the top three of all industries for export surplus and that 18 of the top 100 medicines in the world were discovered in the UK, which is more than any other country except the United States of America (USA) (ABPI, 2006).

A parliamentary report into the influence of the pharmaceutical industry substantiated the ABPI's claims in terms of the industry's importance to the economy and also recognised that it takes an average of 12 years and over £500 million investment to bring a single new drug to market (House of Commons, 2005). However, it was concerned by the fact that medicines cost the NHS in England over £7 billion every year and that this sum, of which 80% is spent on branded (patented) medicines, accounted for approximately 12% of the total NHS budget (House of Commons, 2005). Furthermore, the ABPI reported that around 14% of the UK pharmaceutical industry's expenditure is on marketing and promotion and that approximately 8,000 drug company representatives are employed in the UK. According to the report the cost of this expenditure in monetary terms amounts to some £1.6 billion (House of Commons, 2005).

With regard to commentary and literature on sales and marketing in general, and on the pharmaceutical industry and context, in particular, although there is a large body of literature relating to sales and sales management any existing frameworks designed to assist sales planning tend to have a narrow focus and lack a management orientation (Neves et al, 2010). According to Jones et al (2005) research into effective selling and sales management lags behind other areas and is predicated on models and assumptions that were often developed decades ago and which may need to be revised in the light of dramatic changes in the marketplace. This is despite the fact that selling and sales management activity is frequently crucial to the achievement of business and marketing objectives. This is substantiated by a

review of (strategic) marketing texts which typically, at best, dedicate very pages to sales forces and process and what is present echoes the above observations (see by way of illustration the treatment of sales in: Czinkota, Ronkainen and Zvobgo (211); Ferrell and Hartline (2011); Dubois, Jolibert and Muhlbacher (2007)). As a consequence, Jones et al (2005) argue that there is a compelling need to develop new theory around the sales and marketing interface in order to respond to the contemporary business environment.

How good is marketing in the pharmaceutical sector? A survey by Stuart-Kregor (2006) of healthcare marketers and their managers concluded that the industry seemed to believe it was doing a good job but that in terms of customer's perceptions of the value offered it was a long way short of excellence. As long ago as 2002, Doyle noted that as a result of the high costs of employing sales personnel, ethical pharmaceuticals is one of the very few remaining industries that can afford to sustain a huge sales force. Outside the pharmaceutical industry a trend has emerged towards an increasing concentration of buyers which has also led to a reduction in sales force numbers (Doyle, 2002). Moreover, this concentration of buyers has also been gradually increasing in the NHS since the formation of PCTs in 2004 but it seems that the UK pharmaceutical industry appears to have been slow in responding to these changes.

Traditional marketing planning suggests a 3-step approach to sales force design. (Neves et al, 2010). The first step begins with environmental analysis following which corporate objectives are set and a business plan is produced. In step two marketing objectives are determined and a marketing plan is compiled. Where the sales force is seen as a component of promotional activity in the marketing plan the third step is the production of a sales plan. From this, it follows that if there is any discrepancy between the environmental analysis and what is actually happening in the marketplace the sales plan may be unsuited to its' purpose. In relation to this point, Jolly et al (2005 p. 156) suggest that in the pharmaceutical industry 'innovation in the more strategic aspects of business and marketing is not well rewarded (being less well understood and more risky)' resulting in a tendency towards inertia in these areas.

In advocating timely organisational change of the sales function in the pharmaceutical industry Smith (2009) describes the industry as 'traditional and insular'. Zoltners et al (2009) urge pharmaceutical companies to embrace change and to adopt a structured approach in constantly refining their sales strategies in order to respond to uncertainties in the marketplace. Willink (2009) observes that the pharmaceutical industry is highly regulated and that the dominant culture within it is one of reliance on established practice. He reports encountering numerous great managers in the pharmaceutical arena but precious few genuine leaders and he urges pharmaceutical managers to adopt a transformational rather than a transactional approach to sales and marketing. Furthermore, Piercy and Rich (2009) note the global adoption of lean manufacturing principles as developed by Toyota, Japan. As

this requires modifications to the purchasing and supply processes of those companies who adopt lean principles it also demands a reorganisation of the sales and marketing efforts of their suppliers. Piercy and Rich (2009) believe that in order to adopt a true market led approach companies seeking to sell to organisations who are striving to become leaner in their operations should also adopt lean principles. Citing Jones and Mitchell (2006) Piercy and Rich (2009) observe that in the UK public sector the NHS has become one of the most significant adopters of lean processes and that this has focused on the way in which the NHS's £20 billion procurement budget is distributed. This has in turn required NHS suppliers to adapt their sales force activity to meet the new challenges.

There are empirical cases available to point up organizational adaptations in response to the challenges faced in pharmaceutical sales. In 2004, the Japanese company Takeda (one of the top 15 global pharmaceutical companies) identified that the principal feature of the UK healthcare market was its fragmentation into geographically based Primary Care Trusts. As a result Takeda replaced its traditional sales representatives with Regional Account Directors whose role was to engage with PCTs and other health trusts rather than with individual doctors in order to build long-term strategic relationships. This bold strategic move was rewarded by Takeda UK Ltd. being shortlisted for 'Company of the Year' in the Pharmaceutical Effectiveness Awards in 2005 and in a 25% growth in sales during the first six months of 2006 (Rogers, 2009).

The long range prospects for the pharmaceutical industry are discussed in a report called Pharma 2020 produced by management consultants PricewaterhouseCoopers. This report forecasts the outlook for the industry to the year 2020 and predicts that by the year 2020 the existing sales model with armies of representatives calling on GPs will be replaced by one where a much smaller number of key account managers will make their representations at a much more senior level to policy makers, regulators and providers (PricewaterhouseCoopers, 2007). This suggestion would represent a sea-change in the manner in which much of marketing and sales are conducted by the industry. David Quigley (2011), Director of Global Commercial Practice for Pharmaceuticals and Medical Products at the leading global consultancy McKinsey and Co. contends that despite any downsizing that has occurred, or which may occur, in future personal selling will continue to play a prominent and important role in pharmaceutical promotion. However he believes that the issue of sales force productivity will be a top priority.

While the House of Commons (2005) report saw prescription drugs as making a huge contribution to the health of the nation in terms of improving the quality of life, reducing the need for hospitalisation and saving lives, it also recognised the huge costs involved in developing drugs. The report criticised drug licensing procedures, marketing and promotion and recommended that tougher restrictions should be placed on GPs' prescribing activities (House of Commons, 2005). The ABPI countered by publishing a manifesto in which it

claimed that the prices of medicines have fallen by over 20% over the last decade, and that British doctors prescribe fewer medicines in general and fewer modern (patented) medicines than other comparable European countries (ABPI, 2006). The ABPI also asserted that despite the enormous costs of drug development only 1 in 10,000 compounds identified in research will ever make it to market and of these only 1 in 3 will ever recover their costs. It further stated that the cost of the average prescription is £11 but the cost of a day in hospital is close to £250 and that therefore pharmaceutical interventions can save money compared with the costs of hospitalisation (ABPI, 2006).

### **A focus on the Nexus of Medicine Prescribing, GPs and Pharmaceutical Representatives**

The argument has now outlined the organizational and governmental structures that surround the healthcare and pharmaceutical environments in the United Kingdom context. The discussion then progressed to provide a range of comments and insights in relation to sales and marketing literature focusing on the pharmaceutical sector. It will now be pertinent to consider a number of points concerning the relationships and interactions between sales representatives in the pharmaceutical industry and GPs.

There have been numerous studies concerning elements of prescribing practice over the last decade. In relation to the role of the pharmaceutical industry, Carthy *et al.* (2000) reported that GPs felt they were not unduly influenced by pharmaceutical representatives. Scoggins *et al.* (2006), in their research concerning prescribing in primary care, found that there was no consensus on the influence of the pharmaceutical industry, although most GPs had reported confidence in their ability to withstand any sales pressure from pharmaceutical representatives. However, other studies have highlighted the role of pharmaceutical industry promotion, particularly pharmaceutical representatives, in influencing GPs' prescribing decisions. Prosser *et al.* (2003) explored the influences on GPs' prescribing decisions in the north west of England and found that on most occasions, a decision to prescribe a new drug derived from a number of factors, predominantly social, situational and psychological, which converged with clinical and pharmacological considerations. Some decisions to prescribe a new drug were motivated by its perceived economic or pharmacological advantage, but often a new treatment was initiated as a result of the suboptimal performance of the first-choice drug. However, it was pharmaceutical industry representatives who were the most frequently cited as having influence on prescribing which was viewed by the researchers as disconcerting because they believed that information derived from this source may be subject to bias (Prosser *et al.*, 2003). The findings of Prosser *et al.* (2003) mirrored those from the earlier work of McGettigan *et al.* (2001), conducted in the Republic of Ireland, which also emphasised the strong influence of sales and marketing activity by pharmaceutical industry in doctors' prescribing decisions.

Prosser and Walley (2003) investigated GPs' reasons for seeing pharmaceutical representatives. Their findings suggested that although GPs were very aware that representatives could influence prescribing, they did not feel that their own prescribing was unduly influenced. Despite this, the findings showed that the pharmaceutical representative was highly influential and that a key explanation for this influence was the method of marketing communications employed (Prosser and Walley, 2003). Jones *et al.* (2001) also found that drug company representatives were an important information source for GPs, though argued that the candour with which both consultants and GPs discussed the influence of the pharmaceutical industry suggested that they did not believe that the information from this source was significantly tainted by bias. Although neither Jones *et al.* (2001) nor Prosser *et al.* (2003) described it as such, Armstrong and Ogden (2006) argued that both sets of authors identified a 'multiple source model' which guides changes in GPs' prescribing behaviour. This relates to the multiple sources of information that GPs have been shown to combine in order to facilitate a change in prescribing behaviour.

In their 2005 study, Prosser and Walley researched GP and Primary Care Organizations (PCO) stakeholders' attitudes to the importance and influence of *cost* on prescribing behaviour. They found evidence of a conflict between a PCO commitment to cost control and GPs who were resistant to cost-cutting at the expense of individual patient benefit (Prosser and Walley, 2005). Prosser and Walley (2007) also looked at the impact of PCOs on GPs' prescribing behaviour. The fact that Primary Care Organisations are referred to in the title of the study rather than PCTs may be revealing as to the timing of data collection. This was in June and July 2001 when both PCOs and PCTs were in existence and before PCTs assumed the wider powers that they currently exhibit. Prosser and Walley found that at this time there was conflict between the views of PCO managers and GPs in respect of drug prescribing. They predicted that the incentivisation which was then practised by PCOs might not be sufficient to achieve the desired outcomes in prescribing behaviour and that in future penalties might need to be imposed on GPs in order to persuade them to comply with PCO policies (Prosser and Walley, 2007).

Authors in the field with professional status in, or links to, pharmacology, such as Aronson (2006), Cantrill (2000) and Maxwell (2005), have tended to focus their writing on apparently 'unscientific' and 'inappropriate' prescribing behaviour by doctors as they explored the reasons why doctors deviated from published guidelines in their prescribing behaviour. Other authors (Britten, 2001, Freeman and Sweeney, 2001, Greenfield *et al.* 2005), writing from a medical perspective, offered some justification for a more subjective approach to prescribing decisions, particularly in instances where patients express their views on treatment options. Maxwell (2005) was sympathetic to prescribers who may be faced with conflicting guidelines from differing but apparently expert sources, believing that while evidence-based medicine should be the goal, achieving this requires clinical experience, common sense and a firm grasp of clinical pharmacology principles. Cantrill (2000) explored

the appropriateness of GPs' prescribing measured against the recommendations made in the British National Formulary (BNF), a publication produced by a Joint Formulary Committee composed of representatives from the British Medical Association (BMA), the Royal Pharmaceutical Society and the DoH. The findings showed that GPs were prepared to prescribe outside the recommendations of the BNF, described as "emotional" prescribing (Cantrill, 2000). Moreover, Aronson (2006) discussed inappropriate prescribing with reference to NICE and other guidelines and stated that it was too early to evaluate the effectiveness of prescribing guidelines computer reminders to doctors, but cited negative experiences. In addition, Greenfield *et al.* (2005) studied the variation between GPs', cardiologists' and practice nurses' prescribing decisions in respect of medicine to prevent coronary heart disease and found that respondents concerns centred on five main areas. These were the risks and benefits of treatment, the patient's role in the treatment, patient characteristics, costs to the patients and costs to the health service. Their conclusion was that prescribing behaviour may be influenced by more subjective factors (Greenfield *et al.*, 2005). Freeman and Sweeney (2001) found the implementation of evidence by GPs to be a fluid and complex process; GPs' decisions were influenced by their personal and professional experience as well as by their knowledge and relationship with the patient. In their study, GPs appeared to view clinical evidence as a square peg which required modification in order to fit the round hole of the patient's life (Freeman and Sweeney, 2001). This air of conflict was captured by Britten (2001), who writing at the inception of NICE and PCOs, described prescribing in general practice as a battlefield where doctors and the State are fighting over the cause of clinical autonomy.

Armstrong and Ogden (2006) undertook a qualitative study exploring the influences on the prescribing decisions of a sample of British GPs and found that clinical autonomy formed the keystone of professional identity for GPs which made them resistant to change agents. Two themes were identified which were termed *clinical etiquette* and *clinical experimentation*; both of these elements allowed change to occur within a framework of commitment to clinical autonomy (Armstrong and Ogden, 2006). Moreover, Barber *et al.* (2005) investigated current methods of measuring the appropriateness of prescribing in primary care and found that the measures in place depended predominately on pharmacological criteria and did not take into account patients' views and contextual factors. This was further contextualised by government research. A questionnaire survey of almost 1000 GPs was conducted for the National Audit Office regarding various aspects of GPs' prescribing behaviour (doctors.net.uk, 2006). The findings showed that the BNF was seen as the most objective and the most useful source of information; NICE clinical guidelines were ranked 4<sup>th</sup> on both scales, with pharmaceutical representatives and company literature ranking at, or close to, the bottom in relation to both usefulness and objectivity. The majority of GPs reported that they still saw pharmaceutical representatives, but that their prescribing advisers had much more influence on them (doctors.net.uk, 2006). Scoggins *et al.* (2006) reported that they had found many factors that influenced GP prescribing behaviour; some of the major influences

were the availability of clear evidence in authoritative journals and the GP's own knowledge and professional experience. The GPs reported that they would change their prescribing behaviour on the basis of clear evidence, financial savings, the convenience of use and the perceived patient or practice benefit (Scoggins *et al.*, 2006).

### Summary Comments on the Literature

A quantity of literature exists which is concerned with the subject of doctors' prescribing decisions. Some writers, including Greenfield *et al.* (2005), have focused on the patient perspective in prescribing decisions (or problem), while others such as Armstrong and Ogden (2006), Britten (2001) and Freeman and Sweeney (2001) stressed aspects central to the doctor. A third group represented by Cantrill (2000) and Maxwell (2005) has been concerned with clinical guidelines (or the social context). These factors do not exist in isolation but are inextricably linked components in a doctor's prescribing decision, as shown in the study of Scoggins *et al.* (2006).

However, the topic of influences on GPs' prescribing decisions has received less recent research attention than might be expected given the enormous economic, social and political implications consequent upon this activity.

There have been few published research studies conducted after PCTs and NICE had been established long enough to exert a significant influence. For the purposes of the present paper, the discussion has worked to indicate the extent to which these local and national bodies have changed, or have the capacity to change, the prescribing landscape. The argument also considers the affect that any changes to the changing organizational structure of health care provision might have on the UK pharmaceutical industry's marketing strategy. From this consideration of the literature and empirical context a number of factors have been surfaced. Firstly, with regards to discussions on sales in the management and organization literature, there is a paucity of commentary on sales. What exists is allocated miniscule amounts of space in key texts and has tendency to offer rather dated views of the modern sales environment and realities. Secondly, in relation to considering sales within a pharmaceutical business context it is evident that sales forces and representatives have been a staple of the industry for through many recent decades. However, there are signs that this *status quo* is in transition and transformation as pharmaceutical companies begin to review the shape and practices of their businesses. This questioning of the effectiveness of pharmaceutical sales representatives is set against a healthcare sector that is one of continual change and transition. A large majority of this change is driven by politics and policy at a government level. In spite of this, GPs have repeatedly demonstrated a capacity to resist, to some greater or lesser, prescribing dictates. This nexus of the interaction between the GP and the 'sales rep', therefore, constitutes a substantially under-researched dimension of the outlined context. It is this above-discussed amalgam comprised of GPs, Pharmaceutical Sales



Representatives and government policy, with all three set in a turbulent environment, that the field work is now ready to elaborate.

### **Design/methodology/approach**

The field work for the study was qualitative and interpretive in nature and used semi-structured interviews to collect the data (Van Maanen, 1998, 2010; Czarniawska, 1998; Gabriel, 2000, 2004; Watson and Harris, 1999, 2008; Weick, 1995, 2001). As a consequence, the approach was mindful of issues of reflexivity wherein it is acknowledged that the researcher-respondent are conjoined in a sense-making process which is unavoidable and inevitable (Alvesson and Skoldberg, 2009).

Robson (2002) cites studies focusing on the meaning of phenomena to their subjects and those studies where the individual perceptions of processes are sought through interviews, as being studies where a qualitative approach is most appropriate. These circumstances aptly describe the nature of this study.

Initial consideration was given to undertaking a postal survey either instead of or to complement the semi-structured interviews. However this approach was rejected because such surveys tend to produce a low level of response (Proctor, 2005) and many participants prefer to be interviewed because this enables them to be given assurances about the way in which information will be used (Saunders et al., 2003). Furthermore studies against which the research would be benchmarked also used semi-structured interviews (Carthy et al, 2000, Jones et al, 2001, Prosser et al, 2003, Prosser & Walley, 2003,).

The study had three main aims:

- to ascertain the main influences on GPs' prescribing behaviour;
- to explore the specific factors that influence GPs' prescribing behaviour in terms of local influences, national influences, the pharmaceutical sales representatives and industry and financial constraints;
- to determine what, if any, changes GPs foresaw in terms of future influences on their prescribing behaviour.

The GPs were asked a series of largely open-ended questions within a format which was generally consistent across the series of semi-structured interviews. Broadly the format of these questions revolved around 3 distinct questions with a follow-up question which enabled the participant to expand on previous answers or introduce a new perspective. The questions deliberately probed the GPs' opinions regarding the influences on prescribing decisions in general and were not specific to the individual GPs' own prescribing behaviour. Within the study, the influences on GPs' prescribing behaviour referred to those influences that exist after a diagnosis had been made, and not to the signs and symptoms which naturally influence a doctor's diagnosis.

An interview schedule was designed to guide the interviews. These were conducted with GPs (n=11) practising in Cheshire and the Wirral, England. Fourteen GPs were originally invited to participate in the study, with one declining and two subsequently dropping out due to problems with access. The participants were selected from three different PCT areas, with two female and nine male GPs taking part. These doctors formed a purposive, judgemental sample. The individuals invited to participate were judged to possess the necessary knowledge base, were accessible, suitably experienced and formed a part of the social structure on which the research focused.

With regard to research procedures, a standard letter sent to the participants set out the purpose of the research, the time allocation, a guarantee of anonymity and gave assurances of consultation with the Local Research and Ethics Committee. It is a requirement of the UK research governance framework for healthcare (NHS, 2005) that all research conducted within the NHS is referred to a Research and Ethics Committee. Approval for this study was sought and received confirmation that the project was not required to be ethically reviewed under the terms of the Governance Arrangements for Research Ethics Committees in the UK.

From an ethical standpoint, the study ensured adherence to the commonly held codes for conducting research. These included recruiting all participants through informed consent and upholding their right of self-determination (i.e. to take part or withdraw at any time without explanation). The principle of justice, requiring fairness and adherence to the notion that the needs of individuals must come before the research process, was met by meeting GPs at their convenience in their own surgeries if that was their preference (and it was throughout) and postponing or terminating the interview if the GP needed to give attention to their patients.

The participants were asked if they consented to the interview being tape recorded; two declined and written notes were taken of their interviews and written up immediately afterwards. The GPs were asked a series of largely open-ended questions which probed their opinions regarding the influences on prescribing decisions in general and were not specific to the individual GP's own prescribing behaviour. A final question enabled the participant to expand on previous answers or introduce a new perspective.

The tape recorded interviews were transcribed by the researcher and the transcripts were sequentially coded D1 through to D11. The data were analysed and coded to explicate themes in relation to the research questions. After the data had been gathered the transcripts were searched for references to discrete influences and when all these had been identified a matrix was constructed. Such an approach may be termed data reduction as advocated by Miles and Huberman (1994).

In summary to this methodological section, it is important to indicate that the principal limitation of this research was that the sample was not designed to be statistically representative and therefore care must be taken in attempting to extrapolate the results to a wider population. A limited degree of generalisability may have been achieved by the fact

that the sample was drawn from three different PCTs with no discernible differences in responses, but the size of the sample was such that no strong claim is made in this regard.

### Findings on Interviews with GPs – What Role for Pharmaceutical Sales?

*Table showing analyses and tabulation of the influences on GPs' prescribing decisions*

GP Code →	D1	D2	D3	D4	D5	D6	D7	D8	D9	D10	D11
PCT	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
NICE	✓		✓		✓	✓					✓
Consultants			✓			✓			✓	✓	
BNF	✓				✓						
Pharmaceutical industry Sales/Marketing			✓			✓			✓		
Patient wishes	✓										✓
Cost/budget	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Other medication/ drug interactions	✓										
Medical press			✓		✓	✓					
Guidelines			✓			✓				✓	
Previous experience or training			✓		✓	✓		✓			✓
Practice Colleagues			✓								
Educational meetings			✓						✓		
Familiarity							✓	✓			
Drug safety			✓	✓					✓		✓

### Preamble on Findings

The most commonly mentioned influences on GP prescribing behaviour in the current organizational health care structure were the quasi-governmental organizational structure such as the PCT, together with drug costs and drug budgets; these were cited by all of the GPs, followed by NICE and the GPs' previous experience or training (aligned with arguments provided above by Pollock, 2005; Scoggins, 2006).

Local hospital consultants were seen to exert an influence, as did drug safety, but the medical press, guidelines, the pharmaceutical industry, patient wishes, educational meetings, the BNF, familiarity, practice colleagues and drug interactions were all seen as being less influential. As will be discussed below, this has major implications for the

### **Sales and marketing practices of the pharmaceutical industry**

The participants were asked which were the most important influences on their prescribing decisions and, while no new themes were introduced, more disparity was evident. Whilst the PCT and cost were universally cited when the GPs were asked about the main influences on prescribing decisions, these influences were only reported three times in the case of the PCT and once in the case of cost (in tandem with mention of the PCT). No real pattern emerged, but three of the GPs focused on their own clinical judgement, and by implication their own clinical autonomy, while the responses of another three other also alluded to clinical judgement.

The remaining discussion on the Findings is organized into a number of emergent themes:

#### **Local influences on GPs' prescribing decisions**

As the PCT and drug budgets were universally cited influences on prescribing decisions, with local NHS consultants also proving to be influential, it appeared from the data that local factors were dominant in prescribing decisions. Although the PCT and drug budgets were mentioned by all GPs, these were not generally regarded as benign influences and some resentment was evident. Comments included:

- I mean the underlying prescribing decisions GPs make is how they're going to help a patient. I feel that currently we are being a little bit restricted with PCT budgets and the way that the Department of Health are screwing us down to prescribe the cheapest drugs available rather than the best drugs available (D5).
- I think the other thing that does alter is the issue now of the interface with PCT and cost and funding and I think that's probably one of the most significant and frustrating aspects of prescribing these days because as I frequently say I think I'm a civil servant not a clinician....it is based on cost (D6).
- I am concerned at the constraints put on general practitioners by the Government through its various agencies such as the Primary Care Trusts which are limiting what we can and cannot do (D7).
- You're being railroaded into prescribing in a certain way dictated by cost – and dictated by PCT and government (D8).

A key finding emerging from the respondent comments is the very real power and influence exercised by factors that are not necessary clinical. Not only is the GP's expertise being occasionally compromised by this, equally, it is clear that they are not readily able to

take on board other information and indications, including, for example, sales representatives from the pharmaceutical industry.

### **National influences on GPs' prescribing decisions**

National influences such as NICE, medical journals and the BNF were clearly influential although the data suggested that their influence was less important than local influences. For example:

- Some GPs may be influenced by what the PCT is telling them and what NICE is telling them (D1).
- My main source of drug information is still the BNF (D5).

The overarching nature of quasi-governmental bodies is all pervasive and insidious. It is clear that this presents a major 'competitor' to any influence that might be able to be exerted by the pharmaceutical industry.

### **The influence of the pharmaceutical industry on GPs' prescribing decisions**

The pharmaceutical industry did receive several mentions as a factor in prescribing behaviour, but this seemed to be much less influential than other factors such as the PCT and NICE and when specifically asked about the current significance of the pharmaceutical industry in influencing prescribing decisions, many of the GPs confirmed perceptions of its waning influence under the extant organizational structure:

- And I suppose, let's be honest, at the bottom of the list comes what you hear from the drugs rep (D3).
- A lot less important now to be honest. I mean, when I was first in general practice, I think then drug reps did have a great influence really on what you did because I think you came out of medical school and we hadn't had much about drugs and prescribing and certainly you didn't bother about cost then. And I think it's different now with new GPs coming out. Much more aware of being a holder of a public purse than we probably were thirty years ago when I was first a GP (D2).
- I think the rebound effect on that is frustration from the reps' point of view in that even though they are portraying a good new drug, the doctors, even though they might want to try it, are being penalised if they do try it. And then there's the knock on effect of short term benefit for the PCT but a long term loss for people in general in the pharmaceutical industry in that there'll be less money available for funding new drugs (D8).
- It has no influence at present. I see many reps but I don't do anything for them (D10).
- Not very much. They provide the data sheet but little else. The pharmaceutical adviser gives most of the data nowadays (D11).

The picture that emerged from the study in relation to pharmaceutical sales representatives was an ambivalent and ambiguous one. The historical transformation of the sales 'reps' role was most apparent. Overall, there was a sense that power was slipping away from the 'reps' due to the influence of quasi-governmental structures (such as, for example PCTs and NICE) however this was far from being the definitive conclusion. Some GP respondents were still reporting the influence of sales representatives. There was very much a sense of the 'rep' being a person with whom the GP might discuss prescribing behaviour and enter a dialogue rather than simply being dictated to by a decree from a centralised body.

### **The influence of financial constraints on GPs' prescribing decisions**

Financial constraints were clearly influential factors as cost or budgets were said by all the GPs to influence prescribing decisions:

- Cost can be the main driver for PCTs deciding on certain things (D1).
- They [the PCT] are always cautious about prescribing because of money, not in the interest of the patient (D9).
- PCT guidelines depend on the cost of the drug. Expensive drugs will be too much burden on the Trust. We tend to prescribe the cheaper drugs which are off patent (D10).

### **Future changes envisaged by GPs in influences on prescribing decisions**

When asked how they saw the influences on prescribing changing in the future, the GPs produced a variety of answers with a common theme. The overwhelming opinion expressed was that PCTs were likely to become even more influential in future and that the cost of drugs is likely to come under even greater scrutiny. Some GPs saw NICE having a greater influence, mentioning an increased focus on guidelines. Some concerns were expressed about the future influences and the effect they would have on GPs' practice and a certain amount of resentment and frustration was evident regarding the perceived loss of autonomy. Comments included the following.

- I think the PCT influence will be much greater. I think the NICE driven and the guideline driven influence will be greater. ... I think more and more we're going to be restricted in what we can prescribe (D3).
- There is going to be a lot more pressure from PCTs to prescribe within budget which will become a more significant influencing factor (D4).
- I think the evidence will come less from pharmaceutical representatives. I think it will increasingly come through either journals or some electronic method. Things like the PCT are going to start being more of an impact because they already are (D6).

- I'm concerned at the pressures that we get to change prescribing which is often not to the benefit of the patient and is often not cost effective because very often consultation time is wasted in explaining it and then if the patient is unhappy with the changes that are made and having to revert back to the original having spent perhaps half an hour altogether in a pointless and fruitless exercise. But I feel that's the direction that they're trying to push us (D7).

## Discussion

The main influences on the GPs' prescribing decisions were shown to be multi-factorial, in line with the findings of Scoggins *et al.* (2006). Local influences appeared to dominate over national influences and the pharmaceutical industry, whilst still a factor, was not a main influence on prescribing behaviour.

### Local influences on GPs' prescribing decisions

All the GPs in the current study cited local influences in the form of the PCT and (local) drug budgets as influences on prescribing with the evidence further suggesting that this was not always seen as a welcome prospect. Prosser and Walley (2005) also found evidence of conflict between PCO commitment to cost control and GPs who were resistant to cost constraints if they were not in the interests of patients. In 2007, Prosser & Walley again reported evidence of conflict between the views of PCO managers and GPs in respect of drug prescribing; these data were collected before the advent of the PCTs and NICE. Prosser and Walley (2007) predicted that the incentivisation which was then practised by PCOs might in future be insufficient to achieve the desired outcomes in prescribing behaviour and that it might be necessary to penalise GPs in order to encourage them to conform to PCO policies. It does appear that PCTs and cost control are now very much stronger influences on GPs' prescribing in the eyes of the GPs in the current study, although the element of conflict was still present.

### National influences on GPs' prescribing decisions

National influences on prescribing decisions received relatively little attention in the academic press until recently.

While Wathen and Dean (2004) reported that NICE guidelines in isolation had little impact on the prescribing behaviour of GPs, Scoggins *et al.* (2006) found GPs reported that they considered NICE guidelines to be an objective, but not a particularly useful, source of information, though NICE was ranked fourth in relation to both elements by GPs in the doctors.net.uk survey (doctors. net.uk 2006). Tanday (2007) referred to claims by NICE that GPs are increasingly following its advice with some circumspection, while Aronson (2006) cited negative experiences in this respect.

The findings of the current study showed that NICE was one of the most frequently mentioned influences on prescribing decisions, indicating that NICE may be becoming more influential.

Cantrill (2000) explored the appropriateness of prescribing with reference to the BNF which she described as a very well respected publication which is in widespread use. The doctors.net.uk survey showed that the BNF was seen as the most objective and the most useful source of information by GPs (doctors.net.uk, 2006). While the BNF was cited as an influence by GPs in the current study, as were guidelines and medical journals, none of these were among the most frequently mentioned influences. This suggested that, at least amongst the group of doctors in the current study, local influences presided over national influences.

#### **The influence of the pharmaceutical industry on GPs' prescribing decisions.**

According to the GPs interviewed, the pharmaceutical industry is not currently a major influence on prescribing decisions. These findings accorded with those of Carthy *et al.* (2000) and the doctors.net.uk study, (2006), but were at odds with the earlier findings of Jones *et al.* (2001), McGettigan *et al.* (2001) and Prosser *et al.* (2003), all of whom found that the pharmaceutical industry was an important influence, and in the case of Prosser *et al.* (2003), that the pharmaceutical representative was the most frequently cited influence on GPs' prescribing decisions.

The findings from these earlier research studies can be contextualised in light of the work being conducted before PCTs and NICE either existed or could have had any influence on prescribing decisions. A later study by Scoggins *et al.* (2006) reported no consensus from GPs on the influence of pharmaceutical representatives. The findings of the current study showed that the GPs felt that the PCT, drug budgets and NICE were stronger and more important influences on their prescribing behaviours than the pharmaceutical industry. This strongly suggests that the influence of the pharmaceutical industry is waning, lending support to the findings of the doctors.net.uk (2006) survey, which ranked pharmaceutical information near the bottom in terms of usefulness and objectivity. However, as the UK approaches yet another transformation and the current PCT structure is about to be transformed, the role of the pharmaceutical sales and marketing representative may have the potential for a resurgence.

#### **Conclusions about the influence of financial constraints on GPs' prescribing decisions**

Drug costs or drug budgets are both derived from, and are inextricably linked to, local PCT policy and were mentioned as an influence on prescribing by every GP in the current study. However, the data implied that the GPs were not entirely content that cost should have such a great bearing on prescribing decisions. Evidence of conflict between GPs and PCOs was found in the work of Prosser and Walley in both their 2005 and 2007 studies.



If such conflict or detachment does exist, it would be interesting to know whether this derives solely from an altruistic desire to help patients irrespective of the cost or whether it is motivated more by a resentment of PCT interference in an area where GPs previously enjoyed greater autonomy.

#### **Future changes envisaged by GPs in influences on prescribing decisions**

There was a widespread belief that quasi-governmental organizations such as PCTs were likely to become even more influential in future and that the cost of drugs was likely to become an increasingly important influence on prescribing decisions. It was evident that the GPs expected that in future they and their colleagues would be increasingly subject to PCT strictures in prescribing matters. There was a degree of resentment and frustration at this prospect; this seemed to be largely due the loss of autonomy. Britten (2001) and Armstrong and Ogden (2006) have highlighted the importance of GPs' autonomy as being a key factor in their professional identity. The current study showed that while GPs were cognisant of the requirements of working within the current framework of healthcare organisation, for many the constraints placed upon them diminished their autonomy and led to feelings of resentment and frustration.

Pollock (2005) had anticipated a shift in the balance of power in the favour of PCTs as a result of the new GP contract. Prior to this, Britten (2001) had likened general practice as a battlefield upon which doctors and the state were fighting over the cause of clinical autonomy. Using this analogy, the comments of the GPs in the current study suggested that they believe that this battle was currently going firmly in favour of the PCTs and that the cause may have already been lost. However, with the planned organizational changes, some adjustment may occur in future.

The issue at the heart of these matters is – where should the judgement reside? Should it be with the highly-trained GP who has specific knowledge of the patient's symptoms, co-morbidities and desired outcomes, or at the other extreme, should it lie with the State (in the form of PCTs and NICE), which may be concerned with ensuring that prescribed medicines are evidence-based but which also needs to control the costs of prescriptions issued to an ageing population with increasing life expectancy and with increasing expectations of the medical profession.

In many ways the pharmaceutical industry has been too successful for its own good. Largely as a result of pharmaceutical innovation life expectancy in the Western World has increased to the point where the working population faces an increasing tax burden in order to pay for the healthcare requirements of the retired population. It remains to be seen how the multi-billion pound UK pharmaceutical industry can exert its influence in future.

## Conclusion

This study set out to discover what the main influences on GPs' prescribing decisions are. If the main influences are synonymous with the most frequently cited influences then the answer to the research question is unequivocal: it is the organizational structure of the PCT together with drug costs and drug budgets, followed by NICE and previous training and experience.

These may well be the main influences; however it may be imprudent to draw this conclusion too readily. When the GPs were asked which were the most important influences on prescribing decisions, the GPs' clinical judgement appeared to be at least as important as the PCT and much more important than cost considerations. Therefore it appears that, in the opinion of the GPs in the study, the PCT may be the most potent influence on GPs' prescribing decisions as long as the PCT advice is consistent with the GPs' clinical judgement. This suggests that although GPs currently value their clinical autonomy highly, they envisage that it may well be at risk in the future. The principal party for whom the findings of this study may have implications is the pharmaceutical industry. It appears that the UK pharmaceutical industry may have been slow to recognise the significant changes that were occurring in its market. Major strategic change may be indicated to the way in which the pharmaceutical industry targets its marketing and promotion. In particular the need to target organizational structures rather than individual GPs is indicated whether those organizational structures be PCTs or groups of GPs acting in commissioning consortia. Such an approach would be consistent with PriceWaterhouseCoopers' report which forecasts a much smaller and more specialised pharmaceutical sales force by the year 2020 (PriceWaterhouseCoopers, 2007)

Pharmaceutical companies are accustomed to targeting their promotional activity towards individual GPs who treat individual patients. PCTs by contrast are concerned with the health of large populations or at least significant cohorts of patients rather than individuals. This may mean that clinical data in support of drug promotion may in future need to be supplemented with pharmacoeconomic data which demonstrates the cost-effectiveness of treating large groups of patients in order to provide an attractive proposition for PCTs to make purchasing decisions. In consequence it may well be the case that the future and the way forward may consist more of a collaborative and allied approach, rather than the current one which can be seen more as contested and adversarial. Pharmaceutical marketing departments and governmental infrastructures may yet find common ground to work to the benefit of the overall healthcare aims and objectives.

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## THE ASSOCIATION BETWEEN MANAGEMENT PERPETRATED FRAUD AND CORPORATE GOVERNANCE DEFICIENCIES

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### Abstract

This paper presents empirical evidence on the relationship between corporate governance deficiencies and the incidence of management perpetrated fraud. Based on a sample of Australian public companies that had encountered management perpetrated fraud during the period 1991 to 2006, it was found that inadequate corporate governance was associated with the likelihood of a firm experiencing management perpetrated fraud. The key finding was that as the proportion of independent directors on the board increased the likelihood of a company experiencing management perpetrated fraud decreased substantially. Notably none of the other possible corporate governance mechanisms were found to substantially decrease management perpetrated fraud. In aggregate, these results offer further support to the agency theory assertion that the appointment of independent directors to the board is an effective control over agency conflict. Therefore, the empirical evidence of the paper is supportive of the appointment of mandatory levels of independent directors to the boards of public companies.

**Keywords:** Corporate governance, fraud, company directors, independent boards

### Introduction

Historically, management perpetrated fraud has been considered to be a significant factor in the failure of many companies throughout the world. In many countries, including the USA, the cost of fraud is high. In the USA, The Association of Certified Fraud Examiners has estimated that the cost of fraud against organisations is \$400 billion annually. The Association also provides evidence suggesting that management perpetrated fraud is a significant component (Association of Certified Fraud Examiners, 1998).

Agency theory suggests that in situations of potential conflict, shareholders' interests are best protected when firms implement effective corporate governance mechanisms. Given that executive fraud represents the extreme embodiment of agency conflict it is not surprising that recent studies have found a significant link between poor corporate governance and management misconduct (Agrawal and Cooper, 2006; Chapple, Ferguson and Kang, 2007; Farber, 2005; and Agrawal and Chadha, 2005). This paper extends the existing literature in two ways. Firstly, it tests whether findings from other countries (primarily the USA) of a relationship between poor corporate governance and management perpetrated

fraud apply in other national context. Secondly, it tests for a relationship between fraud and an expanded set of governance variables. It is the intention of this paper to address the following research question. “Are companies who experience management-perpetrated fraud more likely to have poor corporate governance than companies that do not experience management perpetrated-fraud?” This study aims to provide empirical evidence on the relationship between corporate governance mechanisms and the incidence of management perpetrated fraud in an Australian setting

The paper proceeds as follows. Section 2 discusses the literature regarding corporate governance and management misconduct and develops the hypotheses to be tested. Section 3 explains the research methodology employed. Section 4 reports the results of logit regression model. Section 5 provides some concluding comments and limitations of the paper.

## Literature Review and Hypothesis Development

There is a reasonably lengthy literature on fraud and its relationship with corporate governance inadequacies. Beasley’s 1996 study of financial statement fraud in US companies was among the earliest. He found a significant *negative* relationship between the percentage of non-management (outside) directors on the board and the likelihood of financial statement fraud (see also the 1999 Report of the Committee of Sponsoring Organisations of the Treadway Commission, COSO).<sup>78</sup> Beasley also found that financial statement fraud was more likely to occur in companies with larger boards. Further, where outside directors were appointed to the board they had longer tenures and held lower levels of equity ownership in the firm. McMullen (1996) showed that audit committees were an effective mechanism in limiting management misconduct. She found that companies with audit committees were less likely to be subject to shareholder litigation alleging management fraud or experience quarterly earnings restatements, regulatory actions or illegal acts. Dechow, Sloan and Sweeney (1996) also found that companies were more likely to overstate earnings when they did not have an audit committee.

Corporate governance factors were also prominent in a comprehensive study by Beasley, Carcello, Hermanson and Lapides (2000) of US public companies subject to Securities Exchange Commission breaches for fraudulent financial reporting. They found firms reporting fraud were less likely to have an audit committee, internal audit support and independent boards, than firms not reporting fraud. They also found that where audit committees existed in fraud firms, the committees were less independent, and met on fewer occasions than audit committees of no-fraud firms.

The findings of recent studies are consistent with those of prior studies. For example, Dunn (2004) shows that financial statement fraud is more likely to occur when the board of directors is not independent. Sharma (2004) reports that fraud firms are more likely to have less independent boards, duality of the CEO/chair positions and lower levels of institutional shareholders. Farber (2005) also

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<sup>78</sup> COSO also reported that the boards of companies committing financial statement fraud tend to be dominated by management or other directors that were closely affiliated with the management of the company.

reports that fraud firms have fewer independent directors on the board, audit committees meet infrequently and contain fewer financial experts, are less likely to be audited by a top-tier auditor and have a higher percentage of CEOs who are also the board chair. Uzun, Szewczyk and Varma (2004) also report a significant negative relationship between the proportion of independent directors on the board, audit and remuneration committees and the likelihood of a firm experiencing management perpetrated fraud. Helland and Sykuta (2005) also find a similar negative relationship between the independence of the board and the probability of shareholder litigation for fraud.

### **Empirical Proxies and Control Variables**

The preceding review of the empirical literature highlights several key corporate governance mechanisms that are associated with limiting the incidence of management-perpetrated fraud. They form the basis for the hypothesis testing conducted in this paper. These hypotheses were grouped as the independence hypothesis, board size hypothesis, board dominance hypotheses, director equity hypotheses, director experience hypotheses and the auditor quality hypotheses. The hypotheses tested are as follows.

The *independence* hypothesis expects that a firm with a greater proportion of independent directors on its board is less likely to encounter management-perpetrated fraud than a firm with a lower proportion of independent directors on its board.

*H1: Firms with a higher proportion of independent directors on the board are less likely to experience management-perpetrated fraud than firms with a lower proportion of independent directors on the board.*

The *board size* hypothesis expects that firms with smaller boards are less likely to experience management perpetrated fraud than firms with larger boards.

*H2: Firms with smaller boards are less likely to experience management-perpetrated fraud than firms with larger boards.*

The *board dominance* group of hypotheses expects that firms are less likely to experience management perpetrated fraud when they segregate the roles of CEO and board chair, have a CEO who is not the founder of the company, and directors do not share family relationship.

*H3a: Firms that segregate the roles of CEO and Board Chair are less likely to experience management perpetrated fraud than firms that do not segregate the roles of CEO and Board Chair.*

*H3b: Firms with CEOs who are not the founder of the company are less likely to experience management perpetrated fraud than firms with CEOs who are the founder of the company.*

*H3c: Firms with lower proportions of directors who share family relationships are less likely to experience management-perpetrated fraud than firms with a higher proportion of directors who share family relationships.*

The **director equity** group of hypotheses expects that firms will be less likely to experience management perpetrated fraud when their independent directors hold greater proportions of the firm's equity and when inside directors hold lower proportions of the firm's equity. It is also expected that firms will be less likely to experience management perpetrated fraud when fewer inside directors hold options over the firm's equity.

*H4a: Firms with independent directors holding larger proportions of the firm's equity are less likely to experience management-perpetrated fraud than firms with independent directors holding smaller proportions of the firm's equity.*

*H4b: Firms where inside directors hold smaller proportions of the firm's equity are less likely to experience management-perpetrated fraud than firms where inside directors hold larger proportions of the firm's equity.*

*H4c: Firms where fewer inside directors hold equity options are less likely to experience management-perpetrated fraud than firms where greater proportions of inside directors hold equity options.*

The **director experience** group of hypotheses expect that firms are less likely to experience management perpetrated fraud when the independent directors have financial experience, qualifications and hold fewer directorships in other unrelated companies, and when their inside directors hold a greater number of directorships in unrelated companies.

*H5a: Firms with independent directors that hold fewer directorships in unrelated companies are less likely to experience management perpetrated fraud than firms with independent directors holding greater numbers of directorships in unrelated companies.*

*H5b: Firms with inside directors that hold greater numbers of directorships in unrelated companies are less likely to experience management perpetrated fraud than firms with inside directors that hold fewer directorships in unrelated companies.*

*H5c: Firms with more independent directors with accounting or finance qualifications or experience, are less likely to encounter management-perpetrated fraud than firms with fewer independent directors with accounting or finance qualifications or experience.*

The **auditor quality** group of hypotheses expects that firms will be less likely to experience management perpetrated fraud when they employ a top-tier auditor and when that auditor provides minimal levels of other services to the firm.

*H6a: Firms that are audited by top-tier auditors are less likely to experience management perpetrated fraud than firms that are not audited by top-tier auditors.*

*H6b: Firms that engage their external auditors to perform minimum levels of non-audit services are less likely to experience management perpetrated fraud than firms that engage their external auditors to perform significant levels of non-audit services.*



### Control Variables

The control variables of rapid firm growth, poor financial performance, and existence of block holders are also included in the research model, as they are known to affect both the likelihood of management perpetrated fraud and the effectiveness of corporate governance environments.

### Research Methodology

The focus of this study is a set of Australian public companies where one or more senior executives perpetrated fraud (ie. fraud firms). Each fraud firm is paired with a control firm where management-perpetrated fraud did not occur (no-fraud firm) selected as its closest match in terms of size, industry and period of reporting. By comparing the corporate governance environments of each matched pair the association between ineffective corporate governance and the incidence of management perpetrated fraud is investigated.

### The Fraud Sample

The sample of fraud firms was drawn from a population set consisting of Australian public companies that had been listed on the Australian Securities Exchange (ASX) during the period January 1991 to June 2006. Fraud companies were identified from disclosures in the Australian Securities and Investment Commission (ASIC) media releases. In total 5,602 media releases were reviewed. Table 1 provides a summary of the sample selection process.

*Table 1- Sample Selection Process*

<i>Total ASIC Media Releases -1 January 1991 to 30 June 2006</i>	<i>5,602</i>
<i>Stage 1: Identify investigations of public company fraud</i>	<i>142</i>
<i>Stage 2: Exclude all subsequent acquittals and successful appeals</i>	<i>(56)</i>
<i>Stage 3: Exclude all unlisted public company frauds</i>	<i>(36)</i>
<i>Stage 4: Exclude all public company frauds where annual reports for the year the fraud commenced were not available</i>	<i>(3)</i>
<b><i>Final data set</i></b>	<b><i><u>47</u></i></b>

As shown in Table 1 the selection process resulted in a data set consisting of 47 Australian listed public companies associated with the conviction of management for fraud related offences. Despite the relatively small data set, it is reasonable to assume it is representative of, or close to, the population of all large public company frauds reported in Australia, given the importance ASIC places on disclosing prosecution of frauds.

### Logit Regression Model

In view of the previous discussion, the following variables will be included in a logit regression model.

$$Fraud_i = \alpha + \beta_1 INDDIR_i + \beta_2 BDSIZE_i + \beta_3 CEODOM_i + \beta_4 FIRSTCEO_i + \beta_5 MANREL_i + \beta_6 INDEQ_i + \beta_7 MANSHARE_i + \beta_8 MANOPT_i + \beta_9 INDJOB_i + \beta_{10} INDFIN_i + \beta_{11} MANEXP_i + \beta_{12} AUDIT_i + \beta_{13} AUDITFEE_i + \beta_{14} FASTGRO_i + \beta_{15} FINLOSS_i + \beta_{16} BLOCK_i + \varepsilon_i$$

Where:

$i$  = company 1 through 94

Fraud = indicator variable with the value of one when a company reports management perpetrated fraud and a value of zero where it does not;

INDDIR = percentage of board members who are independent;

BDSIZE = number of directors serving on the board;

CEODOM = indicator variable with a value of one if the chairperson of the board holds the chief executive officer position and a value of zero otherwise;

FIRSTCEO = indicator variable with a value of one if the chairperson of the board was the founder of the company and a value of zero otherwise;

MANREL = cumulative percentage of directorships in the firm held by directors sharing family relationships;

INDEQ = cumulative percentage of shares in the company held by independent directors;

MANSHARE = cumulative percentage of shares in the company held by inside directors;

MANOPT = percentage of inside directors that hold equity options in the company;

INDJOB = average number of other directorships held by independent directors;

INDFIN = percentage of independent directors on the board that hold either professional or academic qualification in accounting, finance or business or financial executive experience with another company;

MANEXP = average number of other directorships held by inside directors;

AUDIT = indicator variable with a value of one when a firm is audited by a top-tier auditing firm and a value of zero when it is not;

AUDITFEE = proportion of fees paid to the auditor for non-audit services relative to the fees paid for audit services;

FASTGRO = average percentage change in total assets for the two years ending with the year the fraud commenced;

FINLOSS = average percentage change in net profit before income tax for the two years ending with the year the fraud commenced; and

BLOCK = cumulative percentage of shares held by block-holding shareholders who each hold at least 5% of the company's voting shares.

## Results

This section reports the empirical findings on the relationship between a company's corporate governance environment and the incidence of management perpetrated fraud.

### Descriptive Statistics - Fraud Sample Characteristics

#### Type of Fraudulent Acts by Directors

Table 2 provides a summary of the various convictions recorded against management that resulted from the prosecution of frauds examined in this study.

*Table 2 - Type of Fraudulent Acts Committed by Directors*

<i>Type of Fraud</i>	<i>Frequency</i>
<i>Using position to derive advantage for private company or relative</i>	<i>17 (36%)</i>
<i>False or misleading statements/fraudulent financial reporting</i>	<i>11 (23%)</i>
<i>Embezzlement of company funds/assets</i>	<i>11 (23%)</i>
<i>Unauthorised dealings in company shares</i>	<i>4 (9%)</i>
<i>Unauthorised borrowings from company</i>	<i>4 (9%)</i>
<i>Total</i>	<i>47 (100%)</i>

Table 2 shows that the most common fraud perpetrated related to managers misusing their position to derive a private advantage (36%). These frauds often involved the awarding of non-commercial contracts to director related parties. The second most common fraud related equally to direct embezzlement of company assets (23%) and fraudulent financial reporting and disclosures (23%). The remaining frauds related to unauthorised dealings in the company's shares (9%) and unauthorised borrowings from the company (9%).

Table 3 provides comparative descriptive statistics between fraud and fraud firms.

Table 3 - Descriptive Statistics – Fraud Firms vs. No-Fraud Firms

Variable	Statistic	Fraud Firm n=47	No-Fraud Firm n=47
INDDIR	Mean	12.9%	44.8%
	Std. Dev.	15.6%	22.5%
BOARDSIZE	Mean	5.19	5.91
	Std. Dev.	2.18	2.24
MANSHARE	Mean	38.2%	17.5%
	Std. Dev.	28.2%	22.1%
MANOPT	Mean	39.2%	37.6%
	Std. Dev.	42.5%	41.8%
MANEXP	Mean	0.58	1.06
	Std. Dev.	0.88	1.78
CEODOM	Proportion	22 (46.9%)	6 (12.8%)
FIRSTCEO	Proportion	24 (51.1%)	6 (12.8%)
MANREL	Mean	6.5%	4.3%
	Std. Dev.	16.9%	13.7%
AUDIT	Proportion	22 (46.8%)	35 (74.5%)
AUDITFEE	Mean	1.94	0.97
	Std. Dev.	4.74	1.40
FASTGRO	Mean	245.4%	53.6%
	Std. Dev.	924.2%	128.9%
FINLOSS	Mean	-150.0%	+16.3%
	Std. Dev.	688.9%	216.4%
BLOCK	Mean	25.9%	36.8%
	Std. Dev.	27.8%	26.8%

Some key observations from Table 3 are as follows. In relation to director independence (INDDIR) there was a marked difference between the proportion of outside directors on the boards of fraud and no-fraud firms. On average, fraud firm boards contained only 12.9% independent directors compared to the average board of a no-fraud firm which comprised 44.8% independent directors. Overall board size (BOARDSIZE) was similar across the two groups with the average fraud firm board (5.19 directors) marginally smaller than the average no-fraud firm board (5.91).

With respect to board domination, fraud firms appear much more likely than no-fraud firms to have a CEO who is also board chair (CEODOM) (46.9% of fraud firms compared to 12.8% of no-fraud firms), and a CEO who is also a founder of the company (FIRSTCEO) (51.1% of fraud firms compared to 12.8% of no-fraud firms). Both fraud firms and no-fraud firms showed a low incidence of inside directors sharing family relationships (MANREL). On average only 6.5% of fraud firm inside directors were related, compared to 4.3% of no-fraud firm insiders.

Director experience, as measured by outside directorships held (MANEXP), also varied considerably across the two groups. Inside directors of fraud firms held on average only 0.58 outside board positions, compared to the 1.06 outside board positions held by their no-fraud counterparts. On average 40.6% of fraud firm independent directors possessed financial experience compared to 44.5% of no-fraud firm independent directors.

Financial profile, shareholder structure and auditor qualities all varied across the two groups. Fraud firms reported on average a 245.4% growth in total assets (FASTGRO) over the year leading to the fraud, compared to a 53.6% growth in total assets reported by no-fraud firms. Fraud firms were also more likely to report poor profitability (FINLOSS) prior to experiencing fraud compared to no-fraud firms. On average, fraud firms reported a decrease in reported profit before tax of 150.0% in the year leading to the fraud, compared to an average increase in corresponding profits of 16.3% reported by no-fraud firms. Fraud firms also had lower proportions of their equity held by block-holders (BLOCK), when compared to no-fraud firms. On average, 25.9% of the equity of fraud firms was held by block-holders, compared to 36.8% of no-fraud firm equity. Auditor quality and independence also appear to vary significantly across both sample groups. Top-tier audit firms (AUDIT) audited only 46.8% of fraud firms compared to 74.5% of no fraud firms. Fees for non-audit services (AUDITFEE) on average represented 1.94 times the audit fees of fraud firms, and only 0.97 of the audit fees of no-fraud firms.

### **Univariate Analysis**

The development of the statistical model used to test the hypotheses outlined follows the process recommended by Hosmer and Lemeshow (2000) for logistic regression analysis of a one-to-one matched study. Those variables shown to be statistically significant at the univariate level are then further examined using a multivariate logistic model. Table 5 presents the results of fitting the univariate models.

Table 4 - Univariate Logistic Regression Models Outcomes

<i>Variable</i>	<i>Coefficient</i>	<i>Standard Error</i>	<i>P value</i>	<i>Odds Ratio</i>	<i>95% Conf Interval</i>	<i>Discordant Pairs</i>
<i>INDDIR – % Independent Directors</i>	-.079	.022	.000	0.924	(0.884, 0.965)	<i>n/a</i>
<i>BDSIZE – Board Size</i>	-.227	.130	.081	0.797	(0.617, 1.029)	<i>n/a</i>
<i>FIRSTCEO – CEO is Founder</i>	1.946	.617	.002	7.000	(2.088, 23.468)	(21,3)
<i>CEODOM – CEO is Chair</i>	1.609	.548	.003	5.000	(1.709, 14.628)	(20,4)
<i>FASTGRO – Change in Assets</i>	.001	.001	.287	1.001	(0.999, 1.004)	<i>n/a</i>
<i>MANSHARE – Insider Shareholding</i>	.027	.009	.003	1.027	(1.009, 1.045)	<i>n/a</i>
<i>MANEXP – Other Directorships Exec.</i>	-.262	.175	.136	0.770	(0.546, 1.085)	<i>n/a</i>
<i>MANREL – % Relatives on Board</i>	.009	.014	.513	1.009	(0.982, 1.037)	<i>n/a</i>
<i>AUDIT – Top-Tier Auditor</i>	1.447	.556	.009	4.250	(1.430, 12.630)	(17,4)
<i>FINLOSS – Firm Profitability</i>	-.002	.001	.116	0.998	(0.996, 1.000)	<i>n/a</i>
<i>MANOPT – Executive Options</i>	.001	.005	.844	1.001	(0.991, 1.011)	<i>n/a</i>
<i>AUDITFEE – Auditor Non-audit Fee</i>	.092	.078	.239	1.096	(0.941, 1.277)	<i>n/a</i>
<i>BLOCK – Block-holders</i>	-.019	.009	.044	0.981	(0.963, 0.999)	<i>n/a</i>
<i>INDEQ – Ind. Director Equity</i>	-.500	.299	.095	0.607	(0.337, 1.090)	<i>n/a</i>
<i>INDJOB – Ind. Director Other Boards</i>	-.391	.138	.005	0.676	(0.516, 0.886)	<i>n/a</i>
<i>INDFIN – Ind. Direct Financial Expert</i>	-.017	.007	.010	0.983	(0.971, 0.996)	<i>n/a</i>

As shown in Table 4 the univariate logistic regression analyses indicate a significant statistical difference (at the 5% significance level) between fraud companies and no-fraud companies with respect to several variables: the proportion of independent directors on the board (INDDIR,  $p < 0.001$ ); company founder serving as CEO (FIRSTCEO,  $p = 0.002$ ); duality of the CEO/chair role (CEODOM,  $p = 0.003$ ); inside director shareholding in the company (MANSHARE,  $p = 0.003$ ); auditor type (AUDIT,  $p = 0.009$ ); the existence of block-holding shareholders (BLOCK  $p = 0.044$ ); other directorships held by independent directors (INDJOB,  $p = 0.005$ ) and independent director financial experience (INDFIN,  $p = 0.010$ ). Two variables,

board size (BDSIZE,  $p=0.081$ ) and the level of shareholding in the company by independent directors (INDEQ,  $p=0.095$ ), were statistically significant at the 10% significance level.

The analysis showed no significant statistical difference between the two groups with respect to firm growth (FASTGRO), the number of other directorships held by inside directors (MANEXP), the proportion of related directors (MANREL), firm profitability (FINLOSS), executive option holding (MANOPT) and the level of fees paid to auditors for non-audit services (AUDITFEE) at the 10% significance level. All ten variables shown to be statistically significant, at either the 5% or 10% significance level, were included in the final model.

### Fitting the Multivariate Main Effects Model

Table 5 - Odds Ratio and P-values for all Variables included simultaneously in the initial main Effects Diagnostic Model

<i>Variable</i>	<i>Odds Ratio</i>	<i>p value</i>
INDDIR	0.865	0.063
BDSIZE	3.799	0.169
FIRSTCEO	1.252	0.896
CEODOM	0.056	0.304
MANSHARE	1.013	0.669
AUDIT	898.146	0.135
BLOCK	0.970	0.278
INDEQ	0.024	0.180
INDJOB	0.810	0.546
INDFIN	0.997	0.882

As shown in Table 5 when all variables are added to the main effects model the proportion of independent directors on the board (INDDIR) has the most statistically significant explanatory power. All other variables are no longer significant at the 5% significance level. An explanation for this effect was found by examining the correlations between INDDIR with all the other variables in the model. Table 6 shows the Pearson Correlation values resulting from this process.

Table 6 - Correlation of INDDIR with other Variables in the initial main Effects Model

Variable	Pearson Correlation INDDIR	Significance (2- tailed)
INDDIR	1	
BDSIZE	0.253*	0.014
FIRSTCEO	-0.316**	0.002
CEODOM	-0.441**	0.000
MANSHARE	-0.499**	0.000
AUDIT	-0.182	0.080
BLOCK	0.148	0.154
INDEQ	0.281**	0.006
INDJOB	0.392**	0.000
INDFIN	0.334**	0.001

\*significant at the 0.05 level \*\*significant at the 0.01 level

The Pearson correlation p values in Table 6 show a statistically significant correlation between the proportion of independent directors on the board and the variables representing board size, CEO/founder duality, CEO/chair duality, the proportion of shares held by executives and the three variables relating to independent director characteristics (independent director equity holding, other directorships held and financial expertise). It is likely the large degree of correlation between these variables and INDDIR resulted in the increase of p values considerably from their univariate significance levels. Such correlation is not surprising given the importance director independence is given in the corporate governance literature. Only auditor type and the existence of block-holding shareholders are not correlated with the proportion of independent directors on the board. The strong correlation evident between INDDIR and other variables in the initial main effects model required a revised modeling approach to determine an appropriate multivariate main effects model. This process involved pairing the variable INDDIR with each individual variable shown to be significant at the univariate level.

Table 7 shows the results of applying the resulting nine individual paired logit regression models.



Table 7- *P-values of each Variable Modeled with Independent Directors*

<i>Model Number</i>	<i>p value INDDIR</i>	<i>Paired Variable</i>	<i>p value Paired Variable</i>	<i>95% Confidence Intervals</i>
1	0.001	BDSIZE	0.468	(0.607, 1.258)
2	0.001	FIRSTCEO	0.308	(0.491, 9.499)
3	0.001	CEODOM	0.878	(0.236, 5.402)
4	0.001	MANSHARE	0.716	(0.981, 1.029)
5	0.001	AUDIT	0.144	(0.624, 25.520)
6	0.001	BLOCK	0.15	(0.957, 1.007)
7	0.001	INDEQ	0.279	(0.234, 1.520)
8	0.001	INDJOB	0.670	(0.711, 1.245)
9	0.002	INDFIN	0.871	(0.983, 1.020)

Table 7 shows that when each variable of interest was included in a model simultaneously with the variable INDDIR only the variable INDDIR retained statistical significance in each case. This suggests that the proportion of independent directors on the board is the primary corporate governance parameter with respect to predicting management perpetrated fraud. For the purposes of this study the inclusion of other corporate governance variables in the final model offered no additional explanatory power.

### Results of the Final Model

The results of applying the final main effects model, containing the variable INDDIR as sole predictor, showed independence of the board is a statistically significant determinant (at the 5% significance level) of the likelihood of a company experiencing management perpetrated fraud ( $p < 0.001$ , Odds Ratio = 0.92 with 95% confidence intervals 0.88 and 0.97). Accordingly hypothesis H1 (i.e. that firms with a higher proportion of independent directors on the board are less likely to experience management perpetrated fraud than firms with a lower proportion of independent directors on the board) is not rejected based upon the evidence available. The remaining hypotheses H2 to H6 were rejected.

### Quantifying the Effect of Board Independence on Management Perpetrated Fraud.

The odds of a firm experiencing management perpetrated fraud are provided in Table 8. These results were obtained by comparing varying proportions of board independence to a reference group of a board comprised of at least 50% independent directors. The reference group was selected as representative of corporate governance best practice, as recommended by prominent market regulators. The three comparative segments (0%, >0% to <25% and 25% to <50% independent directors) were selected as representative of the distribution of proportion of independent directors across the range of INDDIR% in the study sample.

*Table 9 - Proportion of Independent Directors and the Odds of Firms Experiencing Management Perpetrated Fraud*

<i>% Independent Directors</i>	<i>Odds Ratio</i>	<i>Odds Ratio 95% Confidence Interval</i>	<i>% of Fraud Firms Sampled</i>	<i>% of No-Fraud Firms Sampled</i>
<i>0%</i>	<i>121</i>	<i>7.7      1894.8</i>	<i>47%</i>	<i>4%</i>
<i>&gt;0% to 25%</i>	<i>14.3</i>	<i>1.5      136.8</i>	<i>23%</i>	<i>15%</i>
<i>&gt;25% to &lt;50%</i>	<i>7.7</i>	<i>0.9      65.4</i>	<i>23%</i>	<i>47%</i>
<i>50% or more</i>	<i>1</i>		<i>7%</i>	<i>34%</i>

As shown in Table 8 the odds ratio for a company having a board with no independent directors is 121. This suggests that the odds of such a company experiencing management perpetrated fraud is estimated to be 121 times larger than the odds of a company with a board comprising at least 50% independent directors experiencing management perpetrated fraud. The confidence interval suggests these odds may be as much as 1,894.8 times or as little as 7.7 times the odds of the reference group experiencing management perpetrated fraud. The analysis also shows the odds of a company with a board containing up to 25% independent directors experiencing management perpetrated fraud is 14.3 times the odds of the reference group experiencing management perpetrated fraud.

### **Concluding Comments and Limitations**

These results offer further support to agency theory's assertion that the appointment of independent directors to the board is an effective control over agency conflict. The results of the research model showed that a firm's corporate governance was associated with the likelihood of it experiencing management perpetrated fraud. In particular, the model provided evidence that as the proportion of independent directors on the board increased the likelihood of a company experiencing management perpetrated fraud decreased. Notably none of the other corporate governance mechanisms were found to substantially decrease management perpetrated fraud.

An inherent limitation in any study of corporate fraud is the inability to identify all firms in which corporate fraud has occurred. Evidence suggests that to avoid adverse publicity, a sizeable proportion of fraud is not reported by firms. For example, the 1997 KPMG study found that only 69% of Australian frauds were reported to authorities. As a result, the findings of this study relate only to publicly reported fraud. This may possibly impact on the external validity of the findings. In addition the following methodological limitations need to be noted:

Firstly, the data set of 47 Australian listed companies reporting management-perpetrated fraud is smaller than comparative studies in the USA. A smaller data set was expected given the large number of publicly listed companies in the US compared to Australia. However, studies utilising similar methodology to this research have been successfully

applied to samples of similar size. Despite the small data set, it is reasonable to assume it is representative of, or close to, the population of large public company frauds reported in Australia, given the importance ASIC places on disclosing prosecution of frauds.

Secondly, identifying the fraud commencement date was critical in determining the appropriate period when reviewing the firm's corporate governance. The fraud commencement date reported in ASIC media releases may be inaccurate given that a perpetrator on trial may be motivated to understate the extent of their crime. However, as most frauds detailed in the study occurred over an extended period of time, analysing corporate characteristics at a given time within this period is considered to provide a reasonable snap-shot of the firm's corporate governance ethos and environment.

Thirdly, the process of determining directors' independence from management relied on evaluating disclosures from the relevant company's annual report. It is possible that these internal disclosures are subject to bias. In addition, limited disclosure in some cases meant that the determination was sometimes partially subjective. Another inherent limitation is that annual report disclosures are only useful in evaluating the physical characteristics of a company's corporate governance mechanisms. Other non quantifiable factors, such as directors' personal relationships, may override the physical controls established.

Finally, the use of control groups to analyse the sample, requires that the characteristics of the control group be identical to those of the sample. In practice no two companies are identical, a problem that is compounded by the relatively small population of publicly listed companies in Australia. Each fraud firm included in the sample was paired with a firm that was its closest match in terms of size and industry. While the control firm was as similar to the fraud firm as possible, it was unlikely to be identical.

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## THE IMPACT OF GLOBALIZATION IN SUSTAINABLE TOURISM IN MEDITERRANEAN COUNTRIES ( INCLUDING ALBANIA SITUATION NOW DAYS )

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### Abstract

The aim of this paper is to study the role of globalization in sustainable tourism focusing on the area (region) of the Mediterranean and then to Albania, which is one of the members of this area. The paper addresses the concept of globalization by linking it with sustainable tourism. Focusing in the Mediterranean area treated different theoretical problem and the specific characteristics of sustainable tourism in the context of globalization, such as environment, food, number of achievements, historical and cultural values of countries in this region, etc.. Then the article goes on describing tourism in Albania, the characteristics of this country, various forms of tourism that exist and the obstacles faced and opportunities that he has in the field of tourism. Various data showing the flow of tourists and revenues in years as well as their structure, from which can be understood well the current state of Albania in the process of globalization in sustainable tourism . At the end of the article provides some conclusions and recommendations that should be considered for the future. The methodology of this article is based on collecting data from various sources, books, articles, internet, newspapers, magazines, images and footage, interviews that were done to tourists and visitors who have spent vacations in Albania. Then they are collected, selected, processed and adjusted according to the structure and purpose of the article.

**Keywords:** globalization, sustainable tourism, Mediterranean, Albania, tourists, travel

### Globalization and Sustainable Tourism

Globalization, simply put, denotes the expanding scale, growing magnitude, speeding up and deepening impact of transcontinental flows and patterns of social interaction (Mc Grew,2002). The term relates to the process in which technology, economics, business, communications, and even politics dissolve the barriers of time and space that once separated peoples (Eckes, 1999). Globalization with its transcontinental flows, patterns of social interaction, and so-called global mass has given the tourism industry free reign to develop throughout the world. In fact, tourism has led the globalization process in the areas of transportation, communications, and financial systems (McLaren, 1999). The ability of tourism to generate foreign exchange revenue, create employment, and absorb

unemployment has provided it with a political and social legitimacy. Furthermore, tourism has become part and parcel of multilateral financial institutions' package for financial bailouts for countries in distress (Gonsalves, 2003). Tourism is now being pursued as a serious development strategy for the Developing World. However, the economic benefits of tourism are, the results of a fundamental process by which expressions and forms of environmental and cultural capital are traded. On the one hand, environmental capital, in terms of natural resources and more intangible aesthetic constructs of landscape and built heritage is clearly recognized as a platform for tourism development. On the other hand, cultural capital, in its art factual form and mosaic of local cultures, together with its way of life and tradition dimensions, is also recognized to be at the root of tourism phenomenon. The rapid expansion of tourism is responsible for adverse environmental and socio-cultural impacts. Although the tourism industry is regarded as being kinder to the environment in general than most other industries, its very size and wide spread presence has created negative environmental impacts, both of a physical and socio-cultural nature. Natural resource depletion and environmental degradation associated with tourism activities undermine the important ecological systems and pose severe problems to many tourism destinations. With globalization, these threats will be exacerbated. International agreements that open up access to the local tourism industry by big travel and tourism transnational cooperation's (TNCs) will only speed up exploitation of the natural resources, culture, and way of life of indigenous peoples (Gonsalves, 2003). Tourism should thus be involved in sustainable development, because it is a resource-based industry, which is dependent on nature's endowment and society's heritage. We can safely ascertain that sustainable development in tourism is premised on the notion that the economy and the environment - physical as well as socio-cultural are but two sides of the same coin, in other words, the two are intimately linked. The continuation of tourism as a dynamic and viable industry is thus dependent upon the adoption of a strategic approach to planning and marketing (Faulkner, 1994). Sustainable Tourism is a phenomenon of the 1990s, however its origins lie in the wider concept of sustainable development (Swarbrooke, 1998). Sustainable tourism operates in harmony with the local environment, community and culture, so that these become the permanent beneficiaries and not victims of tourism development. Achieving sustainability depends on a balance of private initiative, economic instruments and regulation, translating global principles into focused local action, and new public-private sector delivery mechanisms. This may give birth to a new and necessary tourism culture that bestows more importance to the environment as a valid raw material for sustainable tourism development. According to the World Tourism Organization (WTO) sustainable tourism development meets the needs of present tourists and host regions while protecting and enhancing opportunity for the future. Sustainable tourism development can thus be envisaged as leading to management of all resources in such a way that we can fulfill economic, social, and aesthetic needs while maintaining cultural integrity, essential ecological processes, biological diversity, and life support systems (Murphy, 1994). The need for resource management reaffirms that tourism is

an economic activity, which must be capable of making a profit in order to survive and benefit the community. The fulfillment of social obligations, means more than inter-generational equity, it means respect for other livelihoods and customs. Such variety and heritage is a major resource for tourism in a world that is fast becoming homogenized into a global economy. The ecological process needs to be understood so that tourism intrusions will have the minimal impact, especially in sensitive coastal areas. The concern over maintaining our biological diversity is particularly germane to tourism, which thrives on the appeal of different flora and fauna along a distinctive sense of place. Finally, the need to sustain our basic life support systems is paramount. If these basic needs are not yet met, then our higher level needs, like travel will fail to materialize.

### **Sustainable Tourism Development along the Mediterranean countries**

Mediterranean countries have one of the fastest growing tourism industries in the world. Vast cultural and natural resources constitute principal attractions for visitors. Dramatic natural features of the region exemplified in the pristine coral reef ecosystem, rare but beautiful mars as, sharms and beaches, uncluttered coastal landscapes, and landforms carved out by wadis constitute a particular tourist attraction. However, these ecosystems are vulnerable and their protection requires special attention in the planning and design of tourism developments. On the one hand, the fragile coastal reef ecosystem is easily damaged by intensive development of tourist facilities and the impact of tourist numbers. Land filling of coastal zones to provide sandy beaches destroys reefs and increases seawater turgidity damaging flora and fauna and resulting in the contamination of coastal sites. On the other hand, the increased demand and pressures of projected expansion of tourism activity in the central core of tourism developments undermines the cultural and built heritage, and places a strain on the existing infrastructure, leading to visual pollution, crowding and traffic congestion, and socio-cultural changes in the local population, ultimately affecting the well-being of the host community. Minimizing visitor consumption to reduce environmental impacts has negative consequences for economic development because the opportunities for revenue generation are reduced. Therefore, because eco-tourists typically spend less than the average tourist, creative alternatives to simply increasing visitor inflows must be found to increase the economic benefits derived from ecotourism in host locations. (WTO, 1998). Food tourism is not a new concept within the tourism industry, but rather that current academic research on the theme of food tourism has made food tourism pertinent for further analysis, perhaps in the area of responsible tourism. Traditionally food consumption by tourists had been very much part of the travel experience, with significant cultural, social, environmental and economic implications. Globalization of food products has emerged in the last few decades, this being named MacDonaliation as some academics. (Symoms, 1999, cited by Hall, 2003). Globalization has resulted in a 'new' form of tourism as food is an integral part of the global village. Food becomes 'the other' as opposed to the norm of the eating experience

at home. Food therefore allows the tourist to confirm their sense of the other and emersion in another culture. Food gives the tourist a 'sense of place' (Hall, 2003). Globalization has resulted in the boundaries of national and cultural identity becoming blurred. In the post-modern cuisine at the local level will be inevitably be influenced by external food imports. (Hall, 2003). Cohen, E and Avieli, N. (2004) state that for local cuisine to become a popular attraction in its own right dishes must be filtered through a tourism-oriented culinary establishments. Local foods are transformed to suit tourist tastes and at the same time foreign dishes are introduced by tourism into local cuisine and transformed to suit local tastes. This could be envisaged as a new art form in that tourist cuisines are new cultural products. The authentic experience of food tourism endorses the principle of hotels and restaurants committed to the procurement of locally grown products and produce whilst at the same time encouraging the protection of the environment. The Mediterranean region is the leading tourist destination. Tourism is mainly concentrated in the coastal areas which receive 30% of international tourist arrivals. The most widely used tourism development model used in the region is based on seaside summer holidays and the attainment of quantitative goals. Of the total 46,000 km of coastline, 25,000 km is urbanized and have already exceeded a critical limit. In the last fifty years, the number of non-resident tourists has multiplied exponentially in the Mediterranean, which is currently the main tourist destination on the planet with more than 232 million international tourists per year, accounting for thirty percent of the totality of the world market and twenty-five percent of the tourist income. At present, three quarters of Mediterranean tourism is concentrated in four EU member countries: France, Spain, Italy and Greece. The Mediterranean is under threat due to the inappropriate practice and development associated with mass tourism. With current development models based on quantity, the projected growth of tourism development in the region will continue to damage landscapes, cause soil erosion, put pressure on endangered species, further strain available water resources, increase waste and pollution discharges into the sea and lead to cultural disruption. With the accession of Slovenia, Malta and Cyprus, the EU will be even further strengthened in this respect. The rest of the Mediterranean region also has a great dependency on tourism as an economic activity and strategy of development, especially Egypt and Tunisia. In relation to accommodation, France, Spain and Italy are also host to around seventy percent of the overall industry in the Mediterranean. Most of this accommodation corresponds to flats and second homes, followed by hotels and other types of non-hotel accommodation such as campsites and caravan parks. Within the non-community countries there is further inequality, given that Turkey, Tunisia and Egypt receive most of the international tourists, especially from the EU countries, and even compete with them for the business of the new republics of the USSR's dismemberment. A joint effort by the different agents is necessary, on the part of the public authorities, international institutions, companies, experts, NGOs and civil society in general, in order to guarantee the implementation of sustainable tourism in the Mediterranean. One of the main problems is tourist seasonality, given that it is calculated that between the months of June and September the Mediterranean



basin receives around forty-five million national tourists and more than fifty million foreign tourists, mainly concentrated on the coast and the islands. This fact leads to a high concentration of visitors and an unequal distribution of tourist income over the course of the year. Most of the tourist products and services on offer focus on the sun and beach scenario, although in the past few years a diversification of these offers has been planned. This pressure of tourism has had both direct and indirect effects on the area such as the totally uncontrolled modification and urbanization of bays and beaches with construction of residences, services and public access. The lineal concentration and the pollution of the coast are issues that are related to an intensive urbanization and indiscriminate land occupation. According to the WTO, the four most important sectors of the tourist market in the Mediterranean countries are those of sun and beach holidays, cruises, and nautical and cultural getaways. The sun and beach package directed at mass tourism is based on tourism of fixed residence. The mature destinations, especially those of the Latin Mediterranean arc, have prompted campaigns for the improvement of hotel infrastructures and the offers of the tourist industries. Apart from meeting halls, the tourism related to business and conventions, and the controversial golf courses which have spread through all the various forms, we should point out other infrastructures such as thematic parks, casinos, as well as sporting ports and cruiser terminals. The Mediterranean represents twenty percent of the world market in cruise holidays. This is a market that is in expansion, and a dynamic phase of growth, and which has evolved from a product directed primarily to elite groups of customers to a product of mass tourism, with all the risks that this evolution may involve. Nautical tourism still preserves a certain exclusivity despite the fact that it has been popularized in recent decades. It is a growing sector among the societies of developed countries which has allowed higher numbers of people to benefit from enjoying nautical tourism activities. This market, consolidated in France, Spain, Italy, Monaco, Gibraltar, Malta, Greece, Cyprus and Turkey has had an equally strong development on the Adriatic coasts (Slovenia, Croatia) as in the north of Africa (Morocco, Tunisia, and Egypt). Cultural tourism is also experiencing a growth in the Mediterranean region. It includes important sectors such as tourism of heritage sites (archaeological sites, monuments, museums, industrial heritage, and traditional festivals and fairs), the tourism of festivals and cultural events, and is especially related to religious tourism, rural tourism and gastronomic tourism. The countries of the Mediterranean basin are home to 212 of the 754 places listed as world cultural and natural heritage sites by UNESCO, which is twenty-eight percent of the world total. Most of these areas of tourist attraction do not have suitable management plans for tourist usage, and investigations into the capacity and management of visitors have not been implemented. Cultural tourism is particularly concentrated on big cities such as Barcelona, Rome, Naples, Athens, Istanbul, Damascus, Jerusalem and Cairo. Medium-size cities employ an exploitation of tourism that centers on weekend packages or city-breaks, or that forms part of the travelling city-route tourism by bus (especially in the cases of Spain, Italy, Greece and Turkey). This industry exerts an excessive pressure on determined museums and monuments

, with a stay and consumption in the city of only a few hours, in many cases with more detrimental effects than benefits. In the case of cities such as Venice, most of the public are day visitors who spend the night in other cities, a fact which is more evident in towns such as Arles, Nîmes, Pisa, Siena, Avila or Segovia where excursionists prevail. A further strategy adopted by Mediterranean cities to position themselves within the international market are cultural events.

### Others characteristics of Mediterranean countries in tourism

The Mediterranean countries in 2009, received 295 million international tourists, that is, around 31% of the global aggregate. Up to 2025, inflows are likely to reach 665 million tourists in the Mediterranean countries, of which 312 million in the coastal regions alone. International tourism earnings stood at over 208 billion US\$ in 2010 for the Mediterranean countries as a whole, which represents an average spending of 803 US\$ per international tourist. Air transport is significantly on the increase for tourism flows in the Mediterranean: from 23% of the arrivals in 1988 to 42% in 2010. However, the arrival of international tourists still takes place, for the major part, by road: 54% in 2010, as against 67% in 1988. Cut down by 3 between 1988 and 2010, arrivals by rail experience a slump, while arrivals by sea have picked up slightly: +2% over the same period.

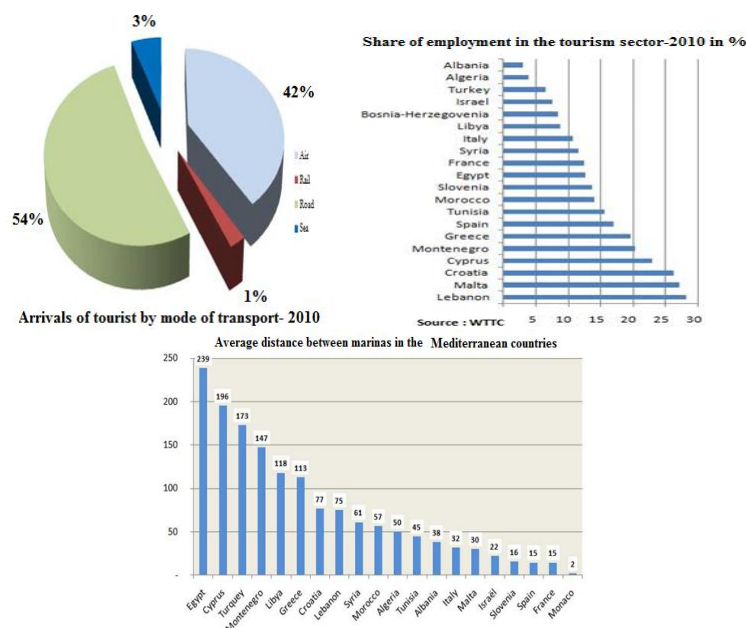


Fig.1. & Fig.2 & Fig.3

They are some other different characteristics among the countries of the Mediterranean area. As you can see the various from one country to another. This can be one factor to go or leave it, but it's not fundamental one. Some countries can have other specific or different profits than can pass those average distance marinas.

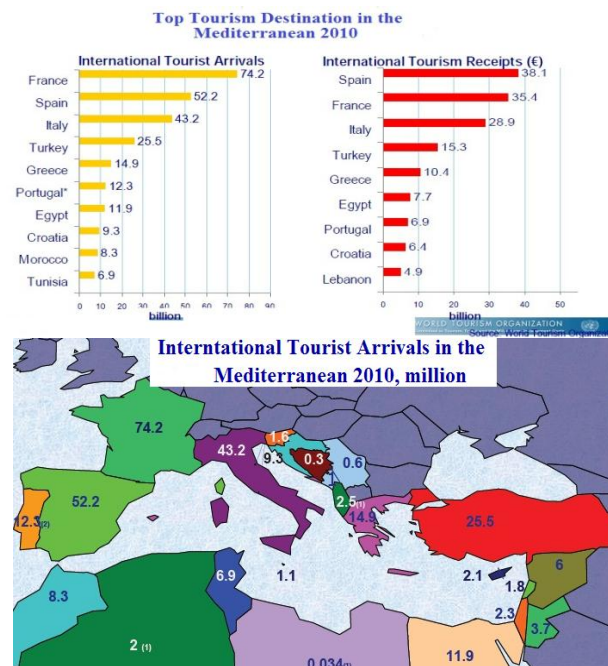


Fig4 &amp; Fig.5

The arrivals tourist number varies from country to country and it depends from different factors and as you can see at the fig.4, France, Spain and Italy are on top from arrival number and the monies collected. Maybe the culture, environment, level of tourism services and hotels, heritage, quality of services, high level of human resources on tourism sector, variation in the time of entertainment, the nature of people, flexibility and adaptation with different people around the world, etc can be the most important factors of this classification. Those reasons are then the fundamentals of globalization in sustainable tourism for the progress in the Mediterranean countries. Those elements and trends will tend in the recent future to absorption of the tourist in this area and to change the tourism structure in favor of the Mediterranean area. Globalization in sustainable and progress tourism can be advantageous for both parties like the two pieces of one coin. In one side the host countries can learn from different cultures and foods requests of foreign people around the world that they need to find some time they way of leaving as they leave in their countries, but some time they need something new, that is one the most important motivation that they are abroad their country. The host countries can profit more monies and good image being sustainable and developing more and more this sector, thinking for the better future of their tourism sector. In another side if the tourists will reach the target performance planned before going on the vacation, they will repeat it next time and it will be possible to become group referees or opinion leaders for other peoples. So the market segments will grow more and more. They can profit new experiences on foods, culture, education, communication; life style etc, so will become more relaxed and more productive in their jobs too.

## Tourism in Albania

Albania has a key geographical position of strategic importance in south-eastern Europe. It is a crossway between the West and East and the coastal border lies along two Mediterranean seas. Because of this favorable geographical position near the current tourism market in the Mediterranean, it creates the opportunity to be included in the international tourism destinations. In a natural sense, Albania has a relatively unique environment because of its variety of landscapes. An especially high tourist potential is presented by the long lowland type coastline of the Adriatic and Ionian Riviera with its long summer season. There are long stretches of beaches, approximately 472 km, alternating sandy zones with rocky massifs. (Beka, 2009). The mosaic relief has a variety of forms: hills, high-unexplored mountain ranges, fields, and valleys. As a result of the specific physical and geographical conditions, there is a dense network of rivers and streams and there are many large lakes of special beauty, which are very rich in fish of many kinds and quality. In addition, Albania is one of the richest countries in terms of floral variety (structure and combinations) and fauna. It has a good Mediterranean climate, which is attractive to tourists. Balkan Enterprise Facility (BEF, 2000) identifies that the summer in Albania is hot and dry with plenty of sunshine, with more than 200 sunny days (second to Spain amongst European countries). Albania is rich also in culture, both material and spiritual. Above all, this country is distinguished for the hospitality of its people. In the last report of the World Economic Forum (2010) on travel and tourism competitiveness, Albania ranked 44<sup>th</sup> in a list of 124 countries according to human, cultural and natural resources. Based on one of the receipts reports of the UNWTO, the Government has stated that Albania earned USD 16,500 for every tourist that visited the country during the 2009 holiday season. Gorica (2005) suggests that income from the tourism industry in Albania is very low compared to other Balkan countries next to Mediterranean. She argues that the statistics in Croatia suggest USD 5,000 - 6,000 millions per annum, in Montenegro USD 2,000 - 3,000 millions per annum, but in Albania not more than USD 400 million per annum (Caku, 2008). According to WTTC (2010), the contribution of Albania's travel and tourism economy to total GDP is estimated at 14.8 per cent in 2009, 15.2 per cent in 2010 and is expected to rise to 18 per cent by 2017. Albanian environment provides conditions for the existence of over 3200 species of higher plants, making up 30% of European flora and 756 species vertebrae, where 91 of them are in our country and world have a protection status. Changing social life in Albania in recent years, according to environmental specialists, has brought a great number of environmental problems, which both represent the negative historical legacy as well as that of the transition period. So the earth as an important natural element is not properly protected and exploited in a sustainable manner, but is significantly affected by erosion. (Çeku et al, 2010)

## **Globalization and sustainable tourism in Albania**

Currently Albania has a small number of tourist offerings and the most important ones we can mention coastal tourism, mountain, historical and cultural, tourist parks. Coastal tourism is concentrated in the west of the country and especially in Velipojë, Shën. Gjini, Durrës, Vlora and Saranda Riviera, Ksamil is all too frequent. These cities offer and a large number of services, hotels and restaurants, pulling in recent years the attention of foreign tourists. Tourism tourist parks historical sites as Apollonia and Butrint, have significantly increased foreign tourist groups. Increased interest has come as a result of an advertisement more intense in the Albanian media and international culture, traditions and history of our country, especially by the Albanian Ministry of Tourism. Mountain tourism in the north is open 40 inns project but lacks assistance to Albania in the south. In difficult moments for example snow climate impact positively on the development of mountain tourism as white or made activities such as skiing, skating etc. Are under development cultural tourism, health, hunting and agro tourism. Tourism in general is a sector which depends from different factors: economic, political, socio-cultural, environmental, etc. In this regard, Albania has problems in these areas which could affect the sustainability of tourism and globalization. Tourists of different countries will want to find tourist services and high diversity of domestic product separate and distinct from other countries, and adapted to different cultures and their ways, Albania in terms of difficulty of a first sensed the truncated Bid, which dominates the coastal tourism and this not extended to the coastline. On the other hand, adaptation to different requirements of tourists from different countries of the region and beyond requires the capacity to prepare human resources, equipment and technology conducive to tourism and hotel sector. Roads under construction and not well maintained beaches and many other environmental factors, or the bureaucracies of many local and central government, for the moment and in the next few years, projecting that inhibit this country in the process of globalization in tourism sustainable. According to the data so far in Albania, more than 21 percent of tourists who entered our country are from Macedonia. Behind them, about 18 percent come from Kosovo generally have frequented beaches. There are few and Montenegrins who have come to our country, although tourism may have been their day. According to records, the rest of the tourists reach countries like Italy, Germany, Czech Republic, Greece, etc. Along with tourists and immigrants originating this year have started to enter our country and groups of tourists from Great Britain, Holland, Germany, Russia, France, USA etc. Tourists other than attendance at the most picturesque places of our country were also interested to conduct real estate purchases and other things in our country. More and more tourism is becoming the main supplier of the economy with income. But as one of the sectors where growth is expected to focus on the future of the country, tourism is still not finds itself in the government's priorities, especially in support of funding. Under the central banking authority, the annual income from tourism is estimated at around 23 per cent. Growth of this sector, in fact, turns out to be higher than in any other sector. Experts explain

that the space for a higher growth is huge, but precise estimates are lacking. Under the current strategy for tourism development, which is currently in force, the income from this sector by 2012 should reach 464 million dollars. World Tourism Organization Albania suggests following a different model of tourism development from Croatia and Montenegro, models that are considered not very successful in streamlining the tourism industry. But without resolving the issue of ownership in the tourist areas there are very few opportunities to offer serious investors and consequently to provide services in the near future competitive with other countries in the region. "Albania is turning into" a new love Mediterranean "and less time will be an unexplored tourist trail. " With these words, Lonely Planet, an international company that provides information for the tourism industry throughout the world considers Albania as one of the most beautiful tourist destinations for 2011.

### Conclusions and recommendations

Globalization in sustainable tourism has its positive side and negative. With the developments that are taking the world today it becomes more evident and inevitable. Mediterranean countries, especially France, Italy and Spain may respond better to this process due their economic development, qualified human resources, technologies in this sector, the diversity of tourism offerings, the ancient culture and traditions, their flexibility etc. These sites can create a good model not only for the region for many other countries in the world that want and intend to turn tourism into a profitable industry or sector. Albania is a country that emerged from the various problems that have accompanied and have made unfortunate for many decades. Currently entered in the path of progress, especially after association with several conditions in the EU, but there are still problems with the environment, economy, roads, politics, bureaucracy and corruption in the central and local levels. These obstacles will be overcome if, as quickly, will open possibilities of natural resources, historical and cultural traditions in Albanian cuisine, becoming a greater opportunity to be visited by different tourists not only from neighboring countries. It is recommended that globalization be accompanied by preservation of the best local and national authorities and exchange of experiences and lifestyles of different countries around the world and the region, and given the same time benefiting cultural values, badly needed for the revitalization of the country life different and their progress. Success depends on the skills that they will have to be managing them.

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**AN APPLICATION OF THE WIN-WIN-WIN PAKONSTANTINIDIS MODEL AS  
AN INNOVATIVE BARGAINING SOLUTION ANALYSIS IN COOPERATIVE SALES  
PROMOTION CAMPAIGNS**

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### **Abstract**

Cooperative promotion is an important instrument for aligning manufacturer and retailer decisions in marketing channels. On the other hand, bargaining seems to be critical for marketing channel coordination, e.g., for vertical cooperative promotion. Based on our previous study (Spais, Papakonstantinidis and Papakonstantinidis, 2009), we propose an extension of the win-win-win papakonstantinidis conceptualization, which may lead us to a more valuable “win-win-win spais-papakonstantinidis-papakonstantinidis model”, as an innovative bargaining solution analysis for cases of optimal allocation of a promotion budget in a cooperative sales promotion campaign in vertical marketing channels. The proposition includes three (3) adjusted utility functions. In accordance to the research question of the study, the literature review findings allow us to extend the three adjusted utility functions considering the parameters of sales response budgeting method, the break-even sales analysis and the independent variable of the trade promotion goals for the existed level of sales of the marketing channel member. Based on the assumptions of the win-win-win papakonstantinidis model, we present the referee solution in order to be accepted by all three cooperating players; and the constraints. The basic initial assumption of this study is that specific contexts of marketing and promotion planning and decision-making in a cooperative level need adjusted bargaining solution analyses.

**Keywords:** cooperative promotion campaign, bargaining solution analysis, win-win-win spais-papakonstantinidis-papakonstantinidis model, utility functions and vertical marketing channels

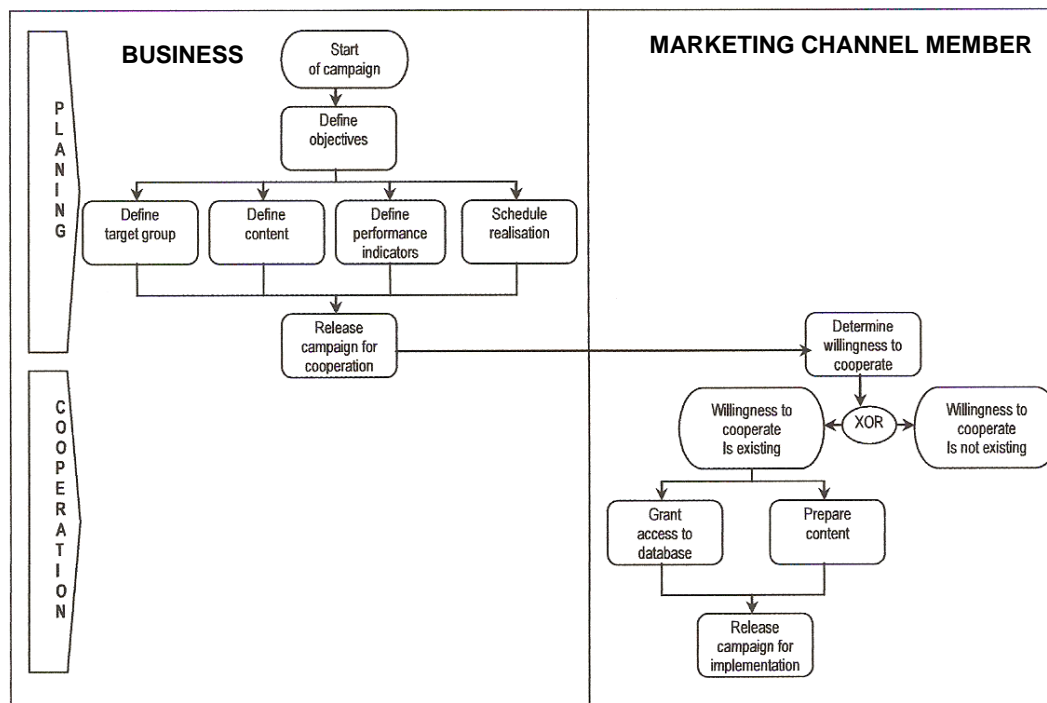
### **Introduction**

According to He, Prasad and Sethi (2009), cooperative promotion is an important instrument for aligning manufacturer and retailer decisions in marketing channels. On the other hand, bargaining seems to be critical for marketing channel coordination, e.g., for vertical cooperative promotion (Ailawadi, Beauchamp, Donthu, Gauri and Shankar, 2009; Huang, Li and Mahajan, 2002) or resolving channel member conflicts as well as for setting trade terms such as transfer special prices and margins, according to Coughlan, Anderson, Stern and El-Ansary (2001). There is a significant literature on constructs such as bargaining problem (Xie and Wei, 2009) and tendency to conflict (Zhuang, Herndon and Zhou, 2005). In



contrast, the normative and behavioral principles governing marketing channel dependency and coordination regarding the tendency to sovereignty, tendency to improvement and mistrust are relatively unexplored. Encouragingly, as the literature reaffirms the critical role of bargaining in marketing channels (Coughlan, Anderson, Stern and El-Ansary, 2001), we strongly believe that the Papakonstantinidis win-win-win conceptualization as a bargaining solution analysis will receive a significant attention in the marketing literature in the nearest future.

In accordance with the framework of a cooperative marketing campaign process as presented by Fux, Mathieu and Myrach (2007), Merzenich (2005), Schumacher and Meyer (2004), a cooperative promotion management campaign process with the members of a vertical marketing channel (on both planning and cooperation levels) can be presented as follows (see Fig.1).



*Fig. 1. An adjusted framework of a cooperative promotion management campaign process with a marketing channel member in accordance to Fux, Mathieu and Myrach (2007), Merzenich (2005), Schumacher and Meyer (2004).*

Although literature clearly shows the raising issue of reinforcing customers' participation in marketing management activities of customer-centric organizations (such as: idea generation, idea screening, concept development and testing, process design, test marketing, building promotion campaigns etc.), (e.g. Lovelock and Young, 1979; Bowen, 1986; Dabholkar, 1990; Wilkstrom, 1995; Youngdahl and Kellogg, 1997; Sundbo, 1997; John and Storey, 1998; Sheth, Sisodia and Sharma, 2000; Wind and Rangaswamy, 2001; Alam, 2002; Piller, 2005; Galbraith, 2005; Hip and Grupp, 2005; Lusch, Vargo and O'Brien, 2007; Etgar, 2007; Chen and Lu, 2007;

Fang, 2008; Payne, Storbacka and Frow, 2008; Awa, 2010; Hu, Jianyou and Na, 2010), unfortunately there is no theoretical framework including the customer (as a “third party” or “third player”) in a cooperative marketing or promotion planning process.

### **Research aim, initial assumption and research question**

Based on our previous study (Spais, Papakonstantinidis and Papakonstantinidis, 2009), we proposed an extension of the win-win-win papakonstantinidis conceptualization, which led us to “win-win-win spais-papakonstantinidis-papakonstantinidis model”, an innovative bargaining solution analysis for cases of optimal allocation of a promotion budget in a cooperative sales promotion campaign in vertical marketing channels. The proposition includes three (3) adjusted utility functions. In accordance to the research question of the study, we intend to extend the three adjusted utility functions considering the parameters of *sales response budgeting method*, *the break-even sales analysis* and the independent variable of the *trade promotion goals* for the existed level of sales of the marketing channel member. Based on the assumptions of the win-win-win papakonstantinidis model, we intend to present the referee solution in order to be accepted by all three cooperating players; and the constraints. The basic initial assumption of this study is that specific contexts of marketing and promotion planning and decision-making in a cooperative level need adjusted bargaining solution analyses.

According to the available empirical evidence, the SMEs seem to be oriented to the Sales School rather than the Communication School regarding to the goals of promotion campaigns (Huang and Brown, 1999; Thrassou and Vrontis, 2006; Elmazi and Bazini, 2008; Bazini, 2008; Demetriou, 2008; Tsiotsou, Rigopoulou and Kehagias, 2010; Vrontis, Thrassou and Czinkota, 2011) and sales response budgeting method seems that becomes quiet popular (Luxton, Hodge and Reid, 2002; Little, 2004; Thrassou and Vrontis, 2006; Miller and Pazgal, 2007; Du, Hu and Ai, 2007; Akanbi and Adeyeye, 2011).

Based on the above, the research question is if the ‘win-win-win spais-papakonstantinidis-papakonstantinidis papakonstantinidis’ utility functions can be extended incorporating *the sales response budgeting method*, *the break even sales analysis* and *the trade promotion goals* in order to be applied as a bargaining solution analysis for vertical cooperative sales promotion management decisions?

### **Theoretical and conceptual framework**

The win-win-win papakonstantinidis model is a methodological tool for conflict resolution, especially in the case of decision-making, or in forming “instant reflection winning strategies” the

BARGAIN (which is the frame). For the needs of the study, we adjust the conceptualization, in order to deal with the development of vertical cooperative promotion management

decisions. It has to prove that building a strong competitive advantage in a market mainly depends on the trust links among the partnerships in the vertical marketing channels.

Cohesion in partnership in the supply chain may be measured by the diversification Rate ( $R^*$ ) from strict rules: from this point of view, customers intervention should be useful, so as to diversify these “rules” at customized level adjusting them to their needs, wants, consuming identity, including communication codes, customs, ethics, culture. The win-win-win methodology, as a marketing channels’ development model, should facilitate customers to “readjust” bargaining rules in each market, through a sensitization process: Community of customers is defined as a discrete spatial/cultural entity at its sensitization process’ limit.

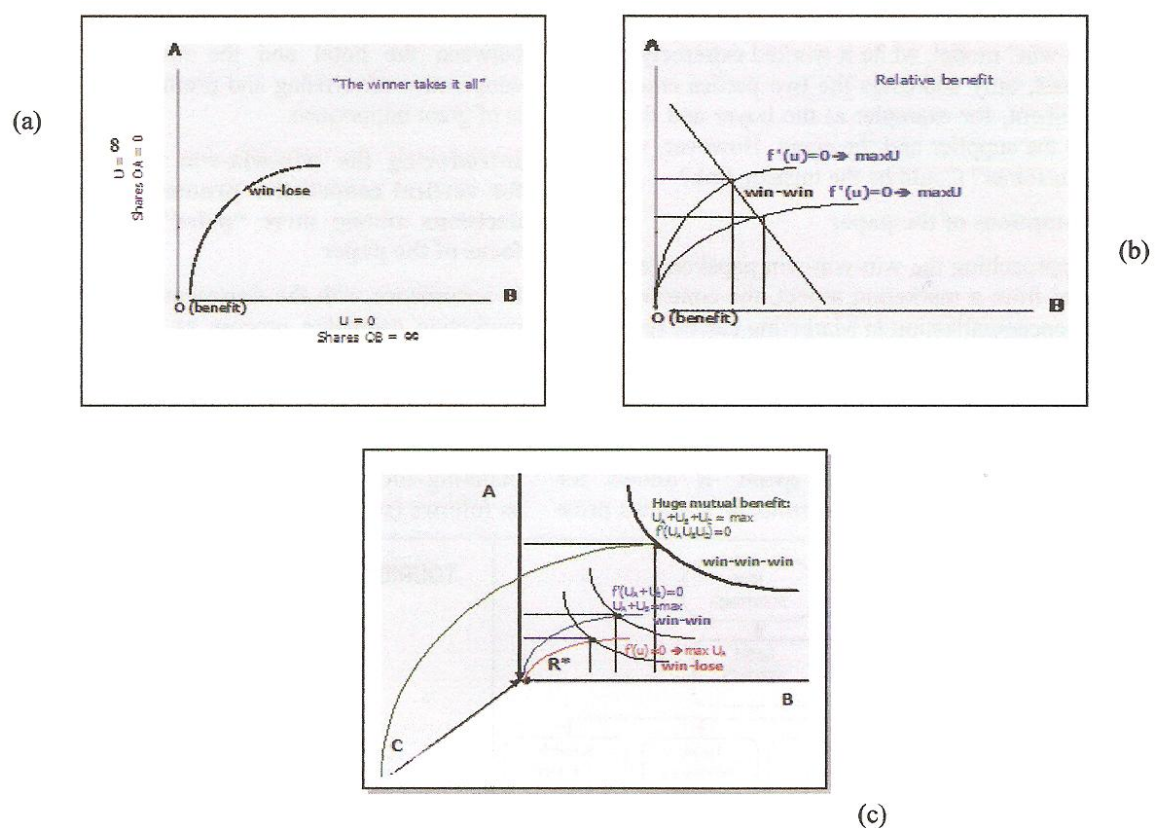


Fig. 2. Conceptual framework – the “win-win-win papakonstantinidis conceptualization” (c) compared to “win-lose” (a) and “win-win” (b) approaches

**1.1. Definitions.** 1.1.2. *Win-win perception:* It is based on when each side of a dispute feels they have won. Since both sides benefit from such a scenario, any resolutions to the conflict are likely to be accepted voluntarily. The process of integrative bargaining aims to achieve, through cooperation, win-win outcomes.

It is necessary to analyze the Nash “non cooperative-instant reflection game”/or a “win-win perception” as follows: Non-co-operative game is a game between two (2) players/individuals who have opposite interests (Aumann, 1987). Each player makes his own choices, based on

instant reflections' rational movements and his physical cleverness. The game (bargain) is determined by the result (pay-off) and not by player's expectations. It presupposes best choices by both players towards meeting individual interests ("winning strategies" – Harsanyi, 1973). Players (negotiators) do not regret, a posteriori, for their own decision taken, based on personal choices, during the bargain. Each of the players knows a priori that the other negotiator (or player) is as clever as he is. During the bargain, "mutual respect" between the two bargainers to each other's best choices is necessary. It is recognized that the more DETERMINED the breakdown of the negotiation (=less utility), the more satisfied (=better shares) – the more risk, the more profit.

Social behavior is not recognized as an acceptable one in the bargain, thus deriving unfair results: That means, "who needs the agreement as the result of a bargain, has to loose in shares, by accepting any result". Information may be the "link" between knowledge creation and the bargaining process. In particular, "Information" is a power factor in pure individuals winning strategies (Aumann, 1987). The more information, the better winning strategy, the more profit. Each of the players (negotiators), starting negotiations with the other, expects to gain the maximum profit. Interaction, based on instant reflection individual winning strategies, is the base of the Nash Non Cooperative Games Theory.

*1.1.2. Win-win-win perception:* It is based on the assumptions of information accessibility and diffusion that characterize the modern globalized societies as well as the complexity in the decision-making values that the "third win" (the "C" factor) could unlock a series of obstacles. Another assumption is that the individual (although his/her doubts) must believe that there is a "third" distinguishable part in the bargain (based on behaviorist analysis through the "neural networks"). Sensitization is introduced (regarding the integrated information) as a main variable of the bargain (the "third invisible part of the negotiation"/ the "C" factor). It is about an encephalic hard process in the bargain, which smoothes the angles of conflict or the shares/utilities (according to Nash). The "third win" functions as an umbrella, which conjoins different "dipolar relationships". Especially, in the business context, it must be understood that the existence of a "distinguishable entity", depends upon the degree of understanding and sensitization of knowing better the other polar (the partnerships in a supply chain), even through pecuniary values.

*1.1.3. Bargaining.* It is defined as a form of energy between two distinguishable entities with different expectations and controversial interests, where each part intends to sovereign. Practically, the social relationship "imitates" the natural relation, which is by nature conflictive; in order, the distinguishable entity acquires independent presence and action. This action is directed by the motive of gaining an individual profit. (Nash, Nasar and Kuhn, 2001).

*1.1.4. Bargaining problem.* A two-person bargaining situation involves two individuals (Von Neuman and Morgenstern, 1947), who have the opportunity, either to be competitors to each

– other (win-lose), or to make coalitions, or even to create pure individual strategies, based on bargainers' instant reflection behavior (win-win) (Nash, 1950; Arrow and Debreu, 1954; Aumann, 1987; Crawford, 1997). Nash (1951) focused on payoff shares/utilities combination. Bargain may result in either agreement or disagreement (Nash, Nasar and Kuhn, 2001). Utility expresses the constraint or the "fear factor" of disagreement for the negotiator who desires negotiations to be led in agreement more than the other one. Who needs more, negotiation leading to an agreement expects more utility, but – probably there is a loss in terms of "shares", due to lack of risk. On the contrary, who is indifferent about "agreement" or expects less utility per unit, has- to win in "shares" under the dogma "the more risk, the more profit" (Crawford, 1997).

So, bargaining problem is mainly based on "Utility Theory" – a mathematical theory of the Neoclassical School of Thought, able to explain (satisfactory) the individual expectations/anticipations, of a possible outcome. Usually, it is expressed in the form of a mathematical function:  $f(u) = u^{1/2}$ . Individual winning strategies are corresponding 1-1 to utilities  $U(A)$  and  $U(B)$  (Chun and Thomson, 1990). Utility theory of the individual is mainly based on the "concept of anticipation". In the "two-person utility theory", two (2) individuals in a bargain have the opportunity to collaborate for mutual benefit in more than one way. In its simple/initial version, no action, taken by one of the two individuals without the consent of the other can affect the well-being of the other one, but in real terms, there is only ONE decision, taken by the individual involved in a bargain.

*1.1.5. Tendency to conflict.* Refers to the tendency to competition between the two parts of the bargain with different expectations and controversial interests, results from the combination of: a) the case of the distinguishable entity, b) mistrust of each distinguishable entity, and c) the tendency to improvement. Based on the above, the motive of individual benefit leads with mathematic precision to the conflict, the tendency to sovereignty and from there to a competition climate, which is the corner stone of our economic system.

*1.1.6. Tendency to sovereignty.* The reason for which it is repeated is stressing the importance of "the need" for sovereignty, which finally "shapes" the expectations. Therefore, we have the following paradox: the expectation determines the motive (individual benefit, sovereignty, competition etc.) and simultaneously "is determined" by the internal need of dominance-sovereignty, something that characterizes our natural world.

*1.1.7. Tendency to improvement.* Constitutes the core requirement of the above tendency to conflict.

*1.1.8. Mistrust of each distinguishable entity.* Deals with the intentions of the other. Two distinguishable entities have different expectations; otherwise, the expectation of each one would be identified with the expectation of the other. Therefore, there would not be a bargaining and, of course, no "conflict" and no "distinguishable entities". If we had two "players" with precisely opposite interests and expectations, then the (A) would doubt the

intentions of (B) and (B) would doubt the intentions of (A). We would have thus a “never-ending circle of expectations” (Varoufakis, 2001).

1.2. Assumptions. According to Papakonstantinidis (2002, 2004a, 2004b, 2007), the conditions describing the bargaining situations of the win-win-win papakonstantinidis model are as follows:

1. In a bargaining situation, there are two distinguishable entities with opposite expectations and opposite interests.

2. These distinguishable entities, with the precisely opposite expectations, should be motivated (for individual benefit), so that they are activated and they transform the opposite expectations in opposite interests and from there in opposite “strategies of victory, or sovereignty”.

3. Since we accept the existence of the “distinguishable entity” and the motive of individual profit, we must accept the following condition: the mistrust of each pole of the bargaining situation, regarding the intentions of other. Two distinguishable entities have different expectations; otherwise, the expectation of each one would be identified with the expectation of other.

4. The natural tendency of individuals to improve continuously their position, results as basic consequence of the above assumptions, but simultaneously recommends the reason for all above. This natural tendency is permanent. It does not have upper barrier, while on the contrary it has a lower one.

5. Tendency to conflict, which refers to the tendency to competition between the two parts of the bargain with different expectations and controversial interests, results from the combination of: a) the case of the distinguishable entity, b) mistrust of each distinguishable entity and c) tendency to improvement.

6. Tendency to sovereignty, which refers to the reason for which it is repeated, is in order to stress the importance of “need” for sovereignty, which finally “shapes” the expectations.

7. The strategic choice, the decision and the strategic plan: If all the above aim to achieve the strategic goal of sovereignty, then the strategic plan is the means for accomplishing such a goal.

8. The respect of each one of the two poles, in the rationalism of the other, without moral or other extensions. This is essential and necessary condition for the establishment of the bargaining (in opposite case, there is no negotiation, but simply a “sovereignty” of the one pole to the other). Each one from the two opposite poles just simply respects the “bargaining power of the other”, or the “rationalism of the other”, which is about “a better organized strategic plan for the achievement of sovereignty”.

9. The two “opposite” poles are involved in a bargaining situation through the STRICT choices (that have resulted from rationalism and strategies for sovereignty that shape their final decisions), they never regret for their choices and for their final decisions.

1.3. Theoretical implications and limitations of the “win-win-win papakonstantinidis model” to the marketing literature regarding to bargaining in cooperative marketing programs. According to Spais, Papakonstantinidis and Papakonstantinidis (2009), the importance of this theory is arisen from the transfer of the pure trust theory to a marketing context, which can be achieved in order to analyze marketing phenomena of bargaining especially in cooperative promotion programs characterized by conflict and mistrust. Marketing phenomena refer to understanding of the bargaining problem resolution and the types of negotiation in which the marketing channel member and the business dispute the price, which will be communicated and the exact nature of the transaction that will take place and eventually come to an agreement in terms of a promotion management strategy.

The theory considers the information accessibility and diffusion that characterize the modern marketing environment, and the complexity in the decision-making of marketing channel members values that the “third win” (the “C” factor: the customer) could unlock a series of obstacles. The individual (although his/her doubts) must believe that there is a “third” distinguishable part in the bargain. The ‘win-win-win papakonstantinidis’ theory supports the significance of the tendency to sovereignty, the tendency of conflict, which results from the combination of: a) the case of the distinguishable entity, b) mistrust of each distinguishable entity, and c) tendency to improvement in a vertical marketing channel.

Based on the assumptions of the ‘win-win-win papakonstantinidis’ conceptualization, the limitation in contexts such as the cooperative promotion programs, as identified in our previous study (Spais, Papakonstantinidis and Papakonstantinidis, 2009) is that utility assessment and cost-utility analyses such as costs/quality-adjusted expected profits model from the partnership for A and B factors and the demand model for C factor are frequently presented to demonstrate the value of many utility options in the marketing literature. However, utility indicators require various methods that introduce significant methodological challenges, which directly influence the results and ensuing cooperative promotion management decisions in vertical marketing channels.

The existed proposition for a bargaining solution analysis in the case of optimal budgeting in a cooperative sales promotion campaign

The three (3) adjusted utility functions introduced by Spais, Papakonstantinidis and Papakonstantinidis (2009) for a bargaining solution analysis in the case of optimal budgeting in a cooperative promotion campaign of a hotel and a tourism operator considering Sriram’s and Kalwani’s functions (2007) are presented below:

*A factor (expected profits for the hotel)*

$$\max U_{\hat{e}st} = (W_{st} - c_s - Pr_{st}) * ms_{st} (MD_t, SO_t, AD_t, PR_t, \xi_{st}) - AD_t$$

$$s = 0, 1, 2, \dots, S, t = 0, 1, 2, \dots, T \quad (1)$$

where  $\hat{e}st$  – is the per period profit;  $\hat{e}$  for the hotel's service  $s$  at period  $t$ ;  $W_{st}$  – is the wholesale price  $W$  of hotel's service  $s$  for the operator at period  $t$ ;  $c_s$  – the marginal cost of hotel's service  $s$ ;  $Pr_{st}$  – is the promotion, respectively of hotel's service  $s$  at period  $t$ ;  $ms_{st}$  – is the hotel's market share for period  $t$ ;  $MD_t$  – is the marketing decision for period  $t$ ;  $SO_t$  – is the sales objective for period  $t$ ;  $AD_t$  – is the total advertising budget at period  $t$ ;  $PR_t$  – is the total promotion budget at period  $t$ ;  $\xi_{st}$  – is the mean utility to hotel's customers from services  $s$  at period  $t$  due to unobserved variables.

*B factor (expected profit for the tourism operator)*

$$\max U_{\hat{e}s} = (c_s - Pr_{st}) * ms_{st} (MD_t, SO_t, AD_t, PR_t, \xi_{st}) - AD_{st}$$

$$s_{op} = 0, 1, 2, \dots, S_{op}, s = 0, 1, 2, \dots, S, t = 0, 1, 2, \dots, T \quad (2)$$

where  $\hat{e}s$  – is the per period profit  $\hat{e}$  for the tourism operator service  $s_{op}$  from the partnership at period  $t$ ;  $c_s$  – the marginal cost of tourism operator's service  $s_{op}$  from the partnership;  $Pr_{st}$  – is the promotion, respectively of hotel's service  $s$  at period  $t$ ;  $ms_{st}$  – is the tourism operator's market share at period  $t$ ;  $MD_t$  – is the tourism operator's marketing decision cost for period  $t$ ;  $SO_t$  – is the tourism operator's sales objective for period  $t$ ;  $AD_t$  – is the total advertising budget at period  $t$ ;  $PR_t$  – is the total promotion budget at period  $t$ ;  $\xi_{st}$  – is the mean utility to hotel's customers from services  $s$  at period  $t$  due to unobserved variables.

*C factor (expected profits for the hotel's customers)*

$$\max U_{ct} = \beta_{0cst} + \alpha_c P_{st} + \beta X_{st} + \gamma_c Pr_{st} + \xi_{st} + \varepsilon_{cst},$$

$$s = 0, 1, 2, \dots, S, t = 0, 1, 2, \dots, T \quad (3)$$

where  $\beta_{0cst}$  – is the utility that hotel customer  $c$  derives from hotel services  $s$  at period  $t$ ;  $P_{st}$  – is the regular price, respectively of hotel's service  $s$  at period  $t$ ;  $X_{st}$  – is a vector of factors that influence the hotel's customer's utility including demand drivers such as seasonal factors at period  $t$ ;  $Pr_{st}$  – is the promotion, respectively of hotel's service  $s$  at period  $t$ ;  $\xi_{st}$  – is the mean utility to hotel's customers from services  $s$  at period  $t$  due to unobserved variables;  $\varepsilon_{cst}$  – is the loyalty of customer  $c$  to the hotel's service  $s$  at period  $t$ .

## Literature review

### A review of the research activity for the bargaining solution analysis for vertical cooperative promotion management decisions

Based on the analysis of 56 published research works (Spais, Papakonstantinidis and Papakonstantinidis, 2009), we can summarize the following findings:

- It seems that *cooperative bargaining solution analysis results* based on mathematical models can show us how to share the profit gain between the two parties in a vertical marketing channel and determine the associated pricing and advertising policies for both parties.



- The bargaining problems are:
  - the complex issue of promotion activities,
  - the reputation that both parties bring to the bargaining table, and
  - the perceived uncertainty in the lateral environment (competitive sector).
- Regarding the tendency to conflict in vertical marketing channels: it seems that communication is the main source of conflict followed by different expectations and organizational structure.
- Regarding the tendency to sovereignty in vertical marketing channels: there is a growing dominance of large retailers, which alter the traditional channel incentives.
- Regarding the tendency to improvement for each member of the vertical marketing channel: it seems that bargaining without side payments is not effective as cooperation at reducing beggar-thy-neighbor effects, it is a welfare-improving alternative to non-cooperation and is likely more practical in many situations.
- There is mistrust between the members of the vertical marketing channels.

Modern empirical evidence focus on the Customer as the third “player”/“pole” of the bargaining solution in cooperative sales promotion management process between the business and the marketing channel member (e.g. Gabrielsena and Roth, 2009; Bontems, Dhar and Chavas, 2007).

**Customer as the third “player”/“pole” of the bargaining solution in cooperative sales promotion management process between the business and the marketing channel member**

According to Misra and Mohanty (2008), bargaining can be seen as the process of distributing the gains obtained from trade among the participants of the trade. In the present context, the gains from trade (between the business or the manufacturer and the marketing channel member) are the total marketing channel profits. Since the wholesale price determines the proportion in which the gains from the trade (total marketing channel profit) are split between the marketing channel members, this wholesale price turns into the decision variable that is bargained over by marketing channel members. An alternative approach to measure bargaining power based on a Nash Bargaining Model between manufacturers and retailers has been recently proposed in the literature (Iyer and Villas-Boas, 2003; Misra and Mohanty, 2008; Draganska, Klapper and Villas-Boas, 2010).

There are two solution concepts for the above-mentioned bargaining problem - the cooperative approach and the non-cooperative approach (Muthoo, 1999). The asymmetric Nash bargaining solution is the cooperative approach to bargaining problems in which the asymmetry in bargaining power between the parties is taken into consideration.

Encouragingly, modern empirical evidence show the raising importance of the customer to be considered as the “third party” in delegated bargaining in vertical marketing channels (between the manufacturer and the marketing channel member), (e.g. Bontems, Dhar and Chavas, 2007; Gabrielsen and Roth, 2009).

Optimal allocation of promotion budgets, the sales response as a budgeting method and break even sales analysis as parameters influencing bargaining solution analyses of cooperative sales promotion campaigns

The optimal allocation of the promotion budgets is an issue of practical importance (Sriram and Kalwani, 2007; Albadvi and Koosha, 2011). According to Gómez, Rao and McLaughlin (2007) and Gómez, and Rao (2009) the theme categories in promotion management can be classified as follows: i. the explanation of the growth; ii. the allocation of promotion budgets; iii. the extent of pass-through; iv. the balance of power between the business and the marketing channel members.

Regarding to the extent of marketing channel’s member pass-through it seems that it ranges widely depending on the product category and retail price zone (e.g. Tyagi, 1999; Besanko, Dubé, and Gupta 2005); According to Cannondale Associates (2003), only 13% of manufacturers reported receiving a good value for their promotion expenditures and, furthermore, claimed that only about half of trade funds were actually passed on to consumers. Kumar, Rajiv, and Jeuland (2001) reported higher retail margins from promotion budgets depend on the product market characteristics, such as the retailer’s clientele and the heterogeneity in consumer search costs, and on frequency and budget of manufacturer deals.

For example, Drèze and Bell (2003) and Gómez, and Rao (2009) report that marketing channel members prefer discount-based promotions flexibility and manufacturers prefer performance-based promotions. Regarding to the research thrust related to the inefficient resource allocation due to the relative power between the business and the marketing channel member as discussed in research works (e.g. Scheffman, 2002; Sullivan, 2002; Paik and Bagchi, 2007; Stet, 2008), correlated to the distortions of demand because of the promotion campaigns.

According to Sriram and Kalwani (2007) promotions besides their strong positive effect on a brand’s performance, they may also have some detrimental effects that need to be accounted for while allocating the marketing budget. Based on this observation, Naik, Raman and Winer (2005) consider interaction effects between advertising and sales promotions in addition to modeling their main effects.

Regarding to the role of the budgeting method to the bargaining solution analysis for optimal budgeting in a cooperative sales promotion campaign, Dant’s and Berger’s study (1996) models the cooperative determination of franchisor’s and franchisee’s advertising contributions under conditions of differing perceptions of the sales response functions to

advertising. The authors report such decisions are frequent source of conflict and the disagreements persist because of the win-win potential of vertical cooperative advertising is not well appreciated.

Ending, regarding to importance of break even sales analysis in bargaining solution analyses of cooperative sales promotion campaigns, it seems that indeed it plays a very crucial role (e.g. Dant and Berger, 1996; Morton and Zettelmeyer, 2000; Ailawadi, 2001; Yue, Austin, Wang and Huang, 2006; Misra, 2008; Roma and Perrone, 2010).

Trade promotion goals influencing bargaining solution analyses of cooperative sales promotion campaigns

The issue of trade promotion goals seems to be underlined in terms of bargaining process in a cooperative sales promotion campaign adopting win-win trade promotion approach by Drèze and Bell (2003).

According to Sigué (2008), the long-term effects of promotions on sales are increasingly linked to the supposed shift of economic power within channels from manufacturers to retailers. However, formal knowledge about how they influence channel decisions under different promotional arrangements and the distribution of channel profits remains very sparse. Sigué's findings indicate that retailers always invest in retailer promotions, while manufacturers may find it optimal to not invest in consumer promotions. Economic power shifts from manufacturers to retailers when consumer promotions significantly expand the baseline demand in the long-term. Otherwise, manufacturers remain more powerful. Trade promotions or other profit-transfer mechanisms may be indispensable in easing conflicts over who should undertake promotions, especially when these promotions substantially increase future sales.

Based on the literature review findings, we extend the three adjusted utility functions (1), (2) and (3) incorporating the parameters of *sales response budgeting method*, *the break-even sales analysis* and the independent variable of the *trade promotion goals* that lead us to the utility functions (4), (5) and (6). The extended adjusted utility functions and the constraints (8), (9) and (10) derived from the win-win-win papakonstantinidis model are presented in the next section.

The new proposition: An extension of the utility functions of the “win-win-win spais-papakonstantinidis-papakonstantinidis model”

“A player” – Business – Promotion Planner (expected profits model for A player):

We consider the business, which is the promotion planner as the A factor, with utility maximizing the profits  $\tilde{\epsilon}$  in a given period  $t$  ( $t = 0, 1, 2, \dots, T$ ) for the brand  $p$  ( $p = 1, 2, \dots, P$ ). We can compute the per period profit for the brand as:

$$\max U_{\epsilon pt} = (W_{pt} - c_p - Pr_{pt}) * S_{pt} (MD_t, SO_{ptBS}, AD_{t ds/dt}, PR_{t ds/dt}, \zeta_{pt}) - AD_t$$

$$p = 0, 1, 2, \dots, P, t = 0, 1, 2, \dots, T \quad (4)$$

where:

$\epsilon_{pt}$  – is the per period profit;  $\epsilon$  for the brand  $p$  at period  $t$ ;

$W_{pt}$  – is the wholesale price  $W$  for the brand  $p$  at period  $t$ ;

$c_p$  – is the marginal cost for the brand  $p$ ;

$Pr_{pt}$  – is the promotion, respectively of brand  $p$  at period  $t$ ;

$S_{pt}$  – is the business' existed level of sales for brand  $p$  at period  $t$ ;

$MD_t$  – is the marketing decision cost at period  $t$ ;

$SO_{ptBS}$  – is the objective of minimum sales volume for brand  $p$  at period  $t$  based on the break-even sales;

where break even sales:

$$\text{Break-even sales} = \frac{\text{fixed costs}}{\text{contribution margin}}$$

where contribution margin:

$$\text{Contribution margin} = \frac{\text{brand's price} - \text{variable cost}}{\text{brand's price}}$$

$AD_{t ds/dt}$  – is the total advertising budget at period  $t$  considering  $dS/dt$ ;

where  $dS/dt$  according to Vidale-Wolfe model (1957):

$dS/dt = rA(t)(M-S)/M - \lambda S$ , where:

$S$  = sales volume at period  $t$

$dS/dt$  = change of sales volume at period  $t$

$r$  = response constant

$A(t)$  = rate of advertising expenditure

$M$  = saturation level of sales

$\lambda$  = exponential sales decay constant (lost sales) when  $A(t)=0$

$PR_{t ds/dt}$  – is the total promotion budget at period  $t$  considering  $dS/dt$ ;

$\zeta_{pt}$  – is the mean utility to consumers/customers from the brand  $p$  at period  $t$  due to unobserved variables.

“B player” – Marketing Channel Member (expected profits model from the partnership with the Business for B player):

We consider the marketing channel member as the B factor, with utility maximizing the profits  $\epsilon$  for the marketing channel member from the partnership with the business in a given period  $t$  ( $t=0, 1, 2, \dots, T$ ) for the marketing channel member (mediating, facilitating and sales) services to the business  $s_{op}$  ( $s_{op}=1, 2, \dots, S$ ). We can compute the per period profit for the marketing channel member services as:

$$\max U_{\epsilon st} = (c_p - Pr_{pt}) * ms_{pt} (MD_t, SO_{ptBS}, TPG_{pt}, AD_{t ds/dt}, PR_{t ds/dt}, \zeta_{st}) - AD_{st}$$

$$s_{op} = 0, 1, 2, \dots, S_{op}, s = 0, 1, 2, \dots, S, t = 0, 1, 2, \dots, T \quad (5)$$

where:

$\pi_{pt}$  – is the per period profit;  $\pi$  for the marketing channel member for brand  $p$  at period  $t$ ;

$c_p$  – the marginal cost for the brand  $p$  for the marketing channel member;

$Pr_{pt}$  – is the promotion, respectively of brand  $p$  at period  $t$ ;

$ms_{pt}$  – is marketing channel member's existed level of sales for brand  $p$  at period  $t$ ;

$MD_t$  – is the marketing decision cost for the marketing channel member at period  $t$ ;

$SO_{ptBS}$  – is the objective of minimum sales volume for brand  $p$  at period  $t$  based on the break-even sales;

where break even sales:

$$\text{Break-even sales} = \frac{\text{fixed costs}}{\text{contribution margin}}$$

where contribution margin:

$$\text{Contribution margin} = \frac{\text{brand's price} - \text{variable cost}}{\text{brand's price}}$$

$TPG_{pt}$  – are the trade promotion goals of brand  $p$  at period  $t$ ;

where typical trade promotion goals:

- expanding distribution
- inventory control
- encourage retail promotion

$AD_{tds/dt}$  – is the total advertising budget at period  $t$  considering  $dS/dt$ ;

where  $dS/dt$  according to Vidale-Wolfe model (1957):

$dS/dt = rA(t)(M-S)/M - \lambda S$ , where:

$S$  = sales volume at period  $t$

$dS/dt$  = change of sales volume at period  $t$

$r$  = response constant

$A(t)$  = rate of advertising expenditure

$M$  = saturation level of sales

$\lambda$  = exponential sales decay constant (lost sales) when  $A(t)=0$

$PR_{tds/dt}$  – is the total promotion budget at period  $t$  considering  $dS/dt$ ;

$\xi_{pt}$  – is the mean utility to consumers/customers from the brand  $p$  at period  $t$  due to unobserved variables.

“C player” - Customers/Consumers (expected profits for customers/consumers):

We consider a market with utility-maximizing customers/consumers  $c$  who while visiting the point of sale in a given period  $t$  ( $t = 0, 1, 2, \dots, T$ ) may choose to purchase the brand  $p$  ( $p = 1, 2, \dots, P$ ) within a category or may purchase a competitive brand (equivalent to not purchasing in the category, denoted by  $p = 0$ ). The presence of the

outside alternative in our model allows for the potential sales increase. We represent the utility that customer/consumer  $c$  derives from brand  $p$ , at period  $t$ .

$$\max U_{ct} = \beta_{0cst} + \alpha_c P_{st} + \beta X_{st} + \gamma_c Pr_{st} + \xi_{st} + \varepsilon_{cst},$$

$$p = 0, 1, 2, \dots, P, \quad t = 0, 1, 2, \dots, T \quad (6)$$

where:

$\beta_{0cst}$  – is the utility that customer/consumer  $c$  derives from brand  $p$  at period  $t$ ;

$P_{st}$  – is the regular price, respectively for brand  $p$  at period  $t$ ;

$X_{st}$  – is a vector of factors that influence the customer's/consumer's utility including

demand drivers such as seasonal factors at period  $t$ ;

$Pr_{st}$  – is the promotion, respectively of brand  $p$  at period  $t$ ;

$\xi_{pt}$  – is the mean utility to consumers/customer from brand  $p$  at period  $t$  due to unobserved variables;

$\varepsilon_{cpt}$  – is the loyalty of consumer/ customer  $c$  to the brand  $p$  at period  $t$ .

In Equation (3), we assume that the consumers/customers in each period will choose to purchase one of the brands at the point of sale  $p$  or settle for the outside good depending on the utility that they expect to derive from each choice alternative. So, their purchase choice is based on a consideration of the: a) characteristics of competitive brands, b) regular prices of competitive brands, c) promotional deals, d) seasonality, and e) marketing channel member's corporate name.

The referee solution, the optimal solutions for the three players and the constraints derived from the win-win-win papakonstantinidis model

$$[\text{profit}_a(\text{Coop}) - \text{profit}_a(\text{Non-coop})] \cdot [\text{profit}_b(\text{Coop}) - \text{profit}_b(\text{Non-coop})] \cdot [\text{profit}_c(\text{Coop}) - \text{profit}_c(\text{Non-coop})] \Rightarrow \max! \quad (7)$$

The constraints presented below (8), (9) and (10):

$$\text{Profit}_a(\text{Coop}) \geq \text{profit}_a(\text{Non-coop}) \quad (8)$$

$$\text{Profit}_b(\text{Coop}) \geq \text{profit}_b(\text{Non-coop}) \quad (9)$$

$$\text{Profit}_c(\text{Coop}) \geq \text{profit}_c(\text{Non-coop}) \quad (10)$$

$\text{Profit}_i(\text{Coop})$ : Profit of the  $i$ -th player from the optimal solution of cooperation,

$\text{Profit}_i(\text{Non-coop})$ : Profit of the  $i$ -th player from the optimal solution of non-cooperation (threat point).

Based on the above, the three "players" should only share the additional profit that results from the cooperation while receiving in advance that part of the profit that they could have

achieved anyway in the case of non-cooperative behavior. The rationale behind this is that the profit cannot be shared in total because the players have different threat points, i.e. profits in the case of non-cooperation. It is thereby plausible to share only the additional profit resulting from the cooperation. Constraints (8), (9) and (10) ensure that the players only accept solutions that are better than the one they could achieve in the case of non-cooperation. For our case, marketing managers have to search for a solution that maximizes the additional joint profit from cooperation (i.e. by operating a cooperative sales promotion campaign) over the respective profits in the case of non-cooperation (i.e. by operating separate sales promotion campaigns).

## Discussion

In this study, we propose an extension of the win-win-win papakonstantinidis conceptualization, which may lead us to a more valuable “win-win-win spais-papakonstantinidis-papakonstantinidis model”, as an innovative bargaining solution analysis for cases of optimal allocation of a promotion budget in a cooperative sales promotion campaign in vertical marketing channels. The proposition includes three (3) adjusted utility functions. In accordance to the research question of the study, the literature review findings allow us to extend the three adjusted utility functions considering the parameters of *sales response budgeting method*, *the break-even sales analysis* and the independent variable of the *trade promotion goals* for the existed level of sales of the marketing channel member. Based on the assumptions of the win-win-win papakonstantinidis model, we present the referee solution in order to be accepted by all three cooperating players; and the constraints. The basic initial assumption of this study is that specific contexts of marketing and promotion planning and decision-making in a cooperative level need adjusted bargaining solution analyses

Cooperative promotion is an important instrument for aligning manufacturer and retailer decisions in marketing channels. On the other hand, bargaining seems to be critical for marketing channel coordination, e.g., for vertical cooperative advertising (Ailawadi, Beauchamp, Donthu, Gauri and Shankar, 2009; Huang, Li and Mahajan, 2002) or resolving channel member conflicts as well as for setting trade terms such as transfer special prices and margins, according to Coughlan, Anderson, Stern and El-Ansary (2001). There is a significant literature on constructs such as bargaining problem (Xie and Wei, 2009) and tendency to conflict (Zhuang, Herndon and Zhou, 2005). In contrast, the normative and behavioral principles governing marketing channel dependency and coordination regarding tendency to sovereignty, tendency to improvement and mistrust are relatively unexplored. The literature reaffirms the critical role of bargaining in marketing channels (Coughlan, Anderson, Stern and El-Ansary, 2001). The research activity until 1987 is quite low. Only a few research works are presented in the leading marketing journals (such as the Journal of Marketing and the Journal of the Academy of Marketing Science). Quite impressive, research activity was over-triplining during the decade (1988-1998) and the research interest remained on the same level

in the decade of 2000. For an analytical presentation of the time evolution of the research activity regarding to the above win-win-win papakonstantinidis constructs, see Spais, Papakonstantinidis and Papakonstantinidis (2009).

No study, till now, has offered new bargaining solution analysis conceptualizations and especially the bargaining games theory analyzing individual winning strategies, through the utilities/shares possible combinations among three (3) “poles” in vertical cooperative promotion management decisions.

We strongly believe that the win-win-win papakonstantinidis model can be extended and as an innovative and valuable methodological tool for bargaining problems in vertical marketing channels regarding cooperative promotion management decisions and will receive a significant attention in the marketing literature in the following years. The importance of this try is arisen from the transfer of the pure trust theory to a marketing channels context, which can be achieved in order to analyze marketing phenomena of bargaining in marketing alliances characterized by conflict and mistrust.

### **Practical implications**

The ‘win-win-win spais-papakonstantinidis-papakonstantinidis model’ is a methodological tool for conflict resolution, especially in the case of decision-making, or in forming “instant reflection winning strategies” the BARGAIN (which is the frame) in vertical marketing channels for cooperative promotion management decisions. Marketing managers must realize that building a strong competitive advantage in a market mainly depends on the trust links among the partnerships in vertical marketing channels. Cohesion in the vertical marketing partnership in the marketing channel may be measured by the diversification Rate ( $R^*$ ) from strict rules: From this point of view, customers’ intervention is useful, so as to diversify these “rules” at customized level adjusting them to their needs, wants, consuming identity, including communication codes, customs, ethics, culture. The ‘win-win-win spais-papakonstantinidis-papakonstantinidis model’, as a vertical marketing channels’ bargaining solution analysis for cooperative promotion management decisions can facilitate customers to “readjust” bargaining rules in each market, through a sensitization process: Community of customers is defined as a discrete spatial/cultural entity at its sensitization process’ limit.

### **Conclusion**

Based on our previous study (Spais, Papakonstantinidis and Papakonstantinidis, 2009), we propose an extension of the win-win-win papakonstantinidis conceptualization, which may lead us to a more valuable “win-win-win spais-papakonstantinidis-papakonstantinidis model”, as an innovative bargaining solution analysis for cases of optimal allocation of a promotion budget in a cooperative sales promotion campaign in vertical marketing channels. The proposition includes three (3) adjusted utility functions. In accordance to the research question of the study, the literature review findings allow us to extend the three adjusted



utility functions considering the parameters of *sales response budgeting method*, *the break-even sales analysis* and the independent variable of the *trade promotion goals* for the existed level of sales of the marketing channel member. Based on the assumptions of the win-win-win papkonstantinidis model, we present the referee solution in order to be accepted by all three cooperating players; and the constraints. The basic initial assumption of this study is that specific contexts of marketing and promotion planning and decision-making in a cooperative level need adjusted bargaining solution analyses

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**MANAGEMENT AND LEADERSHIP IN THE PUBLIC AND STATE  
ADMINISTRATION SECTOR**

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**Introduction**

Which is the best method of Human Resources management – or, better, for the “management of people” – for the public sector? And which is the best leadership style? In this paper we try to focus and summarize both, theory – the latest theories – and practice – the operational everyday practices, according to the importance that Avallone (1994) attributed to this linkage. This purpose appears particularly significant, since, unlike in the private sector, HR management in public administration area affords a fundamental obstacle: there is not the aim of profit maximization. The mission of the organization, thus, does not result quantitatively measurable, but is situated on an ideal plan. So this mission is less clearly identified and less perceptible by the actors involved than that of the private sector, and organizational efficiency and individual productivity may then heavily suffer from this.

**Theoretical trends in the EU area**

The two pillars of modern management are the system of Total Quality Management (TQM), widespread in the eighties, and the process of self-assessment.

TQM underlines that the quality must accompany each organizational process. Operational planning and strategic planning of the organization must include the operational and strategic planning of its improvements.

In this respect, the self-assessment becomes essential. Self-assessment is an unique opportunity to make an overview of the overall strengths and of the areas of organizational improvement to implement quality management, being thus the platform of the whole organizational development.

Quality development and self-assessment represent together a “joint project” for managers and employees, both in the private and in the public sector.

For this, at the European level the Common Assessment Framework (CAF) model and its procedure were elaborated, resulting from the cooperation among EU governments in the field of public administration. Its first version was presented in May 2000 and next versions in 2002 and 2006. A CAF Resource Centre (CAF RC) was funded at the European Institute of

Public Administration (EIPA) in Maastricht, that works jointly with the network of CAF national correspondents.

The CAF is a simple free tool for TQM in EU public administration. In fact, it is based on the main Total Quality models in general, and on the Excellence Model of the European Foundation for Quality Management (EFQM) in particular, shaped according to the characteristics of public sector organizations. The CAF model presumes that great results in organizational performance are obtained through leadership driving strategy and planning, relating to people, partnerships, resources and processes.

The main goals of CAF model are: a) to familiarize public administrations to the principles of TQM and self-assessment; b) to encourage this self-assessment with the aim to make a diagnosis and to reach a practical effective improvement by the consequent action; c) to synthesize the various models used in quality management; d) to help public organizations in bench-learning.

By the CAF model the staff involvement is implemented, because management and staff must meet in order to analyze the current organizational situation and then promote quality at all levels.

The CAF model gained popularity among EU public administrations, so that in 2009 the CAF External Feedback was established to support such various organizations by peers and experts in TQM providing an external feedback (CAF-Common Assessment Framework).

But even if the above mentioned method is now provided by the evidence of results and by a certain number of good practices, it should not been forgotten that in public management science in general the major limitation is the lack of application of experimental methods (Hood, 2011). For example, in the United Kingdom, the shortage of experiment-based projects affected the 2004-10 Public Service research programme launched by the Economic and Social Science Research Council.

To escape from this impasse, the digital-era governance give us today a great opportunity: it makes possible a new form of theorization, that results from the opportunities of web resources and thus reduces the costs of experimentation, according to Margetts (2011). An example of this is the effort of the Public Sector People Managers' Association, that in the whole UK provides online services, from its website, to the community of the national public HR managers (UK Public Sector People Managers' Association). The presence of an apposite blog means that, since a two-way relationship can take place, there may be an interplay between theory and practice (UK Public Sector People Managers' Association Blog). Quite the same is done by the Public Sector HR Podcast, which defines itself as "the online radio show for People Managers in the Public Sector", providing the listening of

monthly interviews with top HR professionals and industry experts (UK Public Sector HR Podcast).

So, the reality of facts shows that scientific theory and practical evidence can and must proceed even more together. By the ex-post analysis of operational results, the current guidelines of scientific research in the field of management of people demonstrates the theoretical truth of value concepts such as "Empowerment" and "Commitment".

In fact, even if relating to the knowledge firms, Amar et al. (2009) demonstrated the exceptional results obtained relinquishing authority and giving employees great autonomy and in the same time leaving them self-motivation by the free expression of their talents and interests; this strategy, being funded on a sort of co-decision, can be called "mutualism". Other keywords related to those above mentioned, in this case, are Creativity, Innovation, Responsibility and Trust.

The actual emphasis on these aspects within public organization (Folador, 2006; Batstone, 2005) can help to fill the gap of the psychological distance from the organizational goal, as just said.

For instance, again, in France the control-based model definitively cease, giving way to a conception where people are no longer "employees", but "accomplices" (AA. VV., 2006), self-motivated enhancing their engagement but also their emotionality and sensibility; but the difficulties in delegating are still hard to be removed. France has been involved in a large movement of modernization of public administrations from 2006, when the "Loi organique relative aux lois de finances" (LOLF) was introduced. This law represents not only a budgetary reform, but also a general administrative reform, so that in it we must include the willingness to organize and motivate employees in the public sector, deepening also specific means like non-monetary approvals.

In The Netherlands, too, emphasis is put on the role playing by local communities and stakeholders to enhance and reinforce the organizational mission and thus the involvement of public employees to achieve organizational goals.

Quite the same orientation is seen in Italy, where drawing up the state to citizens and enterprises, according to an orientation towards internal and external customers, appears crucial, as public organizations have a certain problem of human resource productivity (Cavaliere, 2003). The need of people of approval for the efforts in their work and of adequate praise are also often theorized and verified (Wolf, 2010).

In general, the major theoretical assumptions followed by practical evidence is that people, in every business asset, need for meaning and positive value / evaluation. It is therefore revealed as essential the focus on existential needs of personal and professional

growth and development, as well as to those of empathy / harmony, sense of belonging, interpersonal communication, satisfaction with the realizations obtained. In the public sector, even more than in the private, a good leader must be able to implement all the above mentioned aspects and to bring them, so to speak, to their "full maturity."

Instead of the role of power, the leader must play a role of service (Folador, 2006; Amovilli, 1995).

The leader takes a coaching function, supporting and accompanying the internal client to achieving the objectives of the public authority.

In this operational framework, training is a key-precondition: it is necessary that the leaders first and then, as in a cascade, gradually the remaining staff are affected by a process of continuous training to increase awareness and responsibility. Just for the importance of what one can broadly define lifelong education, career paths must be constructed refocusing on that.

### **Practical evidence at the workplace**

The daily experience of management in a governmental office led to add other aspects to the considered framework. The case that we show concerns a territorial office of a state administration. A team of officials was formed and their manager was appointed. The group was composed of four officers and a team leader. Officials were three men, two older and one younger, and a woman, young. The manager was a woman. The problem was the relative inefficiency and non-productivity of the group with the assigned tasks, which derived mainly from the characteristics of each subject; at a glance:

1- the most senior officer had willingness and had much experience, but family problems distracted him enough to put into the work;

2- the another middle-aged officer, in turn, had family problems that distracted him, but he applied; but, despite this, the experience was not specific enough to allow him to be sufficiently productive;

3- the younger officer was quite prepared and motivated, but highly insecure and anxious and still inexperienced;

4 - the young officer woman was well prepared and very motivated, but had just arrived in the office and tackled for the first time that kind of work (Goleman et al., 2002; Robinson, 1990).

The approach adopted by the team leader was different for each person in the group, but towards all of them were used empathy and support.

In details:



1 - more dialogue was initiated, allowing the subject to develop a relationship of greater confidence, the team leader has shown a sincere interest in the family situation of the official, so that he felt more relaxed at work and at the same time more optimistic about the resolution of his personal problems, and this allowed to him fewer distractions and a greater productivity; the team leader assigned vicarious tasks to the officer, increasing his self-esteem and enhancing his experience within the group, while making him responsible towards colleagues;

2 - even with this official was engaged a dialogue, through which he could feel valued and encouraged as a person and not just as a worker; since he was a more reserved person, the team leader respected this side of character and didn't force him to open up; this behavior of respect was appreciated by the official, who, as the other above mentioned did, became more passionate about their work;

3 - the team leader sought to reduce his anxiety by giving repeated assurances to this colleague on his abilities and urging him to show their positive potential;

4- the team leader made that the oldest official instructed the newcomer, and put the younger colleague side by side to her; this way, the two youngest in the group supported themselves mutually by compensating and helping each other.

Towards all her staff, the team leader have tried to maintain a friendly, sympathetic attitude, and to avoid sudden changes of mood. Sometimes it was necessary to show some more bossy attitude to maintain the fixed road map, but first of all called to their mind the organizational and personal ethics. To support the scheduled road map, instead to blame, she taught them the principles of time management. In addition, the team leader always endeavored not to divide but to keep the group cohesive despite the differences in character among members.

At the end of this process, that is at the end of the year, the fixed performance objectives were totally achieved. In addition, the next transfer of the head of the team leader to another group led to the request by members of the first group to get themselves transferred to the new group along with the team leader.

## Strategic implications and conclusions

Finally, the focus now is on these critical needs to be satisfied in order to achieve the best management of people in the public administration:

1 – to have a good reputation, by implementing the internal and external communication, because HR function and communication function must go on together; this reflects itself on the people productivity;

2 – to maintain a strict relationship between the HR function and the customers and stakeholders feedback to the public administration: in fact, employees will be more motivated if it is really everyday tangible the satisfaction of the local community;

3 – to create and change organizational culture if it seems necessary.

In public administrations, it is important that people be helped to have a clear idea of both organizational mission and vision and thus to aim at ambitious goals, even when the challenge may seem great: in fact, often the effort required to achieve a modest goal is no different than what you need for a bigger. This concept is particularly important where the public good is the primary objective and idealism must play a determinant role, as Goleman et al. (2002) stressed yet.

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**ETHNO-CULTURAL CONSIDERATIONS IN NEGOTIATION:  
PRETENSE, DECEPTION, LIES AND FORMAL CONTRACTS IN GREECE**

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**Abstract**

A retrospect into *ethos*, this study endeavors to illuminate the impact of individualism, collectivism, idealism and trust on business people tendency to endorse questionable negotiation tactics and to sign formal contracts in Greece. A thousand survey questionnaires were administered to Greek employees, of which 327 usable responses were collected. The use of an online platform allowed the rigorous management and control of the acquired data. The research findings highlight the significant role of ethical idealism in negotiation processes and agreements. The impact of individualism/ collectivism on the endorsement of questionable negotiation tactics and the propensity to sign formal contracts is corroborated. This research does not investigate respondents' actual negotiation behavior; it rather explores perceptions about preferred negotiation tactics, and attitudes towards ethical behavior, general trust and formal contracts. The findings may deviate from real-life behavior in the Greek setting.

Emphasizing the non-US and non-Western European nature of the empirical data collected, the originality of this research stems from the development of a comprehensive research framework about questionable negotiation tactics and formal contracts.

**Keywords:** Negotiation tactics, formal contracts, individualism, collectivism, general trust, ethical idealism, culture, Greece

**Introduction**

Aristotelian ethics summarized the ancient debate on ethical behavior and human well-being. Aristotle, following Socrates' and Plato's insights on ethical virtues, systematically discussed the significance of *ethos* on individual and collective excellence. Yet, it wasn't until the 1980s, when ethical behavior gained importance in the business world. It was the period when *code of ethics* became the buzzword in business research and a separate field of study emerged (Farrell et al., 2002).

A framework in which individual values and contextual psychological perceptions gain applicability has been that of negotiation tactics (Lewicki and Robinson, 1998). In negotiation, two or more parties try to work out a trade of items or services that would satisfy all involved parties. Not always the tactics adopted by the counterparts can be considered ethically

acceptable. For instance, in some cases, one or both sides may attempt to mislead each other, or keep secret information that could benefit the other party. Such tactics have often been challenged as questionable (Reitz et al., 1998).

Existing literature in the areas of social psychology and international business suggests three types of factors that relate ethical attitudes and behavior in negotiations: cultural, economic, and personal factors (Volkema, 2004). Although a stream of research acknowledges the role of these factors in ethical negotiating, the field has still been fertile for further examination.

Culture is a factor that influences negotiators' values, thoughts, behaviors and approaches, and thus one of the major variables present in the negotiation process (Cohen, 1993). Culturally diverse individuals interpret questionable negotiation behaviors differently, demonstrating different levels of tolerance towards questionable negotiation tactics. Also, the propensity of culturally distinct individuals to adopt questionable negotiation tactics varies significantly (Gelfand and Realo, 1999; Triandis, 1995; Volkema, 1998; Volkema, 2004; Volkema and Fleury, 2002; Zarkada-Fraser and Fraser, 2001). For example, in collectivist cultures people tend to comply with the norms that they are expected to follow, and frequently opt for questionably ethical activities when this is required by their family, community or other in-groups (Triandis, 2001; 2006).

A number of personal or demographic factors have been suggested to influence negotiators' propensity to use various questionable negotiation tactics. Most research of personal factors has focused on gender and age discrepancies as predictors of the actor's negotiating behavior (Kronzon and Darley, 1999; Lewicki and Robinson, 1998; Volkema, 2004). Male, rather than female, and younger, rather than older, individuals have been reported to have lower ethical standards (McDonald and Kan, 1997; Weeks et al., 1999). Other researchers have tested the influence of factors such as personality (Ma, 2005), problem-solving approach (Ma, 2006; Mintu-Wimsaat et al., 2005), and emotional intelligence (Foo et al., 2004) on the counterparts' bargaining behavior. In this study we highlight the role of two personal factors that have attracted minor research interest: ethical ideology (Al-Khatib et al., 2005), and general trust (Elahee et al., 2002).

The researchers in this study expand on the existing literature in negotiations, examining the impact of cultural and personal factors on questionable negotiation tactics. However, the ultimate purpose of every negotiation procedure is to reach the point of the parties' agreement. For this reason, the scope of this work extends beyond negotiation tactics to negotiators' tendency to sign formal contracts. We investigate whether cultural and personal factors relate negotiators' tendency to sign formal contracts. Consequently, this study's innovation and contribution consist in extending a comprehensive framework of business people tendency to endorse questionable negotiation tactics or to sign formal contracts to Greece, and beyond traditional western cultures.

We decided to test our instrument in Greece, a geographic region where, very early, the concepts of ethics, trust, and collectivism were systematically studied and codified. The choice of Greece as our research setting was motivated by three principal reasons. First, in an era of increasing globalization, much of the research on culture and negotiation tactics has been largely limited to US and Western European samples, a fact that emphasizes the need for more international evidence (Gelfand et al., 2001; Ma, 2007). Second, Greece is located at the crossroads of Europe, Asia and Africa, and Greek culture interestingly combines a collectivistic mentality (Hofstede, 1983) with several individualistic elements (Georgas, 1989). Third, ethics, negotiation tactics and formal contracts in Greece have sparsely been researched and previous literature does not present adequate empirical work (Kavali et al., 2001).

## Theoretical Framework

### The Greek Context

Greece has been classified as a collectivist culture (Georgas, 1989; Vassiliou and Vassiliou, 1973). For many centuries, the prevalent word and the highest virtue within the Greek milieu has been that of *philotimo*, loosely translated as the *love of honor*. The traditional concept of *philotimo* connotes that Greek people must act as is expected of them by their larger in-groups, such as family and friends (Triandis, 1989). The implicative meaning of *love of honor*, one of the regulatory components of the Greek behavior, embodies specific norms that dictate to the person the proper conduct as described by the prevailing standards of morality.

During the past decades, Greek society has experienced rapid changes, such as the increasing involvement of women in all sectors of social life, extensive immigration waves towards Athens, a steady influx of Albanian, African and Middle-eastern migrant laborers, and a systematic urbanization of many peripheral to the capital cities. The most recent milestone that intensified Greek social reformation was the country's admission into the Euro zone in 2001, a catalytic change reflected into the impressive surge of the annual GDP per capita.

The transition to a more complex and demographically diverse structure has generated alterations in the degree to which collective norms regulate individual social conduct. Analogous shifts have been reported in earlier studies of the Greek social setting (Georgas 1991; Vassiliou and Vassiliou, 1973). Following the typical individualist-collectivist classification, Greece ranked in the middle between individualist and collectivist countries (Hofstede, 1980; House et al., 2004; Triandis et al., 1986). Interestingly, Greek respondents scored the lowest of all 62 countries on Societal Institutional Collectivism in House et al.'s (2004) GLOBE study, thereby being classified as a discrete cluster by the study's researchers. These findings indicate that Greek collectivism may encompass different virtues than western collectivism or that individualist values are gradually replacing the traditional Greek

collectivist values. This fact makes the current study even more valuable in its potential to shed light on the concept of collectivism.

Embedded within a rather collectivist environment, Greek business is vastly characterized by extensive close relationships among in-group actors. Compared to other cultures, Greek people maintain long-lasting, emotionally close, and frequently overlapping ties with their family, friends, and relatives (Kafetsios, 2006; Stefanidis, 2009). Very often, business and kinship or friendship bonds are strongly tangled, nurturing a 'community of common fate' climate. High levels of trust are based on common interests and mutual benefits, limiting opportunistic behavior among in-group members (Stefanidis et al., 2007). Drakopoulou-Dodd and Patra (2002) comment eloquently that professional problems are often resolved not by asking 'what shall we do?', but 'who we should call?' or 'do we have anyone (an acquaintance)?'.

Within this context, the exploration of the interrelations among the dimensions of ethics, trust, questionable negotiation tactics and formal contracts gains particular interest. Kavali et al. (2001) highlight this need, introducing to the discussion specificities of the Greek economic structure, such as the presence of many small and medium enterprises (SMEs), which externally depend for their survival on government, the existence of a bureaucratic public sector, and relevant problematic phenomena associated with political 'clientelism', questionable business funding and tax favoritism. Indeed, Greeks have been proven to be tolerant of marginally ethical behaviors, such as extortion payments and bribery, compared with samples from countries such as the United States (Kavali et al., 2001; Tsalikis and LaTour, 1995).

### **Questionable Negotiation Tactics**

Individuals may use a number of negotiation tactics that do not comply with contemporary ethical standards (Anton, 1990; Lewicki, 1983). Lewicki and Robinson (1998) and Robinson et al. (2000) classified marginally ethical negotiation tactics into five groups: traditional competitive bargaining, attacking opponent's network, false promises, misrepresentation, and inappropriate information gathering. While traditional competitive bargaining is considered rather ethical, the other four tactics are considered questionable (Al-Khatib et al., 2005).

Relatively acceptable tactics include examples such as endearing oneself to the other party, pretending to be angry or happy, and making high opening demands. These tactics are often classified as 'pretense' or 'traditional competitive bargaining'. At the same time, negotiating behaviors such as misrepresenting facts, making extortion payments or feigning friendship for information, are considered relatively unacceptable by negotiators. These tactics are classified as 'bluffs', 'deception' and 'lies'. In line with this classification, our study examines unethical negotiation attitudes described as 'pretense', 'deception' and 'lies'.

Although the adoption of ethically questionable negotiation tactics provides transient benefits (Curhan et al., 2006), it also breeds adverse business consequences, including financial loss, and jeopardizes future business agreements (Scroth, 2008). Additionally, public relations and corporate image are considerably affected, provoking the loss of trust between negotiating parties (Cramton and Dees, 1993). In the long-run, opposing negotiators may choose to adopt more rigid attitudes, and consequently, established relationships may be imperiled, and future opportunities may be missed (Reitz et al., 1998). The fact that unethical negotiation tactics cause a negative climate between parties makes difficult the joint reach of mutual objectives and cultivates distrust (Tenbrunsel, 1998). Boles et al. (2000) report that negotiators who detect unethical behaviors feel less enthusiastic about the success of future negotiations.

Particularly in Greece, negotiators tend to regard 'traditional competitive bargaining' and 'bluffing' tactics as relatively acceptable. In their study, Zarkada-Fraser and Fraser (2001) observe that Greek negotiators are more tolerant towards the adoption of 'threatening' tactics, compared to other negotiators from countries such as USA, Russia and Australia. When faced with moral dilemmas, Greeks primarily adopt those negotiation tactics that are dictated by their organizational in-group culture and their superiors. Also, they tend to demonstrate feeble moral objection towards the use of threatening to make the other party's negotiators look foolish in front of their boss (Zarkada-Fraser and Fraser, 2001).

### **Tendency to Sign Formal Contracts**

Under various circumstances negotiation process can be either time-consuming or brief. Irrelevant to its duration, every negotiation concludes when involved parties achieve a mutually acceptable agreement (Reitz et al., 1998). Frequently negotiations result in the signing of a formal contract, while in certain cases negotiating sides reach non-contractual agreements.

Formal contracts represent promises or obligations that the co-signing parties will perform particular actions in the future (Zhou, Poppo and Yang, 2008). Contracts decrease uncertainty and attenuate risks that stem from opportunism or other moral hazards (Williamson, 1983). Relational literature suggests a number of social norms that hold an essential role in the conduct of the negotiating parties. These norms set the grounds of acceptable behavior, control relationships and regulate individual activities (Macneil, 1985). Personal bonds and relational consequences of adopted behaviors determine parties' expectations and constitute 'principles of right action' (Gundlach and Achrol, 1993).

Personal characteristics, propensity to trust or distrust, ethical standards, and local cultural dimensions affect differently individual propensity to form contractual relationships. In this study we examine whether cultural and other personal factors relate to negotiators' tendency to sign formal contracts rather than rely on non-formal agreements.

### **Individualism/ Collectivism**

Although the concepts of individualism and collectivism date back to ancient Greek literature and philosophy, Hofstede (1980) was the first scholar who systematically measured this cultural dimension (Triandis and Gelfand, 1998). Following Hofstede, several authors have highlighted different dimensions of cultural diversity (Banai and Reisel, 2007). In collectivist societies, individuals tend to form groups within which mutual dependence is high and group objectives' prioritization over personal is predominant.

In Greece, it has been documented that the social context has been rather collectivistic (Gelfand and Christakopoulou, 1999; Georgas et al., 1997; Hofstede, 1983; House et al, 2004). However, after the late 1980s, Greek society has been experiencing a widespread transition characterized by the acquisition of multiple individualistic attributes (Georgas, 1989). Analyzing their research findings, Triandis et al. (2001) observe that Greece deviated from Hofstede's ranking; the sample participants displayed higher levels of individualism than those originally expected. The authors attribute Greeks' increasing individualistic attitudes to the recent enlargement of the national product per capita.

Although, the selection and use of negotiation tactics varies between collectivist and individualistic societies, there has been no consensus regarding the relationship between collectivist/ individualist societies and ethical decision-making in negotiations. Some researchers suggest that individualist societies demonstrate more examples of unethical behavior, due to the dominance of self-interest. Others state that collectivist societies display more incidents of unethical behavior, due to the increased levels of competitive behavior even amongst the manifold social in-groups (Rivers and Lyle, 2007). Research findings provide support for both arguments (Elahee et al., 2002; Volkema, 1997; Volkema, 1998; Volkema, 2004). Voronov and Singer (2002) propose that individualism/ collectivism variables cannot explain sufficiently complex cultural dimensions and, thus, predict various negotiating behaviors. Moreover, in non-homogeneous cultures, like that of Switzerland, there may be simultaneously variable individualistic and collectivist trends (Kozan, 1999).

Triandis (1995) argued that individualism/ collectivism may be further classified as horizontal, emphasizing equality, or vertical, emphasizing hierarchy. He related individualism/ collectivism to Hofstede's 'power distance' attribute, associating vertical collectivism with collectivist societies, and horizontal individualism with individualistic societies. Triandis (2001) divided individualism/ collectivism into four dimensions: 'horizontal individualism' (HI), 'vertical individualism' (VI), 'horizontal collectivism' (HC), and 'vertical collectivism' (VC).

In horizontal individualist cultures, such as Australia and Sweden, the values of uniqueness, independence and self-reliance are emphasized, while hierarchical differentiation is less important (Triandis and Gelfand, 1998). According to the Berlin Corruption Index, the



levels of corruption in horizontal individualist countries are very low. In general, horizontal collectivists make the least use of deceiving tactics (Triandis et al., 2001).

*Hypothesis 1: Higher levels of horizontal individualism are negatively related to the endorsement of 'Pretending', 'Deceiving', and 'Lying' negotiation tactics.*

In vertical individualist cultures, such as the United States, diversity and status are important; individuals try to differentiate from their counterparts (Triandis and Gelfand, 1998). Vertical individualists are competitive, they focus on the maximization of their earnings, and they try to be 'the best' in order to climb the hierarchy (Triandis and Suh, 2002). Vertical individualists frequently use competitive conflict management styles and employ unethical negotiation tactics (Kaushal and Kwantes, 2006; Komarraju et al., 2008).

*Hypothesis 2: Higher levels of vertical individualism are positively related to the endorsement of 'Pretending', 'Deceiving', and 'Lying' negotiation tactics.*

In horizontal collectivist cultures, individuals perceive themselves as equal members of their groups, and they emphasize empathy, sociability, and cooperation (Triandis et al., 2001). They seek to establish mutually respectful relations, to share objectives, to communicate and to socially comply with the other members of their groups (Triandis and Gelfand, 1998). In conflict resolution, horizontal collectivists prefer cooperative, accommodating, and compromising conflict management styles (Komarraju et al., 2008), avoiding unethical tactics.

*Hypothesis 3: Higher levels of horizontal collectivism are negatively related to the endorsement of 'Pretending', 'Deceiving', and 'Lying' negotiation tactics.*

Vertical collectivism has been associated with individuals' tendency to be submissive to authority and to endorse conventionalism (Triandis and Suh, 2002). Vertical collectivists accept that some group members are more important than other, and that individuals should be self-conscious of their position in the hierarchy. In this context, authority is unconditionally accepted and self-sacrifice for the group is seen as valuable (Triandis and Gelfand, 1998). Triandis et al. (2001) suggested that most vertical collectivist cultures would practice high levels of deceptive behavior in their negotiations, an argument supported by the Berlin Corruption Index. Vertical collectivists demonstrate avoiding and competitive conflict management styles (Kaushal and Kwantes, 2006; Komarraju et al., 2008) and tend to adopt

even more deceitful negotiating behaviors than horizontal individualists (Triandis et al., 2001).

*Hypothesis 4: Higher levels of vertical collectivism are positively related to the endorsement of 'Pretending', 'Deceiving', and 'Lying' negotiation tactics.*

Individualism and collectivism influence people's attitudes towards relationships (Triandis and Suh, 2002). In conflict situations, collectivists are primarily concerned with maintaining the relationship in the future, whereas individualists are largely concerned with achieving justice even if this is damaging for the relationship (Ohbuchi et al., 1999). Triandis and Suh (2002) refer that collectivists tend to prefer conflict resolution methods that do not harm relationships, whereas individualists would be willing to even go to court to resolve disputes. Additionally, collectivists tend to emphasize more the emotional proximity to their in-groups, the interdependence with others, the family integrity and sociability. Norms, rather than attitudes, and communal, rather than exchange relationships, are prioritized (Triandis and Gelfand, 1998). Koehn (2001) emphatically states that both Japanese and Chinese businessmen have been loath to sign formal contracts. In many collectivist societies, individuals do not adhere to the contracts and they often not even read them. Contracts are merely 'letters of intention' that express the parties' intention to cooperate. Relational ties outweigh formal contracts (Zhou, Poppo and Yang, 2008).

*Hypothesis 5: Higher levels of individualism are positively related to the individuals' tendency to sign formal contracts.*

*Hypothesis 6: Higher levels of collectivism are negatively related to the individuals' tendency to sign formal contracts.*

## **Trust**

Trust is an essential element of all exchange relationships (Granovetter, 1985; Zaaher and Venkatraman, 1995). Trust facilitates communication and strengthens relationships (Elahee et al., 2002; McAllister, 1995; Ross and La Croix, 1996). Levels of trust between negotiating parties have been reported to affect the negotiation process and the tactics adopted.

Specifically, negotiators who trust each other communicate their thoughts more comfortably and they are more receptive to the other party's ideas. Several researchers have demonstrated that, in negotiation, mutual trust increases cooperative behavior, expedites information-sharing between parties (Butler, 1995), encourages problem-solving behavior (Mintu-Wimsatt et al., 2005), and increases earnings (Olekals et al., 2007).

Trust also tends to make negotiators more considerate concerning ethical patterns of behavior (Rodgers, 2009). Elahee et al. (2002) and Elahee and Brooks (2004) observed a statistically significant inverse relationship between general trust and unethical behavior. Negotiators who detect unethical behaviors feel less enthusiastic about future negotiation outcomes (Boles et al., 2000). Trust further reflects whether negotiations between parties are fair (Anderson and Narus, 1990). High perceived levels of trust decrease the use of deception as a negotiation tactic and promote fair trade (Olekalns and Smith, 2009).

*Hypothesis 7: High levels of trust are negatively related to the endorsement of 'Pretending', 'Deceiving', and 'Lying' negotiation tactics.*

The presence of trust in trade relationships indicates that one party believes that its requirements will be fulfilled through future actions undertaken by the other party (Anderson and Weitz, 1989). High levels of trust are more likely to be present in situations in which past commitments have been accomplished (Mayer et al., 1995; Anderson and Narus, 1990). Trust frequently holds the role of a psychological contract that minimizes opportunistic behavior and betrayal (Gullett et al., 2010; Olekalns and Smith, 2009; John, 1984). Zaheer et al. (1998) observe that high levels of trust decrease the costs associated with contracting, such as negotiating and renegotiating, and allow parties to address issues of mutual interest without resorting to legalistic remedies. Trust transforms informal commitments into established, mutually accepted norms and routines.

*Hypothesis 8: High levels of trust are negatively related to the individuals' tendency to sign formal contracts.*

### **Ethical Idealism**

Ethical idealism is evidently one of the factors that determine individuals' attitudes towards negotiation tactics and contracting. Personal moral philosophy provides the standards for judgments, stances and behavior (Ferrel et al., 1989) and therefore affects negotiators' decision-making.

Hitt (1990) classifies ethical decision-making into four different categories: end-result ethics, rule ethics, social contract ethics, and personal ethics. In general, individuals oriented towards results adopt an end-result ethical approach, while communities set their ethical norms under the social contract approach. Conversely, Forsyth (1980) described ethical decision-making employing the concepts of idealism and universalism. The former implies that universal rules are valid for everyone, and that individuals make decisions following these rules, whereas the latter rejects rules on the basis of relativism. Vitell et al. (1993) found

that high-idealists and low-relativists tend to adopt more ethical behaviors than individuals who score low on idealism and high on relativism.

Banas and Parks (2002) detected an inverse relationship between ethical ideology and unethical behavior; while high-idealist individuals consider unethical behaviors less acceptable, high-relativists tend to accept them. Al-Khatib et al. (2005) observe that idealism is negatively correlated with unethical behavior, which, in turn, is positively correlated with relativism. In their study among university students, Perry and Nixon (2005) report that individuals who accept (highly idealistic) rule ethics show lower levels of unethical behavior, whereas individuals who accept (less idealistic) end-result ethics display higher levels of unethical behavior.

*Hypothesis 9: High levels of ethical idealism are negatively related to the endorsement of 'Pretending', 'Deceiving', and 'Lying' negotiation tactics.*

Ethical decisions vary significantly between individuals (Tsalikis and LaTour, 1995). Besides, ethical behavior may differ under different negotiation circumstances. Nielsen (2009) cites cases of extortion payments in Greece, the UK and the US to illustrate that such unethical behavior can be adopted due to environmental contingencies and loose implementation of contractual agreements. Individuals active in highly relativist contexts are expected to be averse towards the signing of detailed contracts that are binding for the co-signing parties (Koehn, 2001). Heugens et al. (2006) refer that those that benefit the most from the signing of an explicit contract are actors that already possess 'high' moral standards.

*Hypothesis 10: High levels of ethical idealism are positively related to the individuals' tendency to sign formal contracts.*

## **Research Method**

### **Data collection**

An ambitious data collection plan was designed and implemented. Based on evidence from the existing literature, the research constructs were compiled to a self-administered questionnaire. The questionnaire was translated from English to Greek with the assistance of two bilingual reviewers. To confirm the validity of the constructs, ten Greek employees were invited to participate in the pilot test of the questionnaire. Participants were asked to make comments about the translated questionnaire items. All the observed comprehension discrepancies were addressed and the questionnaire was revised.

Before the launching of the survey, an online platform was set up. The translated questionnaire was uploaded, and a thousand participation invitations were sent out during a four-month research period. The use of the online platform provided several advantages associated with the rigorous management and control of the input data. A 32.7% response rate was achieved. The 327 usable responses were collected from participants geographically dispersed all over Greece.

Participants represented a diversity of backgrounds with regard to their socio-economic status, education, and professional hierarchical ranking. The survey respondents were employed in various areas of the Greek private and public sectors, including telecommunications, manufacturing, construction, retailing, tourism, insurance, banking, and public authorities. 52% of the participants were male and 48% were female. The average respondent age was 34 years. 78% of the sample population had received at least 4 years of college education. 48% earned an annual income of at least 20 thousand euro where the national GDP per capita at current market prices is 21,300 euro (European Commission, 2010).

### **Reliability and validity considerations**

To ensure the reliability and validity of our research, a number of successive precautions had to be taken. Apart from pre-testing the consistency of the pilot questionnaire, all used scales were assessed with regard to their internal reliability employing Cronbach's Index.

Due to the self-report nature of the survey, we recognized potential common method bias issues and thus we employed the Harman single-factor test (Podsakoff and Organ, 1986). We did not observe any unusual variations in the collected responses. Not a single factor accounted for the majority of the covariance in the measured variables. Thus, we regarded that common method variance issue is rather limited.

Close examination of the online database allowed us to further confirm that no random responses were counted as usable. All respondents devoted adequate amount of time to the completion of the questionnaire. Towards the same direction, we controlled for the development of response patterns, reversing a number of anchor scales in different parts of the questionnaire.

Finally, the several email messages and feedback comments we received from the participants, strengthened our belief that the validity of the collected responses is particularly high. Our confidence was later supported by the finding that our results were in line with published literature.

## **Measures**

### **Negotiation Tactics**

Based on Lewicki et al.'s (2006) classification of highball tactics, we employed seventeen questions to measure questionable negotiation tactics. A seven-point Likert-type scale was

used to indicate responses that ranged from 1=strongly disagree to 7=strongly agree. Respondents were asked to recall a negotiating situation very important to them and their business and choose the appropriate tactic.

To validate the structure of the construct, factor analysis (varimax rotation technique) on the 17 items describing tactics was conducted (Churchill, 1995). The three-factor solution that provided the best fit explained 53.63% of the overall variance. The first factor, named 'Lying', included five items and explained 20.01% of the variance. The second factor, named 'Deceiving', included four items and explained 18.55% of the variance. The third factor, named 'Pretending', included four items and explained 14.99% of the variance (Table 1). The internal degree of reliability was confirmed using Cronbach's Alpha test that yielded a coefficient of .83. The Cronbach's Alpha coefficients of the three components were .73, .75, and .63, respectively.

Table 1  
Factor Analysis Matrix of the Negotiation Tactics Variables

	Components		
	Lying	Deceiv g	Pretending
<i>Pretend to be disgusted at the other party's comments.</i>	.78		
<i>In return for concessions from the other party now, offer to make future concessions that you know you will not follow through on.</i>	.74		
<i>Intentionally misrepresent information to the other party in order to support your negotiating arguments or positions.</i>	.73		
<i>Gain information about the other party's negotiation position by cultivating his friendship through expensive gifts, entertaining, or personal favors.</i>	.53		
<i>Convey a false impression that you are in absolutely no hurry to come to a negotiated agreement, thereby trying to put time pressure on your opponent to concede quickly.</i>		.72	
<i>Make an opening demand so high/low that it seriously undermines the other party's confidence in his/her ability to negotiate a satisfactory settlement.</i>		.70	
<i>Overwhelm the other party with so much information that they have trouble determining which factors are important and which are merely distractions.</i>		.66	
<i>Make an opening demand that is far greater than what you really hope to settle for.</i>		.62	
<i>Deny the validity of information, which your opponent has that weakens your negotiating position, even though the information is true and valid.</i>		.56	
<i>Get the other party to think that you like him/her personally despite the fact that you don't really.</i>			.78
<i>Express sympathy with the other party's plight although in truth you don't care about their problems.</i>			.64
<i>Promise that good things will happen to the other party if s/he gives you what you want, even if you know that you cannot (or will not) deliver these things when the other's cooperation is obtained.</i>			.60
<i>Pretend that an issue of little or no importance to you is quite important.</i>			.55
<i>Eigenvalue</i>	2.61	2.41	1.94
<i>Percent of variance</i>	20.09	18.55	14.98

Extraction method: principal component analysis. Rotation method: varimax with Kaiser normalization.

### Tendency to Sign a Formal Contract

To measure respondents' tendency to sign a formal contract, we employed a 5-item construct designed by the authors. A five-point Likert-type scale was used to indicate responses that ranged from 1=strongly disagree to 5=strongly agree.

To validate the structure of the construct, factor analysis (varimax rotation technique) was conducted. One factor that included four items was extracted. The one-factor solution, named

'Tendency to sign a formal contract', explained 46.36% of the total variance. The internal degree of reliability, which was measured using Cronbach's Alpha coefficient, was .60.

### **Ethical Idealism**

To measure ethical idealism we used a six-item construct adopted from the 'Ethics Position Questionnaire' (Forsyth, 1980). A five-point Likert scale that assessed the degree of idealism of the respondents was used (1=strongly disagree, 5=strongly agree).

The factor analysis (varimax rotation) led to the extraction of a single factor, named 'Ethical Idealism'. The extracted factor included all six items and explained 51.02% of the total variance. The Cronbach's Alpha reliability coefficient of the construct was .80.

### **Trust**

The levels of trust between the negotiating parties were measured employing an 8-item scale adopted from Mayer et al. (1995). Respondents were asked to self-report agreement or disagreement with regard to their levels of general trust towards other individuals. Levels of general trust ranged between 1=strongly disagree (minimal levels of trust) and 5=strongly agree (maximal levels of trust).

Following the literature, factor analysis (varimax rotation) was conducted on the 8 items describing levels of general trust. One factor that included five items was extracted. The 5 items of the 'Trust' factor explained 43.98% of the total variance. The Cronbach's Alpha reliability coefficient of the construct was .68.

### **Individualism/ Collectivism**

Respondents' orientation towards individualism and collectivism was measured using a 32-item construct developed by Singelis et al. (1995). A nine-point Likert-type scale was employed to measure horizontal individualism, vertical individualism, horizontal collectivism and vertical collectivism (1=strongly disagree, 9=strongly agree).

Following the literature on individualism/ collectivism (Triandis and Gelfand, 1998), factor analysis (principal component/ varimax rotation) on the 32 items was performed (Churchill, 1995). For the extraction of the factors, we adopted a reflective perspective based on the findings of the relevant literature (Chiou, 2001). After the purification of the items, 19 elements were retained. Four components that account for 54.72% of the total variance were extracted: horizontal individualism, vertical individualism, horizontal collectivism and vertical collectivism (Table 2). Horizontal individualism included 5 items and explained 13.56% of the variance, vertical individualism included 5 items and explained 14.44% of the variance, horizontal collectivism included 5 items and explained 15.82% of the variance, and vertical collectivism included 4 items and explained 10.89% of the variance. The Cronbach Alpha reliability coefficient of the scale was .74 ( $\alpha_{\text{Horizontal Individualism}}=.73$ ,  $\alpha_{\text{Vertical Individualism}}=.78$ ,  $\alpha_{\text{Horizontal Collectivism}}=.79$ ,  $\alpha_{\text{Vertical Collectivism}}=.70$ ).



Table 2  
Factor Analysis Matrix of the Individualism/ Collectivism Variables

	Component			
	Horizontal Collectivism	Vertical Individualism	Horizontal Individualism	Vertical Collectivism
<i>The well-being of my co-workers is important to me.</i>	.77			
<i>I feel good when I cooperate with others.</i>	.76			
<i>If a co-worker gets a prize, I would feel proud.</i>	.73			
<i>I like sharing little things with my neighbors.</i>	.71			
<i>It is important to maintain harmony within my group.</i>	.62			
<i>Without competition, it is not possible to have a good society.</i>		.79		
<i>I enjoy working in situations involving competition with others.</i>		.77		
<i>Competition is the law of nature.</i>		.72		
<i>Winning is everything.</i>		.68		
<i>It is important that I do my job better than others.</i>		.66		
<i>I like my privacy.</i>			.79	
<i>One should live one's life independently of others.</i>			.69	
<i>I prefer to be direct and forthright when in discussion with people.</i>			.66	
<i>I often do "my own thing."</i>			.62	
<i>When I succeed, it is usually because of my abilities.</i>			.57	
<i>I would sacrifice an activity that I enjoy very much if my family did not approve of it.</i>				.76
<i>Before taking a major trip, I consult with most members of my family and many friends.</i>				.76
<i>I would do what would please my family, even if I detested that activity.</i>				.72
<i>I usually sacrifice my self-interest for the benefit of my group.</i>				.54
<i>Eigenvalue</i>	3.00	2.74	2.57	2.07
<i>Percent of variance</i>	15.81	14.44	13.56	10.89

Extraction method: principal component analysis. Rotation method: varimax with Kaiser normalization.

## Results

The descriptive statistics and correlations between the dependent and independent variables are presented in Table 3. 'Deceiving' negotiation tactics rank first (Mean = 3.84, S.D. = 1.20), followed by 'pretending' negotiation tactics (Mean = 3.58, S.D. = 1.06) and 'lying' negotiation tactics (Mean = 2.53, S.D. = 1.19).

Table 3  
Descriptive Statistics & Correlation Analysis Matrix between Negotiation Tactics, Individual Attitudes and Demographic Variables

	Correlations																	
	Mea	Std.																
	n	Deviation	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1. Pretending	3.58	1.06	1.00															
2. Deceiving	3.84	1.20	.44**	1.00														
3. Lying	2.53	1.19	.39**	.55**	1.00													
4. Formal Contract	4.54	.47	.05	.10	-.12*	1.00												
5. Ethics	3.98	.70	-.17**	-.17**	-.33**	.32**	1.00											
6. Trust	2.37	.60	-.09	-.00	.17**	-.16**	.05	1.00										
7. Horizontal Individualism	6.84	1.16	.02	.11	-.11*	.31**	.13*	-.06	1.00									
8. Vertical Individualism	5.63	1.63	.19**	.22**	.15**	.11*	-.18**	.06	.22**	1.00								
9. Horizontal Collectivism	6.85	1.33	-.06	-.01	-.19**	.23**	.29**	.04	.29**	-.01	1.00							
10. Vertical Collectivism	5.18	1.70	.03	-.00	.06	.04	.23**	.11	-.14*	.11	.31**	1.00						
11. Rank	5.98	2.47	.05	.04	-.01	-.07	.05	.02	.08	.18**	.08	.11*	1.00					
12. Industry	0.18	.39	-.02	.06	.09	-.05	.01	.07	.01	-.12*	-.04	.01	-.15**	1.00				
13. Gender	0.47	.50	-.01	.00	-.04	.07	.19**	-.08	.18**	-.12*	.03	-.12*	-.05	.22**	1.00			
14. Age	33.86	9.72	-.11*	-.11*	-.07	-.01	.13*	.10	-.04	.03	.03	.24**	.35**	.08	-.04	1.00		
15. Education	3.09	1.07	.09	.05	-.04	-.08	-.20**	-.16**	-.05	.02	.04	-.08	.00	-.02	-.05	-.17**	1.00	

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16. Income	2.77	1.26	-.06	-.06	-.15**	.01	-.03	-.01	.04	.19**	.10	.10	.39**	-.13*	-.19**	.44**	.18**	1.00
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\*. Correlation is significant at the 0.05 level (2-tailed).

\*\*. Correlation is significant at the 0.01 level (2-tailed).

Vertical individualism was found to be positively correlated with all four dependent variables, namely, the 'Pretending,' the 'Deceiving,' and the 'Lying' negotiation tactics and the 'tendency to sign formal contracts'. A negative statistically significant correlation between ethical idealism and questionable negotiation tactics was traced. Ethical idealism was positively correlated with individuals' tendency to sign formal contracts. General trust was not significantly correlated with questionable negotiation tactics. Lower levels of general trust appeared to significantly increase individual propensity to enter contractual relationships.

To further investigate the explanatory power of the statistically significant correlations, multiple regression analyses were conducted. We tested our hypotheses employing four separate two-step hierarchical regression analyses; one for each dependent variable. Employees' rank, business industry, gender, age, education, and income were treated as control variables. No significant hierarchical regression model emerged from the first step of the four regression analyses. Independent variables HI, VI, HC, VC, ethical idealism and trust were entered in the second step of the regression analysis. The enter method was adopted, and following Hair et al. (1998) special emphasis was laid on the independence of the relationship among the independent variables (correlation coefficient < .80).

The hierarchical regression analysis results for the 'Pretending' negotiation tactics are presented in Table 4. The first step of the analysis did not provide a statistically significant model ( $F=2.23$ ). The deriving model of the second step of the hierarchical regression was statistically significant ( $F=3.01$ ,  $p<.001$ ). Employees' age, VI and ethical idealism significantly explained 8.7% of the total variance of the endorsement of the 'Pretending' negotiation style. The coefficient of the control variable age was negative ( $\beta=-.13$ ,  $p<.05$ ), the coefficient of the VI was positive ( $\beta=.15$ ,  $p<.05$ ), while the coefficient of the idealism was negative ( $\beta=-.14$ ,  $p<.05$ ). These findings suggest that: (a) younger individuals, (b) vertical individualists, and (c) individuals who score low in ethical idealism tend to accept pretending negotiation styles.

Table 4  
Hierarchical Regression Analysis on 'Pretending' Negotiation Tactics

Variable	FIRST STEP		SECOND STEP	
	$\beta$	<i>t</i>	$\beta$	<i>t</i>
Gender	-.01	-.12	.04	.71
Age	-.14	-2.28	-.13*	-2.19
Rank	.10	1.72	.08	1.30
Education	.07	1.19	.04	.67
Horizontal Individualism			.01	.23
Vertical Individualism			.15*	2.55
Horizontal Collectivism			-.05	-.83
Vertical Collectivism			.10	1.57
Ethics			-.14*	-2.28
Trust			-.08	-1.35
<i>R</i> <sup>2</sup>		.02		.08***
Adj. <i>R</i> <sup>2</sup>		.01		.05***
<i>F</i>		2.23		3.01***

\*  $p < .05$  \*\*  $p < .01$  \*\*\*  $p < .001$

'Deceiving' negotiation tactics' hierarchical regression analysis results are presented in Table 5. The first step of the analysis did not provide a statistically significant model ( $F=1.76$ ). The second step of the hierarchical regression led to a statistically significant model ( $F=3.12$ ,  $p < .001$ ). Employees' age, VI and ethical idealism significantly explained 9% of the total variance of the endorsement of the 'Deceiving' negotiation style. The coefficient of the control variable 'age' was negative ( $\beta = -.13$ ,  $p < .05$ ), the coefficient of the VI was positive ( $\beta = .17$ ,  $p < .01$ ), while the coefficient of the idealism was negative ( $\beta = -.16$ ,  $p < .01$ ). These findings suggest that: (a) younger individuals, (b) vertical individualists, and (c) individuals who score low in ethical idealism tend to accept deceiving negotiation tactics.

Table 5  
Hierarchical Regression Analysis on 'Deceiving' Negotiation Tactics

Variable	FIRST STEP		SECOND STEP	
	$\beta$	<i>t</i>	$\beta$	<i>t</i>
Gender	.00	.01	.04	.73
Age	-.14	-2.37	-.13*	-2.09
Rank	.09	1.58	.06	.94
Education	.02	.43	.00	.07
Horizontal Individualism			.08	1.30
Vertical Individualism			.17**	2.88
Horizontal Collectivism			-.01	-.09
Vertical Collectivism			.05	.87
Ethics			-.16**	-2.55
Trust			.01	.16
<i>R</i> <sup>2</sup>		.02		.09***
Adj. <i>R</i> <sup>2</sup>		.01		.06***
<i>F</i>		1.76		3.11***

\*  $p < .05$  \*\*  $p < .01$  \*\*\*  $p < .001$

For the dependent variable 'Lying' negotiation tactics, hierarchical regression analysis' results are presented in Table 6. No significant model derived from the first step of the regression analysis ( $F=.82$ ). Yet, the second step of the regression analysis provided a statistically significant model ( $F=7.63$ ,  $p < .001$ ). HC, VC, ethical idealism and trust explained 16.9% of the total variance of the acceptance of the 'Lying' negotiation style. The coefficient of the HC was negative ( $\beta = -.14$ ,  $p < .05$ ), the coefficient of the VC was positive ( $\beta = .16$ ,  $p < .01$ ), the coefficient of ethical idealism was negative ( $\beta = -.33$ ,  $p < .001$ ), and the coefficient of the trust variable was positive ( $\beta = .17$ ,  $p < .01$ ). Our results suggest that (a) low levels of HC, (b) high levels of VC, (c) low levels of ethical idealism, and (d) high levels of trust are associated with the 'Lying' negotiation tactics.

Table 6  
Hierarchical Regression Analysis on 'Lying' Negotiation Tactics

Variable	FIRST STEP		SECOND STEP	
	$\beta$	<i>t</i>	$\beta$	<i>t</i>
Gender	-.04	-.77	.07	1.33
Age	-.09	-1.50	-.10	-1.83
Rank	.02	.31	.02	.42
Education	-.06	-.98	-.08	-1.41
Horizontal Individualism			-.04	-.61
Vertical Individualism			.08	1.41
Horizontal Collectivism			-.14*	-2.30
Vertical Collectivism			.16**	2.79
Ethics			-.33***	-5.74
Trust			.17**	3.35
<i>R</i> <sup>2</sup>		.01		.19***
Adj. <i>R</i> <sup>2</sup>		-.00		.16***
<i>F</i>		.81		7.62***

\*  $p < .05$  \*\*  $p < .01$  \*\*\*  $p < .001$

Based on the regression analyses on the questionable negotiation tactics, we conclude that only hypothesis 9 was fully corroborated. Hypotheses 2, 3, and 4 were partially supported. Hypotheses 1 and 7 were rejected.

The results from the hierarchical regression analysis on the 'Tendency to sign formal contracts' are presented in Table 7. As was the case with the previous three analyses, no significant model derived from the first step of the regression analysis for the 'Tendency to sign formal contracts' ( $F=1.25$ ). The control variables explained 0% of the total variance of the dependent variable. The second step regression model was found to be significant ( $F=10.10$ ,  $p < .001$ ). Employees' rank within the organization, HI, VI, ethical idealism and trust explained 21.8% of the total variance of the individuals' propensity to sign formal contracts. The coefficient of the employees' rank was negative ( $\beta = -.14$ ,  $p < .05$ ), the coefficient of the HI was positive ( $\beta = .20$ ,  $p < .01$ ), the coefficient of the VI was positive ( $\beta = .16$ ,  $p < .01$ ), the coefficient of ethical idealism was positive ( $\beta = .31$ ,  $p < .001$ ), and the coefficient of the trust variable was negative ( $\beta = -.18$ ,  $p < .01$ ). In particular, individuals will be characterized by a higher tendency to sign formal contracts under the following conditions: (a) the lower their hierarchical position in the organization, (b) the more horizontally and vertically individualists they are, (c) the more ethically idealists they are, and (d) the less general trust they display towards people around them.

Table 7  
Hierarchical Regression Analysis on 'Tendency to Sign a Formal Contract'

Variable	FIRST STEP		SECOND STEP	
	$\beta$	$t$	$\beta$	$t$
Gender	.06	1.07	-.04	-.76
Age	.00	.05	.01	.24
Rank	-.07	-1.13	-.14*	-2.55
Education	-.08	-1.43	-.05	-.95
Horizontal Individualism			.20***	3.58
Vertical Individualism			.16**	2.89
Horizontal Collectivism			.11	1.91
Vertical Collectivism			-.03	-.58
Ethics			.31***	5.61
Trust			-.18**	-3.52
$R^2$		.01		.24***
Adj. $R^2$		.00		.21***
F		1.25		10.09***

\*  $p < .05$  \*\*  $p < .01$  \*\*\*  $p < .001$

Regression analysis on the 'tendency to sign formal contracts' discloses that hypotheses 5, 8, and 10 were corroborated, while hypothesis 6 was rejected. Table 8 provides a detailed summary of all the significant and non-significant relationships of the examined dependent and independent variables.

Table 8  
Summary of the significant relationships between examined variables

#	Hypothesis	Significant Relationships
H1	Horizontal Individualism – Questionable Negotiation Tactics	Not Supported
H2	Vertical Individualism – Questionable Negotiation Tactics	VI $\hat{u}$ – Pretense $\hat{u}$ , Deception $\hat{u}$
H3	Horizontal Collectivism – Questionable Negotiation Tactics	HC $\hat{u}$ – Lies $\hat{u}$
H4	Vertical Collectivism – Questionable Negotiation Tactics	VC $\hat{u}$ – Lies $\hat{u}$
H5	Individualism – Tendency to Sign Formal Contracts	HI $\hat{u}$ , VI $\hat{u}$ – Formal Contracts $\hat{u}$
H6	Collectivism – Tendency to Sign Formal Contracts	Not Supported
H7	Trust – Questionable Negotiation Tactics	Not Supported
H8	Trust – Tendency to Sign Formal Contracts	Trust $\hat{u}$ – Formal Contracts $\hat{u}$
H9	Ethical idealism – Questionable Negotiation Tactics	Ethics $\hat{u}$ – Pretense $\hat{u}$ , Deception $\hat{u}$ , Lies $\hat{u}$
H10	Ethical idealism – Tendency to Sign Formal Contracts	Ethics $\hat{u}$ – Formal Contracts $\hat{u}$

## Discussion

Tactics, ethical idealism, trust, and personal attributes hold an integral role both during the negotiation process and afterwards, during the signing of a formal contract. The present



study sought to address the lack of empirical evidence from cultures that do not demonstrate purely individualistic properties, taking as context of reference that of Greece. The explicit objective was to examine the impact of horizontal and vertical individualism-collectivism, ethical idealism, and general trust on the endorsement of questionable negotiation tactics and on the tendency to sign formal contracts.

A preliminary look at the descriptive statistics of the measured variables provides some interesting insights into Greek perceptions, stances and attitudes concerning our studied field. Among the three categories of negotiation tactics examined, 'deception' ranks first, higher than the somewhat more acceptable traditional bargaining-'pretense' tactic. The vertical individualists were found to endorse more the tactics of 'deception' and 'pretense,' but not that of 'lying'. In other words, individualists that emphasized social status, competition and hierarchical climb endorsed more 'deception' and 'pretense.' This finding follows at large existing literature (Kaushal and Kwantes, 2006; Komarraju et al., 2008; Triandis and Gelfand, 1998; Triandis and Suh, 2002). 'Deception' and 'pretense' were also accepted more by younger individuals, an observation that has been previously attributed to the egocentrism of youth, the pressure to perform and succeed early in life (Weeks et al., 1999), and differences in economic and social conditions compared to those experience by older people (Volkema, 1999; 2004). Also, relativists as compared to idealists endorsed more 'deception' and 'pretense'.

Based on mean values, we conclude that 'lies' is the least acceptable negotiation tactic. In agreement with previous literature, individuals who score low in HC and individuals who score high in VC tend to accept more 'lies' as a negotiation tactic. Indeed, quite often, vertical collectivists who hold low hierarchical positions or social status, use lies to feel more secure, whereas vertical collectivists who hold high hierarchical positions and social status, may prefer to adopt a competing style and therefore opt for lies (Kaushal and Kwantes, 2006; Komarraju et al., 2007). General trust has been referred to as one of the most important factors relevant to ethical negotiation behavior (Butler, 1999; Elahee et al., 2002; Olekalns and Smith, 2008). Trust was found to be significantly and positively related to 'lies': higher levels of trust were found to lead to more 'lying' behavior. The direction of the relationship is not supported by the literature. A probable explanation could be that negotiators who trust others expect others to trust them and, consequently, they feel that they could take advantage of these trustful relationships and lie without being exposed. With regard to questionable negotiation tactics, this survey's outcomes do not identify any significance of 'trust' as an explanatory variable of the acceptance of questionable negotiation tactics. Although existing literature provides strong evidence about this relationship, our findings appear to be in accordance with those of Erkus and Banai's (2011) study conducted in the non-Western Turkish cultural context. Exactly as in the cases of 'deception' and 'pretense', 'lies' were favored more by individuals who scored low in 'ethical idealism' scale. The most significant impact on questionable negotiation tactics originates from individuals' ethical idealism levels. Low

levels of idealism are clearly associated with the presence of marginally ethical negotiation tactics, such as 'deception' and 'lies'.

A major contribution of this study has been the discussion of the largely neglected impact that culture, ethical idealism, and general trust have on individuals' tendency to sign formal contracts. Interestingly, our original contention that personal attributes and ethical attitudes affect tendency to sign formal contracts was supported by the outcomes of our analysis. Specifically, we discovered that professional hierarchical ranking, HI, VI, ethics and general trust explain tendency to form formal contractual relationships.

Employees' low hierarchical positions seem to result in an increased willingness to sign a formal contract, a reality that can be explained by the low levels of power and the increased need for contractual safeguards that eliminate opportunistic behaviors (Williamson, 1983). Individualists tend to rather stick with justice and collectivists tend to prioritize relational norms (Koehn 2001; Ohbuchi et al., 1999; Triandis and Gelfand, 1998; Triandis and Suh, 2002). In accordance with this statement, our research observed that both HI and VI increase significantly individuals' tendency to sign formal contracts. According to the literature the presence of trust plays a substantial role in the decision to sign formal contracts (Gullett et al., 2010; John, 1984; Olekalns and Smith, 2009; Zaheer et al., 1998). Our survey results detect a significant inverse relationship between levels of general trust and tendency to sign formal contracts. It seems that the less negotiators have trust in others, the more they would tend to generate a signed document, with the hope that a written document, more than a verbal agreement, could secure the implementation of the contract. Finally, in line with reports of other researchers (Heugens et al., 2006; Koehn, 2001), this study indicates that low levels of ethical idealism are connected to individuals' aversion towards the signing of formal contracts. In short, actors' tendency to sign formal contracts would be higher, whenever (a) hierarchical rank is low, (b) HI and VI are high, (c) ethical idealism scores are high, and (d) levels of general trust are low.

From a country-specific perspective, research outcomes propose that Greece is a 'horizontal' society in between collectivism and individualism (Hofstede, 1980; House et al., 2004; Triandis et al., 1986). Previous studies state that Greek society has been undergoing a transition from collectivism into individualism (Kavali et al., 2001; Tsalikis and LaTour, 1995); we reflect that, essentially, Greeks combine equally collectivistic and individualistic traits. Concerning ethical orientation, Greeks appear to be reasonably inclining towards idealism, while they are lenient towards deceptive negotiating styles and fairly wary of the strangers – general trust levels are low. These findings can be considered in combination with the fact that Greece ranks very low –last within the Euro zone– in terms of transparency (Transparency International, 2009). Our empirical evidence does not differentiate considerably from the observed phenomena described by other researchers (Kavali et al., 2001; Tsalikis and LaTour, 1995). Several arguments, such as the affluence reflected in the past

decade's skyrocketing of the Greek GDP per capita, or the accommodation of extensive bribery and extortion payment cases, have been previously employed in various efforts for credible moral interpretations. The available evidence implies that Greek society has indeed changed from the era when the superior virtue of Greek ethics was *responsibility* and *sacrifice* (Kazantzakis, 1960).

### **Research Implications**

The authors of this study strived to illuminate dim spots within business ethics and negotiation tactics research. The results, discussion and conclusions of our work pioneer several implications.

From a theoretical perspective, the tested interrelationships provide a preliminary coherent basis for the creation of a comprehensive inductive research framework. Our proposition for simultaneous implementation of cultural, ideological and personal factors for the interpretation of the endorsement of marginally ethical tactics requires further evaluation. We expect that our original conclusions about the impact of the independent variables on individuals' tendency to sign formal contracts will introduce the discussion around formal contracts both at conceptual and empirical level.

From a practical perspective, practitioners, especially international business executives, should not overlook the importance of cultural dimensions and ethical standards in the negotiation process and the signing of formal contracts. Recognition and exploitation of cultural and ethical perceptions, stances and attitudes would potentially signify synergies regarding the amount of time and effort devoted to the negotiation and the achievement of a contractual agreement. Those managers conducting business in Greece have to recognize the importance of individualism within the Greek society, strive to comfort themselves with the flexible ethical ideals of their Greek counterparts, and attempt to ease Greeks' low levels of general trust.

### **Limitations and Future Research**

In general, the results of this study display consistency with those of previously conducted surveys in the areas of business ethics and negotiation tactics. Yet, the authors of this study consider that there are several limitations inherent in the design and implementation of their research work.

First, the results of our study are country-specific. The insights gained from the Greek culture are not necessarily applicable in diverse cultural settings, outside that of Greece. More specifically, research studies which take into account variables such as those of collectivism/individualism and ethical idealism, are cross-cultural in nature. Consequently, the comparative examination of multiple cultural environments would be a more secure direction towards the arrival at comprehensive conclusions.

Second, the generalization of the findings obtained from the current study is limited, due to weaknesses attributed to the use of convenience sampling. This issue would be attenuated if the developed framework and construct of our study would be tested in different samples in the future.

Lastly, in this study we did not investigate respondents' actual negotiation behavior; we rather explored perceptions about preferred negotiation tactics and propensity to sign formal contracts. Similarly, the survey participants were asked to report their attitudes towards ethical behavior and general trust. As a result, the findings may deviate from real-life behavior in the Greek setting. Future studies should focus on the collection of real-life data employing observation as a complementary method to the survey method. The necessity for real-life data is highlighted by the fact that, in the existing literature, conclusions about variables such as the 'tendency to sign a formal contract' or the 'general trust' have been rather equivocal.

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## ENHANCING THE COMPETITIVENESS OF PALESTINIAN SMEs THROUGH CLUSTERING

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### Abstract

The research aims to discuss the competitiveness of SMEs working in the food processing sector in Palestine through clustering. To benefit from the regional experiences, the Jordanian and Israeli food processing sectors were studied. A combination of quantitative and qualitative methods is used in the research. The analysis of data shows that the Palestinian experience in clustering is frail, where there are weak collaboration between businesses and the related and supporting industries such as universities, banks, research institutes, insurance companies and governmental institutes. The weakness in the ties between the businesses and related and supporting industries has a negative impact on the competitiveness of SMEs working in the food processing sector in Palestine. Thus, building and formalizing a dynamic cluster within this sector will lead to enhance the competitive advantage of these firms. On the other hand, the research encourages the regional cooperation between the food processing clusters. This cooperation will lead to create economies of scale and technology and research and development transfer.

**Keywords:** SMEs, Competitiveness, Clustering, Palestine

### Introduction

Almost 99% of the industrial firms in Palestine are SMEs compete solely on the basis of price. As well, very few SMEs have direct access to foreign markets. However, Palestinians should think seriously to shift the sector to the innovation-driven stage. The shift to an innovation-driven stage implies many changes: a new mindset, new ways of doing things in production, marketing and buying. It is very important to ensure that people's skills, investment capital, technology, infrastructure, business climate and quality of place support the transformation (Porter 1990).

The quality level of the industrial production in Palestine has improved greatly in the last decade. The percentage contribution of this sector in total GDP has increased from 8% in the mid-eighties to 17% in 2010. The industrial sector has employed an average of 85,000 workers (an average of 13% total work force). The sector includes the following subsectors: stone and marble, textiles and garments, food processing, engineering and metallurgical industries, chemical industries, pharmaceuticals and veterinary, construction industries, handicrafts, paper and printing, furniture, leather and shoes, and plastics (PFI 2010).

The food sector is growing rapidly both vertically and horizontally. The official figures of the sector indicate that there are 225 manufacturing firms including the large scale milk cow farms; 152 of them are active members of the food industry association, which is a strong association. The labor force is estimated with 8000 worker. The sector is comprised of a wide variety of products. These are: meats, vegetables (fresh and frozen), oils and fats, dairy, flour mills, animal feed, chocolates and confectionaries, spaghetti, water and soft drinks and beverages, chips and snacks and others (PFI 2010).

The researcher aims to discuss the competitiveness of the firms working in the food processing sector in Palestine through clustering based on the experiences received by studying the food processing sectors in Jordan and Israel.

## **Literature Review**

Story (1994) defines the SMEs as follows: (a) enterprises with a relatively small share of their market; (b) enterprises managed by owners or part-owners in a personalized way, and not through the medium of a formalized management structure; and (c) enterprises acting as separate entities, in the sense of not forming part of large enterprise or group. While it is acknowledged that using the number of employees as a measure of firm size may create a number of anomalies. Storey (1994) discusses the general differences between large and small firms in terms of centrality of owner-manager, structure, resources and number, and variety of products and range of markets served. In smaller firms, owner-managers are less able to influence competitive environment than larger firms. Besides, smaller firms' organization structures are likely to be organic and loosely structured rather than mechanistic and highly formalized (Jennings and Beaver 1997). In smaller firms, all the roles will either be performed by one manager or by a very narrow range of managers who may have been appointed because they are family members or friends rather than on the basis of ability or education. However, small firms generally have little commitment to research and development (R&D) and are highly dependent on external knowledge sources (Vossen 1998).

The size of the SMEs in the developed countries is interlinked with the size of the international niche markets where they compete, while the size of the SMEs in the developing countries is mostly determined by the domestic markets where they operate. Moreover, the SMEs in developed countries are more likely to be highly specialized compared to those in the developing countries. Most of the SMEs in the developing countries are one-person businesses, and the largest single employment category is working proprietors (Fisher and Reuber 2000). The informal relationships of the family dominate formal, explicit relationships when trust, loyalty and family ties are important to advancing the businesses (Habbershon and Williams 1999).

In order to improve the competitiveness of SMEs is not only about understanding problems confronting businesses, but also about better understanding of how to overcome these barriers. Although many factors are hypothesized to impact on business outcome, there is no

consistent pattern to the characteristics, which contribute to business competitiveness, success and growth (Gibb 1996; Audretsch 2001). Employment generation may be an appropriate growth function (Smallbone and Wyrer 2000). However, not all small firms are growth-oriented, and the majority of owner-manager focuses on day-to-day survival. As pointed out by Storey (1994), the numerically dominant group of small businesses is those that are small, and even if they survive they are always likely to remain small-scale operations. Jennings and Beaver (1997) show that in smaller firms all the roles will be either being performed by one person or by a very narrow range of managers who may have been appointed because they are family members or friends rather than on the basis of capability or education.

Competitiveness, as explained by Porter, can be defined at three levels: firm, industry and nation. Measures of the competitiveness at the firm level include firm's profitability, firm's exports, and market share. Measures of the competitiveness at the industry level include the firms' profitability, the industry's trade balance, and the balance of outbound and inbound foreign direct investment. While at the national level, competitiveness means the citizens' ability to achieve a high and constantly rising standard of living. A high and rising standard of living for all nationals can be sustained by the continuous improvement of productivity. This research discusses, in particular, the competitiveness of the SMEs working in the food processing sector in Palestine.

Competitiveness is the mean by which entrepreneurs can improve their firm's performance, and which can be measured according to a number of dimensions including market share, profit, growth, and duration. At the same time, Man and Chan (2002) stress the importance of links between competitiveness and performance as having a long term rather than a short-term orientation. They conclude that their theoretical framework is complex and therefore difficult to be operationalized.

The SMEs belong to clusters and networks are often more competitive and innovative than those operating in isolation (OECD 2000). Some clusters are structured and formal while others are informal. Some clusters are shared at general information, while others deal with more specific objectives. Networking allows the SMEs to combine the advantages of smaller scale and greater flexibility with economies of scale and scope in larger markets – regionally, nationally and globally. A large number of firms result in greater competition for new ideas and facilitates (Porter 1990). Competitiveness of small firms is strongly influenced by the level of the inter-firms collaboration. The links take different shapes in which different firms join together to co-produce, co-market, or co-purchase, cooperate in new product development, or share of information.

While networking is viewed as an important requirement in enterprises of all sizes, these learning opportunities are argued to be of particular importance to small firms in order to offset the vulnerability of size acting as the key determinant of organizational success. Pecos and Henriques (2006) argue that the collaboration between universities and the SME

companies should be based on a small-projects base. These projects must be focused in localized and specific problematic areas in the industrial companies. Ramsden and Bennett (2005) provide a better understanding of the form of intangible benefits that businesses receive from advice.

Related and supporting industries measure the presence or absence of related and supporting industries that are internationally competitive. The presence of internationally competitive supplier industries in a nation creates advantages in downstream industries. That could be achieved by providing efficient and rapid access to the most cost-effective inputs. Moreover, close working relationships between suppliers and firms help firms perceive new methods and opportunities to apply new technologies and to gain quick access to information and new ideas.

Related industries are those in which firms can coordinate or share activities in the value chain. Creating an efficient network can affect the competitiveness of the SMEs by increasing their productivity, and deriving the direction and pace of innovation. Working within a network allows the SMEs to benefit as if they had greater scale or merged together without requiring them to sacrifice their flexibility.

In this research, the competitiveness of the SMEs is measured by the Balanced Score Card (BSC). The Balanced Score Card is a mean to implement organizational strategy. In the Balanced Score Card, strategy is translated in a set of critical success factors, which are translated into one or more performance measures. In that manner, strategy turns into operational objectives and measures (Kaplan and Norton 1992). The four categories for Balanced Score Card are: financial performance, customer knowledge, internal business processes, and learning and growth.

In Palestine, the market share of food products varies between 90% for meat products to 30% for dairy products; the average is around 50%. The food industry has experienced export mainly to Arab countries. Olive oil and other fair trade products have been exported to many countries around the world. The total investments in the sector are estimated by USD 480 million (PFI 2010).

In Jordan, however, from 2001 to 2010, Jordan's agricultural exports have grown rapidly by an average 22% per year, increasing more than two-fold by 2005. Jordan's fastest growing agricultural exports include a mix of raw agricultural commodities and processed foods such as olive oil, malt extracts, fatty acids, and live sheep and goats. Other significant exports include fresh tomatoes and other fresh vegetables. While a substantial share of agricultural goods are destined to other Middle East countries (GAFTA accounted for 76.5% of Jordan's agricultural exports in 2005), an increasing share (8%) is being exported to the EU (fresh fruits & vegetables, vegetable oil, and fruit & nuts). Because of Jordan's chronic water shortage, a large portion of the technical components of development projects address that issue (Medibtikar 2009).

While in Israel, the climate ranges from semi-arid to arid so that shortage of high quality water is one of the main constraints facing Israeli agriculture. Extensive greenhouses production under the climatic conditions in Israel enables vegetables, fruits and flowers to be grown for export to the European markets during the winter off-season. Israeli's agriculture is supported by both basic and applied research. Intensive production systems in Israel are the result of close cooperation and interaction between scientists, extension advisors, farmers and agriculture-related industries (Medibtikar 2009). The Israeli (civil) research expenditure is very high at 4.7% of GDP and industry contributes a much bigger part than in the EU. Israel has excellent universities and research organizations, and there is strong university-industry collaboration which is actively supported by the government. Agricultural research in Israel is carried out by the public and private sectors. In the public sector, the Ministry of Agriculture and Rural Development (MOARD) supports research in agriculture as does, to a lesser extent, the Ministry of Science and Technology (MST). Private sector research is carried out by manufacturers of agriculturally related products (e.g. fertilizers, seeds, irrigation equipment pesticides etc.) with the support of the Office of the Chief Scientists (Medibtikar 2009).

### **Research Problem**

The food processing firms in Palestine are positioned in the factor-driven stage. The industry draws its advantage almost from the basic factors of production, natural resources and inexpensive semi-skilled labor pool. The firms solely compete on the basis of price and very few firms have direct access to foreign markets.

The Palestinian food firms are not allowed to sell their products in Israel, not even to the Arab-Israeli community. The main reasons for this are:

- Inability to obtain relevant authorization from Israel's Ministry of Health, necessary for all imported food products into Israel.
- Lack of Kosher certification of Palestinian food products, necessary for imported food products.

The Palestinian participants also emphasized the security obstacles to bringing food products into Israel, even in the case of food products sent from the West Bank to the Gaza Strip:

- At border crossings, trucks carrying food products have to go through lengthy security checks.
- Products have to be switched to Israeli vehicles (within containers) for transportation within Israeli territory.
- The Palestinian producers have no way of monitoring what becomes of their consignments once they have crossed into Israeli territory.

By contrast to these problems, the Palestinians pointed out the Israeli food products enter Palestinian territory with relative ease, and that 99% of manufactured inputs and raw materials designated for the Palestinian food industry are imported from Israel. In addition, there is a lack of necessary laboratory testing; these labs are very important for the survival of the industry.

### **Research Objective**

The main objective of the research is to discuss how to enhance the competitiveness of the Palestinian SMEs working in the food processing sector through clusters. In addition, the research aims benefit from the experiences of the food processing clusters in Jordan and Israel.

### **Research Hypothesis**

The research aims to testify the following main hypothesis:

( $H_2$ ): There are no significant differences in the related and supporting industries on the competitiveness of the SMEs working in food processing sector between Palestine, Jordan and Israel.

### **Research Methodology**

An academic literature and some business, and other appropriate literature sources search were conducted. As part of the literature review, books, journal articles, tertiary literature such as indexes and catalogues, company minutes, government surveys, CD-ROM in university libraries, Internet sites, chambers of commerce surveys and professional association surveys have been used. A combination of quantitative and qualitative methods is used in the research. Employing both qualitative and quantitative data offers an opportunity to probe deeply into the issues raised by the research questions. Although questionnaires may be used as the only data collection method, it is usually better to link them with other methods in a multi-method approach.

The clustering random sampling is used. Four-hundred fifty (450) questionnaires were collected from Palestine, Jordan and Israel; 150 questionnaires from each country. The purpose of the survey is descriptive-exploratory with some explanatory analysis. The questionnaire was developed. The questionnaire consists of three parts. Part one covers the different elements of the related and supporting industries. Part two covers the firms' performance, and part three covers the demographic data. The scale items were tested on the reliability and validity of the final test to examine the consistency of the constructs and related the items.

The interviewees were asked about their competitiveness by asking about the Balanced Scored Card (innovation, customer's satisfaction, internal business and financial performance) of their firms as an indication of their competitiveness. It was measured with a five-point

scale (very negative to very positive). Furthermore, the respondents were asked to evaluate the different elements of the related and supporting industries. These elements were also measured with a five-point scale (1 = very negative and 5 = very positive).

## Findings and Discussion

Based on the survey method described above, 450 questionnaires were received from Palestine, Jordan and Israel. As shown in table (1), there are significant differences in the extent of relations with banks, insurance firms, research centers and universities, local manufacturers, public institutes, government, firms working in the same sector, firms working in other sectors, and supplier buyer relations. Palestine has the lowest rank, in comparison with Jordan and Israel, in all of the abovementioned elements. It means that Palestine has a weak food processing cluster.

*Table 1. Kruskal-Wallis Test – Related and Supporting Industries*

<b>No</b>	<i>Variable</i>	<i>Chi-Square</i>	<i>Sig</i>
1	<i>Supplier buyer relations</i>	125	.00*
2	<i>Relation with banks</i>	319	.00*
3	<i>Relation with insurance firms</i>	213	.00*
4	<i>Relation with research centers and universities</i>	293	.00*
5	<i>Relation with local manufacturers</i>	168	.00*
6	<i>Relation with public institutes</i>	121	.00*
7	<i>Relation with government</i>	198	.00*
8	<i>Relationship with food processing firms in Palestine, Jordan, and Israel</i>	173	.00*
9	<i>Relation with firms from other sectors</i>	261	.00*

\* Significant (values are less than or equal 0.05) with DF = 2

Table (2) presents results of the balanced scored card. The results of the survey show that there are significant differences in the financial indicators, innovation, customer satisfaction and internal businesses between the three countries. The Palestinian SMEs have a lower rank, in comparison with Jordan and Israel, in all of the elements of the four perspectives of the balanced scored card. This is not a surprising result since the related and supporting industries are relatively poor in Palestine in comparison with Jordan and Israel.

Table 2. Kruskal-Wallis Test – Clustering and Balanced Scored Card

No	Variable	Chi-Square	Sig.
<i>Innovation</i>			
1	Percentage of new products of total turnover	98	.00*
2	Time necessary to develop new generation of products	125	.00*
<i>Customer Satisfaction</i>			
3	Customer satisfaction	65	.00*
4	Market share	69	.00*
5	Customer loyalty	57	.00*
<i>Internal Business</i>			
6	Employees satisfaction	15	.00*
7	Employees loyalty	10	.00*
8	Productivity of your employees	25	.00*
<i>Profitability</i>			
9	Return on Investment	76	.00*
10	Profitability	150	.00*
11	Revenue growth	135	.00*
12	Cost reduction	10	.00*
13	Exportation	140	.00*

\* Significant (values are less than or equal 0.05) with DF= 2

### **Innovation**

The data shows that the innovation is low in Palestine in comparison with Jordan and Israel. Innovation perspective is a measure of potential future performance. Adequate investment in this area is critical to all long-term success. However, innovation should be taken in its broad definition and not limited to creating a new product. Innovation could be creating new methods in production, purchasing, selling... etc. To achieve that, there should be adequate investment in the human and infrastructure and the government should start creating the environment that is necessary for innovation.

### **Customer Perspective**

The data shows that the satisfaction of the customers, retention ratio, and market share are low in Palestine. The Palestinian SMEs lack the competitive elements such as the lowest prices in comparisons with Jordanians, or highest quality in comparison with Israelis, while they have the advantages in fast delivery time and flexibility in production. Understanding this perspective may help the owners of the SMEs to assess their clients' happiness and to make needs clear.

### **Internal Business**

The result of the survey shows that the efficiency of the manufacturing process is relatively low. The manufacturing cycle time, employee's productivity, and employees' satisfaction. The



family business could be a reason for this result since most of the employees are hired based on relatively-basis criteria rather than qualifications. Another reason could be the old machinery and production methods the Palestinian SMEs are using.

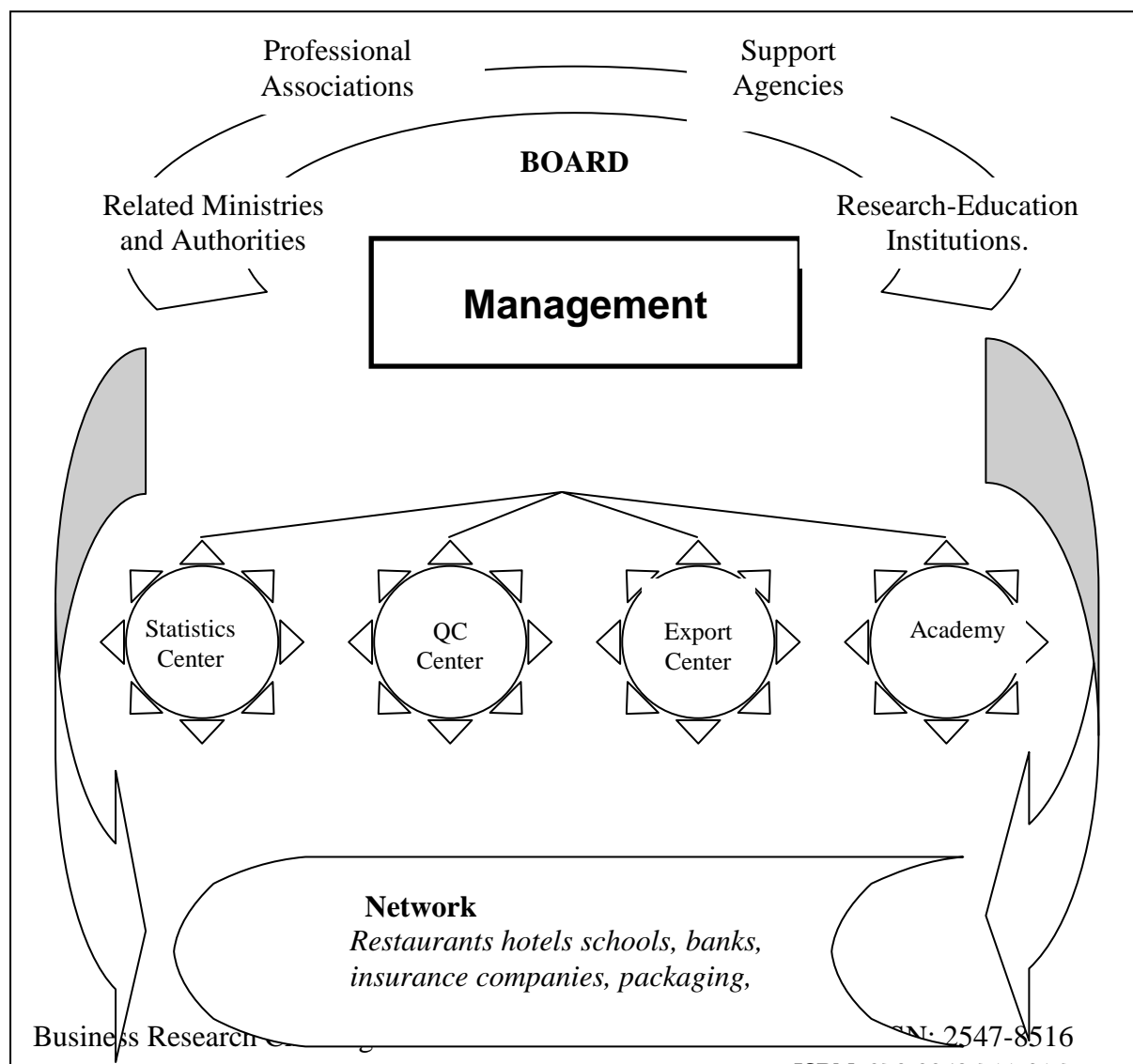
### Financial Perspective

Palestinian SMEs have the lowest rank in the financial perspective. As a result of the limited market size, old machinery and production methods, and employees' low productivity, the cost per unit is high. That leads to a reduction in the revenue, profit growth, and exportation.

### Food Processing Cluster at National Level

Below is a proposed Food Processing Cluster Model (FPCM) where the board is led by the related ministries and authorities, in a consensus framework with involved organizations (professional associations, educational-training, technical and financial support organizations and related ministries). The Food Processing Cluster should be an independent, non-profit and private membership based organization.

Figure. The Food Processing Cluster Model (FPCM)



In order to achieve the targeted objectives of the proposed cluster, the following four centers are recommended:

#### **Statistics Center**

The main aim of this center is to strengthen the relation with the members. The center will help in building the nucleus base for any study about the food processing industry in Palestine through analyzing the collected data.

#### **Academy**

The academy provides education, research and training for the food processing sector in Palestine. It works on the development of the industry through establishing a study center to be specialized in food processing studies. It will also conduct a series of educational and training programs. These programs facilitate entrepreneurs from all over the country to work together in an environment of sharing, and to expand their common interests in food processing.

#### **Quality Control Center**

Food processing industry addresses quality. The proposed center includes a laboratory equipped with all the necessary tools to conduct various quality tests. It will provide training, consultations and counseling to the food processing firms' owners and workers. The main purpose of this center is to improve and maintain the quality of the food products in order to a better presentation of the sector in local and international markets.

#### **Internationalization and Export Promotion Center**

This center is aimed to remain physical and on-line, exhibitions and fairs of locally manufactured products. This facility will provide an environment where wholesalers and customers from Palestine and other countries can visit, thus allowing for more efficient exchange of information on market demand. This approach is one of the tools to ease the sales efforts of the local producers by helping cut costs. It helps in the understanding of the needs for improved packaging and branding policies, as they see and experience a more efficient and transparent marketplace.

#### **Food Processing Cluster at Regional Level**

The results of the research show that the Jordanian, Israeli and Palestinian food producers have a weak trade relationship between them, but they expect that by building a regional cluster will have a strong impact on their competitiveness. The required institutions, universities, professional schools, research centers, professional associations, and relevant regional authorities already exist, but the networking is weak in training, education, and research and development.

Cooperation between the food processing sectors in Palestine, Jordan and Israel is an essentially important in building the competitiveness of the Palestinian SMEs. Palestinian SMEs could benefit from the Israeli and Jordanian SMEs new ways of productions, and exportations. It might be expected that the growth in quantity of high quality products, on one hand, and the wider activities of the research centers, on the other, will generate a bottom-up clustering process, i.e., the development of new industries with a high added value.

## **Conclusion and Recommendations**

Based on the data analysis, below are the main conclusions of the research:

- Palestine has a weak clustering in the food processing sector in comparison with Jordan and Israel. As a result, Palestinian SMEs working in this sector have the lowest performance.
- There is a weak relationship between firms working in the food processing sectors in Palestine, Jordan, and Israel due to the obstacles in products' movement and standard's requirements.

The main recommendations are:

In order to enhance the competitiveness of SMEs working in the food processing sector in Palestine:

- There is a need to build a formal dynamic cluster. The research presents a suggested model to build such a cluster. The cluster can promote productivity, innovation and competition in a number of ways, e.g., the reduced cost of sharing resources, the critical mass created by having a pool of specialized skills, expertise and value-added products. The cluster enhances economic foundations such as a skilled workforce, research and development capacity and infrastructure, and thus creates assets such as trust, synergy, collaboration and cooperation, which are all essential for competitiveness.
- There is a need to strengthen the relationship between the food processing clusters in Palestine, Jordan and Israel. This regional clustering will assist in enhancing the competitiveness of the Palestinian SMEs through economies of scale, research and technology transfer, sharing the production of inputs, production processes, transportation processes and warehousing of products.
- The governments in the three countries can encourage clustering by offering an improved infrastructure and other incentives to producers and related service providers. The government can facilitate cluster development by providing an institutional framework that allows cluster participants to form, grow and discuss mutual needs and interests. The private sector and business associations can

identify barriers and opportunities, propose legislative and policy changes, and collaborate with research and educational institutions to translate research and development and technological advances into commercial applications.

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## KNOWLEDGE, INOVATION AND NEW TECHNOLOGIES FOR SUSTAINBLE DEVELOPMENT: THE CASE OF THE OCCUPIED PALESTINIAN TERRITORY

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### Abstract

Palestine is pa3ssing through a transition period. Palestinians are in a need to build their national systems based on innovative basis. Palestine's innovation system is still underdeveloped and not working efficiently. The innovation system still suffers from weak components and a lack of coordination and managed links between its components. In order to build a national innovation system in Palestine, there is a need to be opened up to global knowledge, imported massively capital goods and components, reform of universities and R&D organizations, establishing an incubation system at universities, induced FDI to set up large domestic research facilities, encourage expatriate scientists set up high tech industries, focus on premier universities as key knowledge institutions, learn from past policies/ review reports, consult with private sector, scientists, government officials and economists, develop human resource, up-grad R&D Infrastructure, and restructuring of R&D Institutions, promote ICT, and build knowledge network.

**Keyword:** National Innovation System, Science and Technology, Palestine

### Introduction

Sustainable development has different meanings and implications in different parts of the world. Sustainable development is for all countries, not just for developing ones. While developed countries need to find alternative sources of energy and other technologies that reduce their own impact on the environment, developing countries need to develop their own innovation capacity, in order to address their own particular needs (Niosi 2002).

Invention is defined as a focused application of the human mind to the world that yields an original creation with practical use. Invention requires a lot of knowledge, thus there is a need to pay careful attention to education. Invention is not a linear process, from idea to product to economic impact. Rather, invention is a complex interaction between human creativity, technology and the marketplace, and iteration must typically happen between all three realms before an invention has a significant economic impact. Invention stimulates entrepreneurship and overall economic activity (MIT 2003).

Innovation is the practice of bringing inventions into widespread usage, through creative thinking, investment, and marketing. That's why basic invention is typically needed to drive innovative activity. Innovation is seen as an essential tool to alleviate poverty; poverty is nothing else then a situation with a high level of constraints which can only be overcome by smart, innovative solutions (Smith 2003). An important reason why so much is expected from the private sector in terms of

fulfilling the needs of the poor is exactly because of the importance of innovation: it is assumed that firms are generally more innovative than other organizations such as public agencies and aid organizations (Prahalad and Hart 2002).

Innovation is a broad term that encompasses any new development in firms (OECD 2000). It can involve creating or reengineering products or services to meet new market demand, introducing new processes to improve productivity, developing or applying new marketing techniques to expand sales opportunities, and incorporate new forms of management systems and techniques to improve operational efficiency (Porter and Stern 2001). In his research paper "Innovation: Location Matters" Porter (2001) showed that innovation is a process rather than a single event and the internal factors that drive innovation are undeniable, but the external environment for innovation, at least, has the same importance.

In the developing world, however, innovations are typically planned and funded by governments or international organizations. As a result, local inhabitants sometimes fall into the trap of thinking that innovation is provided to them rather than something they create on their own. That's why it's so important for invention and creativity to be nurtured on the local level (MIT 2003). Economists often focus on helping poor countries become richer by improving primary education and infrastructure such as roads and telephones. Unfortunately, it is only a small part of the problem and only explains the gap between developed and developing countries. More important, why can't the poor country seem to do anything about it? Couldn't improve its schools, factories, license technology, and seek foreign partners? The problem of twisted rules and institutions explains part of the gap while the corruption destroys every effort to improve the infrastructure, attract investment, and raise educational standards (De Soto 2000).

According to Freeman (1987) a national system of innovation has been defined as "the network of institutions in the public and private sectors whose activities and interactions initiate, import, modify and diffuse new technologies"<sup>5</sup>. Niosi defined national innovation system as "A national system of innovation is the system of interacting private and public firms (either large or small), universities, and government agencies aiming at the production of science and technology within national borders. Interaction among these units may be technical, commercial, legal, social, and financial, in as much as the goal of the interaction is the development, protection, financing or regulation of new science and technology".

The unique situation of the Palestinian economy, as a result of occupation, makes it impossible to understand the Palestinian economy and the challenges facing it without first understanding the impact of the political and security situation on the economy as a whole and also on the Palestinian private sector. As a result, isolated from the regional and the global economy, leading to a limited degree of economic, social, and technological development as well as the lack of policy-making capacities and underdeveloped institutions.

## The Palestinian Context

The location of the Occupied Palestinian Territory (OPT) consists of two parts. West Bank (5860 square kilometre) including East- Jerusalem, and Gaza Strip (360 square kilometres). In 2009 population was estimated at 4.4 million (63% in the West Bank and 37% in Gaza Strip). The macroeconomic situation continued to improve in the West Bank, but in Gaza conditions remain difficult due to the blockade. Real Gross Domestic Product (GDP) in the West Bank and Gaza (WBG) is estimated at 6.8%, consisting of an estimated 8.5% growth in the West Bank and 1% in Gaza (IMF 2010). The GDP composition by sectors is as follows: agriculture (5%), industry (14%), and services (81%).

The West Bank economy is growing and for the first time in years, it experienced positive real growth, estimated at seven percent in 2009. This should be placed in the context of an economy recovering from years of protracted conflict during which per capita GDP fell by nearly a third since 1999. According the Palestinian Central Bureau of Statistics (PCBS 2010), in the early part of 2009 most of the growth took place in two sectors: real estate, renting, and business services; and community, social, and personal services, both of which grew by more than 24%. Public administration grew by nearly 9% and construction by over 10%. Meanwhile, mining and manufacturing grew by only 2% and agriculture fell by more than 17%. This suggests that higher output was based on donor-funded sectors such as health, education, and public administration rather than private investment in productive sectors such as manufacturing, agriculture, and tourism.

## Method

A side of the Academic-Government-Industry Partnership (AGIP) Conference that was held on May 12th 2010 in Palestine Polytechnic University in Hebron-Palestine, the researcher organized a workshop for 20 senior experts representing different sectors: government; private sector; educational institutes and donors. The main goal of the brain-storming workshop was to discuss the drivers of the national innovation system. The participants were asked to grade each driver based on a five-point likert scale (1 to 5): 1 means very poor; 2 poor; 3 average; 4 good while 5 means very good. The average was calculated for each factor.

The researcher focused the analysis on the following factors:

- Educational system
- Business
- Research and Development (R&D) System
- Business incubation and Information and Communication Technology (ICT)
- Institutions (Government, educational, and private)
- Capital for Innovation
- Culture for Innovation

## **Palestine's Innovation System**

This section discusses each of the abovementioned drivers.

### **Educational System**

With a high 91% adult literacy rate, Palestinians are the most educated population in the Middle East and North Africa (MENA) region (WB 2006). Tertiary education consists of universities that provide bachelor and master degrees and colleges that provide 2 or 4 years of education for a diploma. In West Bank and Gaza there are 11 traditional universities, 1 Open University, 12 university colleges, and 18 community colleges.

Today, there are more than 200 institutions in the West Bank and Gaza providing short and long term training programs. These include vocational secondary schools, vocational training centres, cultural centres, societies and charitable organizations, and agricultural and economic development centres. In addition to these institutions, come the 18 community colleges providing postsecondary educations, 5 of them are technical colleges. These institutions are run by several bodies that include: the Ministry of Education and Higher Education (MoEHE), the Ministry of Labor (MoL), the Ministry of Social Affairs, UNRWA, several Philanthropic associations, and large number of religions and profit organizations, in addition to private and public organizations. There are five streams in school-based vocational training: industrial, agricultural, commercial, hotel and home economics.

Palestine's primary and secondary education systems do not promote innovations. The system is built on memorizing textbook facts instead of creative learning systems or explorative research. In this sense, the academic system up to the BA grade is an extension of the rigid school system. Only in master courses, students are exposed to independent learning and are applying creative learning concepts. Interests in innovations are thereby stimulated far too late in the educational system. Only a few dedicated courses to innovation management and entrepreneurship can be found in public universities while private academic institutions seem to be slightly more advanced in this field.

At the educational institution level, there are insufficient flexibility, innovation and responsiveness; weak institutional autonomy; overly bureaucratic and centralized management, administrative and human resources practices; inadequate gender sensitive policies and practices; inadequate recognition of and connection to workplace experience; and little consideration of Life Long Learning strategies. OPT is not productive when it comes to the generation of knowledge.

At the educational program level, business participation in program planning, curriculum design review and delivery is weak; there is insufficient use of flexible models for program delivery such as student centered approach; educational programs focus continues to be on the academic rather than the applied knowledge; insufficient gender sensitive measures in recruitment and program delivery mainly in the technical and vocational education and training (TVET); instructors/trainers lack relevant, current and recurrent workplace experience; and weak guidance and student support, job counseling and placement with weak consideration to gender-based differences. The comparatively low levels of entrepreneurship call into question OPT's ability to foster growth and jobs. The challenge



for education is to provide learning environments that stimulate independence, creativity and an entrepreneurial approach to harnessing knowledge.

The participants ranked the innovation in educational system as "average" emphasizing that educational institutes are providing standards specializations and programs focusing on the supply rather than the demand driven approach.

(17%), industry (15%) and services (68%). Female employment is heavily concentrated in just two sectors: agriculture and services. In contrast, the male labor force is more evenly distributed across the main sectors. The two main changes during the last five years are the relative decline in agriculture, manufacturing and construction and the quite marked increase in the share of the services sector (WB 2006). The unemployment rate recorded as 16.3% and the inflation as 2%. The industrial sector includes: stone and marble, textiles and garments, food processing, engineering and metallurgical industries, chemical industries, pharmaceuticals and veterinary, construction industries, handicrafts, paper and printing, furniture, leather and shoes, and plastics. The services sector include: domestic trade, tourism, transport and communications, engineering design, communications, financial services, software services and others. In the OPT, enterprises employing less than 20 employees constitute 98 % of the total number of registered companies that operate in the local Palestinian economy in 2009

The participants ranked the innovation in business as "average" emphasizing that Palestinian businesses are mainly family-owned traditional SMEs producing standard products and services and competing each based on prices.

### R&D System

The OPT's heterogeneous R&D framework consists of public and private universities as well as national research centers. Apart from general research, these institutions focus their work on the areas such as: water, environment, energy, biotechnology, and ICT. Though a clear need for new technologies and R&D results exist by Palestine's industrial sector, dedicated and effective technology transfer processes are still under development and current processes work less efficiently. State initiatives to stimulate cross fertilization between industry and the academic institutions are little accepted and not very effective. Table below presents the main indicators for R&D in the West Bank (PCBS 2010).

*Main Indicators for (R&D) in the West Bank, 2008-2009*

	2008	2009
<i>Number of Enterprises Engaged in R&amp;D</i>	38	40
<i>Number of R&amp;D Personnel</i>	1,555	1,542
<i>Number of R&amp;D Personnel with Full – Time Equivalent FTE</i>	566	669
<i>Number of Researchers in R&amp;D</i>	981	992
<i>Number of Researchers (Males) in R&amp;D</i>	744	765
<i>Number of Researchers (Females) in R&amp;D</i>	237	227

<i>Number of Researchers in R&amp;D with FTE</i>	280	363
<i>Number of Researchers in R&amp;D with FTE Per Million inhabitants</i>	120	150
<i>Total Expenditure on R&amp;D (million\$)</i>	11.5	10.9
<i>Percentage of External Funds for R&amp;D</i>	50.4	40.3
<i>Expenditure on R&amp;D Per Researcher with FTE (Thousands \$)</i>	41	30

*Source: PCBS 2010*

Data showed that the number of employees in research and development reached 1,542 workers representing 669 workers in Full-Time Equivalent in 2008 (Full-Time Equivalent defined as 90.0% of the total number of working hours in the year on research and development) compared with 1,555 workers representing 566 workers in full time equivalent in 2007. The number of researchers was 992 of whom 363 researchers in full time equivalent in 2008 compared with 981 researchers of whom 280 researchers in full time equivalent in 2007.

The participants ranked the R&D as "poor" emphasizing that there are no publications to speak of and no enough budgets allocated for R&D.

### **Business Incubations and ICT**

Business incubation as an important tool to unleash human ingenuity, enable competitive enterprises and create sustainable jobs. Business incubators can also be instrumental in developing new economic sectors, and expose entrepreneurs to information and communication technologies (ICTs) that in turn help increase the productivity and market reach of enterprises across sectors. Business incubators are initiatives which stimulate the commercialization of innovations by supporting entrepreneurial ventures by a wide array of business support services.

The deployment of ICT in Palestine started relatively late in comparison with developed countries and some countries in the Third World. Palestinian companies began their work in providing ICT in the West Bank and Gaza only in the early 1980's with services that were mostly focused on retail and some wholesale of computers and electronics. All of the Palestinian companies were mostly sub-agents to the Israeli dealers and had limited experience in after-sale services and programming software. The few companies that offered software and programming services focused on accounting-related packages to serve the local market. The Palestinian ICT market during the Israeli occupation years was severely constrained by the total Israeli control over the ICT products. The growth in the Palestinian ICT sector was induced by increased demand for ICT products and services by the Palestinian private sector, universities and the public sector, as well as the establishment of the first Palestinian Internet Service Provider (ISP), which made the Internet commercially accessible to all.

The Palestinian ICT sector started to show significant growth by the end of 1995. The biggest end-user of technology products and services was the PA, followed closely by Local Government (Municipalities) and then by the larger companies. By 1997, the Palestinian telecommunication sector was 100% privatized with the creation of PALTEL, the Palestine Telecommunications Company,

which was licensed to be the exclusive telecommunication operator in Palestine. PALTEL installed a digital network connecting the West Bank and Gaza and currently offers a wide range of services such as fixed telephone lines, leased lines, ISDN connections, ADSL.

The software industry produced a wide range of solutions and packages in areas such as human resources management, projects and sales management, Finance and accounting, education related solutions, management information systems, children education and entertainment. Many new companies were also established and specialized in web development, e-business solutions, web portals development, ICT consultancy, training, and office automations.

The percentage of households having a computer in the OPT reached 49.2%, in 2009 compared with 26.4% in 2004. With regard to internet connectivity, 28.5% of households in the OPT have Internet connection in 2009 compared with 9.2% in 2004, while the percentage of households that own TV dish was 92.0% in 2009 compared with 74.4% in 2004. The data also indicated that 92.4% of the Palestinian households (at least one member) possess a mobile phone in 2009 compared with 72.8% in 2004 (PCBS 2010).

The data below showed that 57.1% of persons (aged 10 years and above) use computer in the OPT in 2009 compared with 35.7% in 2004. Data revealed that 32.3% of persons (10 years and above) use Internet in 2009 compared with 11.9% in 2004. Almost 21% of economic enterprises used computers in the year 2007; while 12.7% of the total number of enterprises accessed the internet. Also 2.3% of the enterprises were using electronic transactions and the percentage of enterprises that have website was 2.6%.

*ICT Access Among Economic Enterprises in the Palestinian Territory, 2009*

<i>Percentage of Enterprises Using Computer</i>	<i>21.3</i>
<i>Percentage of Enterprises Using Internet</i>	<i>12.7</i>
<i>Percentage of Enterprises Practiced Electronic transactions</i>	<i>2.3</i>
<i>Percentage of Enterprises having Website</i>	<i>2.6</i>
<i>Percentage of Enterprises Engaged in Research and Development in (IT)</i>	<i>1.2</i>
<i>Number of Computers in Enterprises Per 100 Employees</i>	<i>24.0</i>
<i>Percentage of Employees Who Are Using Computer</i>	<i>22.0</i>
<i>Percentage of Employees Who Are Using the Internet</i>	<i>15.0</i>
<i>Percentage of (IT) Specialist</i>	<i>3.5</i>

*Source: PCBS 2010*

The Palestine Information and Communications Technology Incubator (PICTI) aims to develop the Palestinian Micro, Small and Medium Organizations (MSME) sector, as a means to generate new jobs, attract investments and improve the economic situation in the target areas. The PICTI work program aims to revitalize entrepreneurial culture in youth by encouraging new business development and entrepreneurs, and provides technical training and capacity building for PICTI staff to benefit its clients.

The participants ranked the Business Incubation in the OPT as "poor" emphasizing that the financial support of early phase entrepreneurial ventures is quite low, while the participants ranked the ICT as "average".

## Institutions

The OPT has in place a higher education law that provides the legal framework for organizing the relationship between education and business. The main problem is that the law has not been implemented as was intended, and in many respects the governance bodies are not functioning optimally. The Council for Higher Education (CHE) is the most and its creation predates the establishment of the MoEHE. As part of the implementation plan of the national strategy for technical and vocational education and training, the Higher Council of TVET was formed in 2005. The council is composed of 16 members with equal representation of public, private, and other relevant bodies. Although the Council for Higher Education and the Higher Council for TVET composed of representatives from educational and business institutions covering all over the West Bank, these two councils are not well functioning and the economic sectors are not sufficiently covered.

In 2002, the MOEHE established an Accreditation and Quality Assurance Commission (AQAC) headed by a chair who is appointed by the Minister, and has a board of 12 professionals whose mandate is to take final decisions about licensing and accreditation — which get ratified by the Minister. The MoEHE has established the Council for Scientific Research (CSR) at the Ministry. It is a body that was established and operates within a draft by-law set out by the Ministry that has not yet been ratified.

The private sector is represented by many institutes such as: Palestinian Federations of Industries, Palestinian Federations of Chambers of Commerce, Industry and Agriculture, Palestinian Trade Centre among others. Although these institutes are overseen by the Ministry of National Economy, they are not active and competing each other rather than complementing each other.

Consultancy contracts can be useful as an indicator of how know-how is oriented toward various economic activities, and this information can help in identifying areas for building endogenous science and technology (S&T) institutions that may target the transfer of know-how from contracting bodies to enhance national strategic plans. In reality, the transfer of S&T depends largely on how these contracts are managed and what sort of a relationship is established between local teams and the consultants in terms of training, bridging and capacity building.

Although, there are many initiatives called for public private partnership in the OPT, the participants ranked the governmental, private, and educational institutions as "poor" emphasizing that these institutes are not active, and competing each other.

## Capital

The OPT's financial support system of innovative entrepreneurial ventures is still underdeveloped. While seed capital generally exists, grants for capital intensive entrepreneurial ventures are very small. Business angel networks are only rudimentary existing and banks are very conservative and risk averse in their investment behavior even with a third party coverage up to 75%. The venture

capital instrument is still underdeveloped due to current legislation. Moreover, most initiatives regarding educational development or private sector development are mostly from donors such as the World Bank, EU, USAID, GTZ, Belgium, Dutch, and French in addition to Arab and Islamic Funds.

The Palestinian firms are facing difficulties in acquiring capital. Family businesses, most of the times, prefer to stay small and prefer not to bring in any external partner to their firms. As well, many banks might lack the knowledge and experience of dealing with small loans. However, in terms of capital assets, the lower investment rate in the OPT is consistent with the Palestine's low capital productivity and the Palestinian's history of relatively high macroeconomic volatility and the bureaucratic rules and regulations.

The participants ranked the financial support system of innovation as "poor" showing that grants and loans supporting innovative entrepreneurial ventures are very small.

### ***Cultural Framework***

"National culture is a system of socially constructed meanings and values that members of a nation develop and pass on to others; these values have resulted from the culture's successful dealings with problems of the environment and the complexities of ordering social relations and integrating people (Hofstede, 2001; Schein, 1985)" Thereby the cultural framework becomes also influential for creativity and innovation. The OPT's culture does not seem to promote individualism as prerequisite for innovations and entrepreneurship. The traditional trading orientation of the culture seems to be less geared towards innovation than a culture which is more manufacturing oriented. This might be one reason for the undeveloped innovation and entrepreneurial system.

Education-business cooperation is still limited. However, the culture of education-business cooperation started to significantly grow up after 1994, after the Palestinian Authority (PA) took over, a state attributed to many reasons: before 1994, education sector was governed by the Israeli occupation through military laws; TVET strategy and Higher Council for TVET were only created after 1994; and the Council of Higher Education, under which all universities and colleges were operating, was activated after the establishment of the PA.

Some of the drivers that have influenced the tradition are: the political effects: like uncertainty and mobility restrictions; the structure of the business community, where most of the business establishments are SMEs and the culture which is still in the stage of having family owned industries, usually limited to employing relatives and close friends, and reluctant or constrained toward approaching the schemes and programs of cooperation.

The participants ranked the culture of innovation as "average" showing that Palestinians manage to find out innovative solutions against many Israeli restrictions.

## Conclusion

OPT's innovation system is still underdeveloped and not working efficiently. It suffers from weak components and a lack of coordination and managed links between its components. The main challenges facing sustainable development in the OPT are: political turmoil; weak educational, private, and governmental institutes; weak linkages between educational and business institutes; low R&D expenditure; few scientists and engineers; non competitive industry and knowledge; low usage of information and communication technology; limited private sector R&D and Innovation activities; and brain drain.

Education and labor force lack an overarching vision at the highest level of government that would serve to guide and coordinate reform initiatives. There exist many persistent national systemic barriers to the creation of an educational system that is demand driven, competency-based, flexible and responsive. Main general obstacles are: the pervasiveness of the academic model, bureaucratic processes, and the lack of performance management systems. In addition, there is an absence of a vehicle for creating a vision for education and leading and coordinating the growth and development, and the absence of strategic planning for the educational and business sub-sectors. In addition, labor market and institutional performance information is not being utilized for program planning.

At the business level, it is obvious that more than 90% of industries are classified as small family administered businesses. This implies that efforts have to be devoted to enrich the family business administration tools and mechanisms and tackle small scale related problems in financing, promotion, technical assistance, raw materials and other business essentials. Productivity across all industrial sectors does not exceed 50% on average, and only few industrial investments were evident in the West Bank in the last decade, most of these were in the form of development to existing enterprises. It worth mentioning that there is a lack of coordination efforts between different private institutes, and inter-sector relations and inter-industry relations are weak. There is no unified reference for the private sector (i.e. unions, chambers, associations) to reinforce capacity to help SMEs to address their needs for skills, lack of information accuracy and the government is not able to control and regulate the internal market and eliminate unfair competition with local producers.

## Recommendations to Move Forward Drivers of Innovation

Cultural development plays an important role in political, economic and social development. In the OPT, however, the cultural sector is witnessing many challenges that threaten to compromise cultural and artistic outputs and constrain innovation, mainly, due to the lack of clear national policies and strategies required to coordinate efforts and provide funding. To build an innovation national system, the OPT should be opened up to the global knowledge, reform of universities and R&D organizations, promote incubation system, attracted Foreign Direct Investment (FDI) for both domestic and export markets, wide consultation with private sector, scientists, government officials and economists, and promoting ICT. There should be legislation governing the relationship between education, business, Capital, R&D, and ICT sectors endorsed by the Ministerial Cabinet and Palestinian Legislative Council.

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## REVISITING ORGANIZATIONAL INTERPRETATION AND THREE TYPES OF UNCERTAINTY

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### Abstract

Interpretive theory and the concept of perceived environmental uncertainty have received great attention in the literature. Yet, despite the link between interpretation and uncertainty, little work has focused on integrating the dominant constructs into one framework or model and the empirical evidence is highly scattered. The aim of this paper is to move towards such a framework and to make a series of conceptual propositions regarding the impact of perceived uncertainty on interpretation processes.

This conceptual paper extends existing conceptual work on perceived environmental uncertainty by linking the interpretation process to three different types of uncertainty: state, effect and response uncertainty.

In this paper I propose that environmental scanning leads to lower state uncertainty, i.e. less uncertainty regarding the estimation of probabilities of events occurring in the external environment of the organization. I also propose that scanning leads to higher levels of perceived control over events and that the actual interpretation of event, in opportunity/threat terms, drives organizational reactions to these events.

This paper proposes a coherent view of the organizational interpretation process and links to three types of perceived uncertainty. It suggests a way to test these links that might help explain and untangle some of the conflicting empirical results found in the extant literature.

For practitioners this paper emphasizes the importance of environmental scanning and how scanning practices can lead to general alertness, to more positive event interpretations, and finally to responses to opportunities in the environment.

I extend on existing work by linking the interpretation process to three different types of uncertainty (state, effect and response uncertainty) with specific testable propositions. This paper provides a unifying view, piecing together in one picture elements that have so far been dispersed in the literature.

**Keywords:** Perceived environmental uncertainty; scanning; interpretation

### Introduction

Management scholars have long been interested in the alignment between organization and environment. The environment is the source of both opportunity and threat for the organization (Dutton & Jackson, 1987; Jackson & Dutton, 1988) and organizations, by perceiving the environment

and acting in response to what they perceive, at least to a certain extent can enact, create and choose the environment with which they deal (Bluedorn, 1993; Weick, 1979). However, this is typically done under conditions of relative uncertainty with which executives must cope (Lawrence & Lorsch, 1967).

The study of managerial and organizational cognition and its constructs has proliferated in the management literature over the past two decades, with management scholars discovering and building on the earlier work of psychologists and cognitive psychology. The rise in general of the organizational learning and knowledge-based view of the firm (Nonaka, 1994), have contributed to the popularity of this area, and started to shed light on the role of sensemaking in reducing uncertainty (Pandza & Thorpe, 2009). A handful of early scholars thus paved the way in the 1960s and 1970s for what has become a generation of organization scholars within the fields of management, who have taken the lead in examining knowledge structures within organizations (Walsh, 1995). Such structures represent a mental map of organized knowledge about an information environment, which enables some form of interpretation of that environment and subsequent action in that environment. The individual manager has thus been referred to as an information worker (McCall & Kaplan, 1985) and organizations as information processing, or interpretation systems (Daft & Weick, 1984; Galbraith, 1974). In fact, organization and sensemaking are so intimately linked that it may be said that organization actually emerges through sensemaking, as people organize to make sense of equivocal information and join to act on that information (Weick, Sutcliffe, & Obstfeld, 2005).

The three step interpretation process proposed by Daft and Weick (1984) suggests that organizations scan the environment and collect data (phase 1), which is later analyzed and interpreted, thereby giving meaning to the data (phase 2). Finally, actions are taken which result in organizational learning (phase 3). Whilst it has long been acknowledged that the environment is both complex and ambiguous (Starbuck & Milliken, 1988), as well a source of uncertainty (Dill, 1958; Duncan, 1972; Lawrence & Lorsch, 1967; Thompson, 1967), the relationship between this uncertainty and the sensemaking or interpretation process remains underexplored and deserves further exploration (Ashill & Jobber, 2009). If uncertainty is in fact omnipresent when organizations attempt to interpret signals from the environment, ignoring its effects on this interpretation seems a serious omission. Rather than simply acting as a form of background noise, as much of the literature on perceived environmental uncertainty seems to suggest, perceived uncertainty is more likely to accompany and influence every step of the interpretation process.

A particularly salient contribution to our understanding of the role of uncertainty in the interpretive process of organizations was made by Milliken (1987), who proposed that perceived environmental uncertainty could be broken down into three types: state, effect and response uncertainty. This concept of three types of perceived environmental uncertainty was related to the interpretation process in a later paper by Milliken (1990), when she suggested how the three types of uncertainty may reflect the three phases of the interpretation process outlined earlier. Unfortunately, despite much attention having been given to both the interpretation process and the three types of perceived uncertainty individually little has been done to extend the idea of bringing the two together conceptually.

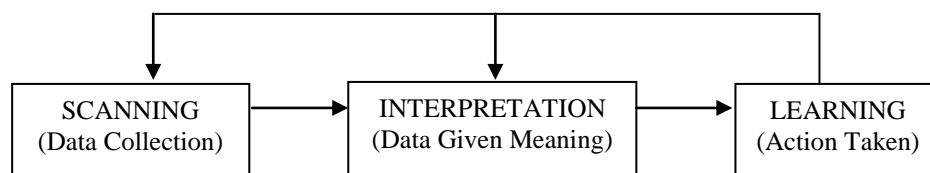
Two problems therefore face the scholar interested in the interpretation-uncertainty link. One is that both conceptualizations and empirical evidence for the link is highly fragmented, with no single study painting a complete picture of the process of organizational interpretation and the links with multiple types of uncertainty. The second is that existing studies of the link between, for instance, scanning and uncertainty, are far from unanimous in their conclusions (Weick, 2002). Specifically, relatively little and sometimes contradictory evidence exists concerning the links between scanning, interpretation and the three types of uncertainty and little is known about the specifics of how these types of uncertainty affect actions. It is this lack of theory development that I will attempt to remedy in the present paper.

This paper therefore integrates and extends on existing theoretical and empirical contributions in the field, to give us a fuller view of how three types of issue-specific perceived environmental uncertainty are linked to the process of organizational interpretation. The paper is structured as follows: first I will review the interpretative process, then the literature on perceived environmental uncertainty, before making a series of conceptual propositions for the links between these various concepts, based on various contributions found in the literature.

### The Interpretation Process

Although human beings carry out the actual interpretation of individual events, organizations build systems and memories based on past processed information. Organizations learn from their actions, as these actions are in turn analyzed and their effects interpreted (Weick et al., 2005). Individual employees may come and go, but certain norms, cognitive maps and organizational knowledge are standardized, stored and preserved over time (Daft & Weick, 1984). Thus, the organization is capable of interpreting as a system. Daft and Weick (1984) drew together various views on how organizations interpret the environment into a simple three-stage process of scanning, interpretation and learning, as illustrated in Figure 1. In this paper I will follow this particular stylized view given its success in the literature.

FIGURE 1  
*The Interpretative Process (Based on Daft and Weick (1984))*



### Scanning

Scanning is defined as the deliberate act of seeking information about events and relationships in the outside environment (Aguilar, 1967; Daft & Weick, 1984; Fahey & King, 1977). Scanning aims to recognize environmental changes (Sutcliffe, 1994), to improve the match between the objective

environment and the manager's or organization's perception of that environment (Bourgeois, 1985), as well as to correctly assign probabilities to the occurrence of potential changes or events (Milliken, 1990).

Due to scarcity of time, scanning is done selectively across sub-sectors of the environment (Boyd & Fulk, 1996; Daft, Sormunen, & Parks, 1988; Garg, Walters, & Priem, 2003; Hambrick, 1981), such that the focus of scanning differs from one organization to another (Hambrick, 1982). Furthermore, organizations exhibit varying levels of scanning and use various methods of scanning (Beal, 2000; Fahey & King, 1977; Lang, Calantone, & Gudmundson, 1997; Sutcliffe, 1994). Scanning can be both regular and irregular (Fahey & King, 1977; Huber, 1991). If knowledge structures are used to interpret change, then scanning serves to add to and enrich the knowledge structure content, whether at the individual, group or organization level. When measured, scanning is frequently divided into scanning scope and scanning frequency, the former referring to the areas of the environment scanned and the latter to the frequency of use of various scanning mechanisms.

## **Interpretation**

Organizational interpretation can be defined as the process of giving data meaning, or of translating external events into a shared understanding amongst organizational members (Daft & Weick, 1984). It is during this crucial phase that cognitive or mental maps play an important role. Managers use their collective knowledge and mental maps to label and categorize events (Thomas, Clark, & Gioia, 1993; Weick et al., 2005). How a given event is categorized by the organization is a part of, and will obviously affect, the interpretation itself (Dutton & Jackson, 1987).

The categorization the most commonly mentioned and investigated in the literature is the categorization of an event as a potential threat or opportunity to the organization. It has been suggested that there are three dimensions to this threat/opportunity categorization: (1) an evaluation of the event by managers in negative or positive terms, (2) an estimation by managers of potential losses or gains as a result of the event, and (3) a consideration of the controllability by the organization (Barr, 1998; Jackson & Dutton, 1988; Thomas et al., 1993; Thomas & McDaniel, 1990). Although individual members of the top management tend to have a large influence over the labeling of strategic issues, these categorizations are shared with the organization and ultimately influence the organizational actions taken in response to the issue (Julian & Ofori-Dankwa, 2008; Thomas et al., 1993).

## **Action**

The final stage of the interpretative process involves organizational actions. It was labeled "learning" by Daft and Weick (1984), but the learning involves a new response or action based on the interpretation. The learning effect refers to the discovering and interpretation of new action-outcome relationships. Thus, the action phase leads to the accumulation of new knowledge and information which is in turn interpreted by the organization, leading to the feedback loops in Figure 1. Organizational actions can be changes of a strategic nature, of a competitive nature or of a structural

nature (Dutton & Duncan, 1987; Ginsberg, 1988; Thomas et al., 1993). As previously mentioned, the particular organizational action is intimately linked to the interpretation given to the environmental change (Barr, 1998). Thus, the particular interpretation given to an event will determine what actions will be taken, as will past experiences, given that these past experiences, and past learning, to some extent constrain the organization's repertoire of actions. Finally it may be worth pointing out again that the actions taken will ultimately influence and to a certain extent form the environment (Bluedorn, 1993; Weick, 1979).

### **Perceived Environmental Uncertainty**

Environmental uncertainty has for a long time been a central concept and variable in the study of organizations (Dill, 1958; Duncan, 1972; Lawrence & Lorsch, 1967; Thompson, 1967). This uncertainty has been considered by some an objective property of the environment, by others a perceptual phenomenon, such that the uncertainty is in the eye of the beholder (Milliken, 1987). As a result, estimation of environmental uncertainty has been carried out either using objective archival measures, or subjective perceptual measures (Boyd, Dess, & Rasheed, 1993). When the environmental uncertainty is viewed as an objective property of the environment, it is typically measured using constructs that deal with particular attributes of the environment such as instability or rate of change, munificence, and complexity (Bourgeois, 1985). These objective measures involve archival time series data, which will help to eliminate survey problems like non-response bias. Perceptual measures, on the other hand, generally depend on survey-based self-reported data, which many researchers have argued are more relevant (Downey & Slocum, 1975). A manager's perception of environmental uncertainty may change quite rapidly (Buchko, 1994), something objective measures may not pick up. It is no wonder then that studies trying to compare objective and perceptual measures have yielded mixed results (Buchko, 1994; Downey, Hellriegel, & Slocum, 1975; Tosi, Aldag, & Storey, 1973). Objective environmental uncertainty and perceived environmental uncertainty are two very different constructs (Doty, Bhattacharya, Wheatley, & Sutcliffe, 2006).

The measurement of perceived environmental uncertainty has been carried out using many different instruments. These usually divide the environment into sectors, such as suppliers, competitors, customers, government and so forth. Managers are then asked to rate the predictability of changes in each sector. It has been found that these operationalizations, including the most commonly used ones, are not necessarily correlated (Downey et al., 1975), owing probably to the fact that they are not necessarily measuring the same underlying construct (Milliken, 1987). Furthermore, there have been demonstrated problems of validity and reliability for many of these instruments. Thus, both the Lawrence and Lorsch (1967) scale, and the Duncan (1972) scale have been found to lack reliability (Downey & Slocum, 1975; Tosi et al., 1973). Miles and Snow (1978) proposed an instrument with 22 items across six external environmental components: suppliers, competitors, customers, financial markets, government and unions. They suggested a link between the strategic type of an organization, scanning behavior and perceived environmental uncertainty (Miles & Snow, 1978). The various environmental components were equally weighted in their instrument, a fact which has been criticized, since for any particular organization, at any particular point in time, the strategic

importance of the various components are likely to be unequal (Daft et al., 1988). One risk with this instrument is therefore that the researcher underestimates the environmental uncertainty.

Milliken (1987) was innovative in proposing that not only may environmental uncertainty arise from any of the various sub-sectors of the environment, but it may in fact arise in three distinct forms. The first she referred to as state uncertainty, which is the lack of predictability concerning environmental change. She suggested that this type of uncertainty is conceptually closest to the common conception of perceived environmental uncertainty. The manager is uncertain as to the probability of particular events or changes taking place. Thus, he or she finds the environment or portions of it to be unpredictable. An example of this kind of uncertainty would be the uncertainty associated with a potential competitor entering the market or not.

The second type of uncertainty is effect uncertainty, which refers to the inability of managers to assess what the effects of a future state of the environment will be on their organization. This type of uncertainty therefore concerns cause-effect relationships and understanding whether an event will affect the organization and how deeply. An example would be the uncertainty linked to the effects that a new market entrant would have on the organization. The third type of uncertainty is response uncertainty, or a lack of knowledge of response alternatives and the effectiveness of these responses (Milliken, 1987). In our example, this would be the uncertainty of how to respond to the new entrant.

In later work, Milliken (1990) measured these three dimensions of uncertainty in a survey of college administrators and found evidence for their existence as separate constructs. A number of later studies have picked up on the notion of three separate types of perceived uncertainty. Gerloff, Muir, and Bodensteiner (1991), who used factor analysis on Duncan's (1972) instrument of perceived environmental uncertainty in the case of a survey of 118 Navy project managers, found that this instrument reflected the three types of uncertainty, although there were some issues of reliability on the measure of effect uncertainty (Doty et al., 2006; Gerloff, Muir, & Bodensteiner, 1991). Based on a questionnaire answered by 204 New Zealand firms, Ashill and Jobber (2009) presented evidence that the three types of uncertainty are conceptually distinct, although empirically linked. In a previous study the same authors used qualitative measures (Ashill & Jobber, 2001), and I have identified at least one study that interestingly used time series data to confirm the existence of the three uncertainty dimensions (Miller & Shamsie, 1999). However, despite the apparent and justified popularity of Milliken's (1987, 1990) work, relatively little has been done to further examine the possible relationship between the three types of uncertainty and the actual process of organizational interpretation. Although Milliken (1990) herself linked the three types of uncertainty to Daft and Weick's (1984) interpretative process, the details of this link remain largely unexplored.

Studies of cognition and the interpretation process have examined the likely factors affecting this process, and the possible origins of the underlying knowledge structures, including strategy (Thomas & McDaniel, 1990) and strategic type (Citrin, Lee, & McCullough, 2007), market orientation (Qiu, 2008), degree of diversification (A. Ginsberg, 1989), organization culture (Harris, 1994), industry velocity (Nadkarni & Barr, 2008), dynamism (Garg et al., 2003), cognitive motivation (Anderson, 2008)

and a host of other organizational, team or individual level factors. Milliken (1990) herself examined the role of perceived probability of change in the interpretation process, but not of scanning as an activity and a tool for improving the accuracy of perception and for lowering uncertainty. A number of more recent studies have examined particular relationships within the process itself, such as the link between information gathering and interpretation (Anderson & Nichols, 2007). Others have examined how uncertainty may hinder responsiveness or actions (Becker & Knudsen, 2005), but common to all of these studies is that they typically don't distinguish between different types of uncertainty, nor do they paint a very complete picture of how uncertainty can affect organizational cognition at each of the different stages of the interpretation process. Thus there is a need for further conceptual and empirical work on perceived environmental uncertainty and its links with the process of identifying, interpreting and responding to environmental change (Ashill & Jobber, 2009).

### **An Integrated Model of Interpretation and Uncertainty**

It is my intention in this section to make a series of propositions, outlined in figure 2, about the three types of uncertainty and how they may relate to a process of organizational interpretation. I seek here to integrate existing knowledge into a somewhat more complete model of uncertainty and organizational cognition than has been done in the literature thus far. In this model I will differentiate between several types of uncertainty, and in keeping with Milliken's (1987; 1990) intentions, I link these to the interpretative process as outlined by Daft and Weick (1984).

The first proposition concerns state uncertainty, as it relates to organizational scanning. The link between scanning and perceived environmental uncertainty has been extensively debated and studied, mostly with the hypothesis being that high levels of environmental uncertainty prompt executives to have higher levels of scanning (Daft & Weick, 1984; Ebrahimi, 2000; Lang et al., 1997; Miles & Snow, 1978; Yasai-Ardekani & Nystrom, 1996). As previously noted, no particular distinction has been made between different types of perceived uncertainty in general (Becker & Knudsen, 2005), and the three types of environmental uncertainty identified by Milliken (1987) in particular. Daft, Sormunen and Parks (1988) found evidence for a link between perceived strategic uncertainty, measured as a combination of the perceived rate of change, complexity and strategic importance of sub-sectors of the environment, and top executive scanning frequency for that sector, and hypothesized that it is the strategic uncertainty which leads to scanning. The "strategic" element of their uncertainty measure was introduced because they posited that uncertainty by itself will not lead to scanning behavior (Richard L. Daft et al., 1988). Subsequent studies trying to replicate their results have produced mixed results (Elenkov, 1997). In a recent study, authors posited that perceived market turbulence triggers efforts at sensemaking (Neill, McKee, & Rose, 2007). Finally, Nadkarni and Barr (2008) hypothesized that industry velocity will influence attention focus. Thus it remains unclear whether environmental factors by themselves prompt scanning, whether perceptions alone lead to scanning, or whether it has to be a combination of uncertainty and strategic relevance. Critically, existing studies have not provided unanimous results to support either of these views. One reason for this is that the exact definition and measurement of perceived uncertainty has varied from study to study. This uncertainty has in most studies not been broken down into its separate components

(despite the mounting evidence pointing to the existence of such components). Interestingly too, the cause-effect relationships reported in these studies often hinge purely on the strength of the lines of argument. In this paper, I will focus on the issue-specific uncertainty, breaking this uncertainty down into the three types originally proposed by Milliken (1987, 1990). I will therefore not theorize directly about the links between environmental dynamism or complexity and scanning, nor about perceived environmental uncertainty in the traditional sense.

It has been suggested that environmental scanning absorbs uncertainty when it advances beyond the mere collection of data and begins to provide interpretations (Boulton, Lindsay, Franklin, & Rue, 1982; Yasai-Ardekani & Nystrom, 1996). Starting from Milliken's (1987) definition of state uncertainty as being uncertainty about the probability of general changes in state in the environment, it therefore seems logical that scanning the environment for information about a specific issue or trend will tend to lower the state uncertainty related to that issue. In addition to this, and as an indirect effect, the more scanning activities a given organization entertains in general, the lower I would expect the state uncertainty related to any given environmental change to be. In other words, organizational scanning leads to more certainty concerning predictions of the likelihood of particular events taking place. This is firstly because higher general scanning will increase the chance that a given event has been recognized by the organization (Kathleen M. Sutcliffe, 1994), secondly because it will improve the basis for estimation of subjective probabilities and their accuracy (Becker & Knudsen, 2005). In short, if state uncertainty is defined by the absence of information about the environment (Downey & Slocum, 1975; Milliken, 1987), collecting more information should help lower uncertainty.

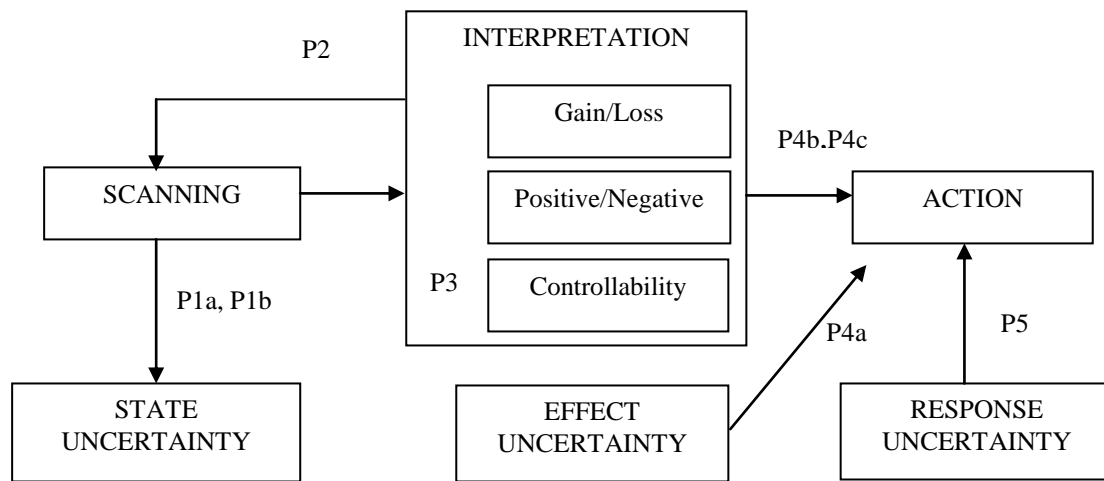
A second element to this first proposition concerns the particular sectors of the environment that are scanned. The more an organization scans a particular sector of the environment, the lower the state uncertainty concerning changes within that sector.

*Proposition 1a: The more an organization scans its external environment, the lower will be the perceived state uncertainty related to environmental changes.*

*Proposition 1b: The more an organization scans a particular sector of its external environment, the lower will be the perceived state uncertainty related to environmental changes taking place in that sector.*



FIGURE 2  
Propositions



The second proposition concerns the feedback loop reported by Daft & Weick (1984) and illustrated in Figure 1. They suggested that learning might lead to further scanning in order to monitor the effects of organizational actions. If this is the case, then one could conjecture that the interpretation given to a particular event upon first identifying the event might influence subsequent scanning related to that particular event. Daft, Sormunen, and Parks (1988) noted that uncertainty by itself will not lead to scanning behavior since managers may not be interested in events unless these are perceived as strategically important. Hence the perceived importance of an event may prompt further organizational scanning (Boyd & Fulk, 1996). This scanning is of an irregular type, being a direct reaction to the given event or "crises" (Fahey & King, 1977). The environment is scanned for specific data concerning the event. The bigger the predicted impact of that event, whether negative or positive, the more likely that the organization will engage in more scanning to help form or perfect the interpretation. Any significant threat or opportunity is likely to act as a trigger for scanning.

*Proposition 2: The higher the predicted impact of a given event and regardless of the uncertainty related to that prediction, the higher will be the interest in the event and the more likely will it be that scanning activity will be undertaken in the related area of the environment.*

The third proposition concerns how scanning affects interpretation. As a reminder I consider here the previously discussed three dimensions of the traditional threat/opportunity categorization: (1) an evaluation of the event in negative or positive terms, (2) an estimation of potential losses or gains as a result of the event, and (3) a consideration of the controllability by the organization. Starting with controllability, the greater the amount and the completeness of information available to decision makers, the greater the likelihood that they will sense that they master the situation and thus perceive any changes as controllable (Eisenhardt, 1989; J. B. Thomas et al., 1993). The fact that scanning

enhances the early detection of events before threat interpretations can emerge should further contribute to increasing the sense of control (Jackson & Dutton, 1988).

*Proposition 3: Organizations that engage in more general external scanning will tend to feel a given event to be more controllable.*

The fourth proposition concerns the links between the actual interpretation of an event, the effect uncertainty relative to the event, and organizational response. Effect uncertainty measures on the one hand uncertainty related to whether a given event will affect the organization and on the other hand uncertainty linked to the predicted magnitude of this impact (Milliken, 1987). This uncertainty accompanies the actual interpretation and categorization of an event. It is not clear at all that this type of uncertainty influences the actual interpretation or threat/opportunity categorization itself, nor that it is a consequence of that interpretation, but rather it influences the time spent interpreting. As Milliken (1987) noted:

*"It seems likely that if administrators are uncertain about the effect of an environmental change or changes, they may spend a lot more time (and use many resources) in the "environmental threat and opportunity analysis phase" of strategic planning... Uncertainty could paralyze the strategic planning process as administrators argue about whether and how significantly their organization is likely to be affected by various environmental changes."*

*Milliken (1987: 140)*

This would suggest that if effect uncertainty has an effect on the interpretation process other than extending the time spent analyzing, this effect might be on the response rather than actual interpretation. It has been shown in the literature that effect uncertainty may arise from the inability to assess how customers, competitors and other actors might influence the organization (Miller & Shamsie, 1996). This can be because the organization may be lacking the necessary skills, information and resources to correctly understand the effects of environmental changes (Miller & Shamsie, 1999). The only paper I have identified dealing directly with the influence of effect uncertainty on the interpretation process is that of Miller and Shamsie (1999), who found that firms experiencing high effect uncertainty will tend to have less varied product lines. Their argument was that the uncertainty would discourage managers from straying into expensive product variations. Product variation and new product launch is clearly one type of decision or action open to organizations facing changing environments. As a result of the above analysis I therefore suggest that higher effect uncertainty will make it more difficult for an organization to determine whether a response is warranted. Therefore, higher effect uncertainty will be associated with less organizational action, at least in the short term.

It has been shown that issue interpretation plays an important role in shaping strategic responses (Ginsberg & Venkatraman, 1995). Within the knowledge-based view, for example, it has been shown that various interpretation mechanisms may benefit the subsequent level of knowledge application (Song, van der Bij, & Weggeman, 2005). Unfortunately few studies have fully explored the effects of the popular threat/opportunity interpretation on response (Julian & Ofori-Dankwa, 2008). Thomas, Clark and Gioia (1993) found that the positive and gain items are indistinguishable and hypothesized

that an interpretation in high positive-gain terms will lead to a greater response, although they did not find empirical support for this hypothesis. Julian and Ofori-Dankwa labeled the positive/gain item "favorability" but we prefer here to keep the original label to avoid confusion. A number of studies have proposed to measure threat and opportunity separately, since these labels have separate connotations (Denison, Dutton, Kahn, & Hart, 1996; Jackson & Dutton, 1988; Julian & Ofori-Dankwa, 2008). Julian and Ofori-Dankwa (2008) thus separated threat and opportunity and found both of these constructs to be positively correlated to intended responses in the case of external environmental change. In summary, it seems reasonable to assume that the interpretation given to a certain event, regardless of the uncertainty linked to that interpretation, will affect the magnitude of the organizational response to this event. We thus posit that an interpretation in high positive-gain terms or in high negative/loss terms is likely to result in higher levels of response.

Controllability can be defined as the extent to which the correct strategic response and the outcome of this response have to be guessed, or escape the control of the manager (Milliken, 1990). The effect of controllability on response has been examined in several studies, with somewhat conflicting results. Julian and Ofori-Dankwa (2008) found a marginal, but non-significant, positive relationship between influence and external response, whilst reporting a strong positive relationship between manageability and response in a separate study (Julian, Ofori-Dankwa, & Justis, 2008). Given the evidence, I posit that controllability, when defined as whether the organization has the capabilities act, and a choice over whether or not to act (Jackson & Dutton, 1988; Thomas et al., 1993; Thomas & McDaniel, 1990), will lead the organization to adopt larger responses.

*Proposition 4a: A higher effect uncertainty will lead to a delay in actions being taken.*

*Proposition 4b: The interpretation of a given event in high positive-gain or negative-loss terms will lead to more actions being taken.*

*Proposition 4c: The interpretation of a given event as controllable will lead to more actions being taken.*

Finally proposition five concerns the effect of response uncertainty on organizational action. This relationship has not benefited from much analysis beyond the simple identification and validation of the response uncertainty construct (Milliken, 1990). Milliken (1987) suggested that high levels of response uncertainty may have the effect of delaying strategy implementation as response alternatives are developed and analyzed. Thus our last proposition concerning the links between the interpretation process and the three types of uncertainty is simply that in the short term at least, the more uncertain the organization feels about the potential effectiveness of a set of organizational actions, the less likely it will be to adopt those actions, preferring to continue scanning and interpreting the event until a suitable course of action can be found for which the corresponding uncertainty is sufficiently low. Although this is a re-statement of Milliken's original proposition it is included here for completeness.

*Proposition 5: Greater response uncertainty will lead to less responsive actions being taken in the short term.*

## Conclusions

The field of managerial and organizational cognition continues to be one of the most promising fields in terms of opening some of the black boxes of organizational behavior, and thus of enhancing the theory of the firm (Walsh, 1995). Interpretive theory and the closely associated concept of perceived environmental uncertainty remains highly popular in the management literature in general, but the field continues to suffer from a multiplication of constructs, labels and measurement instruments (Walsh, 1995), that often make the thorough verification and validation of existing constructs and models through repeated studies difficult, if not impossible. Some of the more salient theoretical contributions have been Daft and Weick's (1984) interpretation process and Milliken's (1987) identification of three separate types of perceived environmental uncertainty. These contributions sought to bring some structure to a growing body of literature and perhaps to explain some of the failures of scholars to reproduce results, particularly with the concept of uncertainty. Although various stages and labels of interpretation have been empirically linked between themselves and with various definitions of uncertainty, the evidence is scattered across the literature and is sometimes incomplete. When brought together these contributions strengthen our understanding of organizational cognition and may help explain some of the empirical evidence on interpretation and uncertainty amassed over the past decades. No study has focused on further developing and integrating existing findings so far and in this paper I have tried precisely that, proposing a fuller account of the interactions between organizational interpretation and three types of issue-specific uncertainty.

Empirical research is needed to continue validating the various constructs and measures discussed, as well as the relationships between these, as outlined in this paper. Furthermore, boundary conditions, contingencies and moderators of the theorized relationships need to be studied, as these may shed more light on the sometimes contradictory empirical evidence found in the literature. The interpretation process and perceived uncertainties constructs continue to be explored within fields as diverse as information systems, human resource management, strategy, marketing and organizational behavior, and all of these fields can validly gain from applying these constructs within their own domains and can further add to our understanding of cognition and uncertainty.

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## DEVELOPING LOGISTICS MODEL TO DISPOSE TRANSFERABLE HAZARDOUS WASTE IN TURKEY

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### Abstract

During last the century, rapidly increasing industrial growth have created a significant hazardous waste problem in the world. Although authorities in the public and private sectors try to minimize the production of hazardous waste in all steps of the production process, large amounts of hazardous waste are still being produced and hence there is an urgent need for hazardous waste management. Hazardous waste management involves the collection, transportation, treatment and disposal of hazardous wastes. In this study, a new multi objective location-routing model is proposed for the transferable hazardous waste. The aim of the proposed model is to identify where to locate disposal facilities within Turkey. The model has the objective of minimizing the total cost and the transportation risk by choosing the shortest way and also it aims to minimize the risk of encountering transferable hazardous waste and the people. The large scale of implementation of the model in Turkey is presented from the data obtained from the Turkish Statistical Institute.

**Keywords:** Hazardous Waste, Location-Routing Problem, Logistics

### Introduction

Wastes have been generated by many type of business. To characterize these wastes as hazardous, one of the following four characters must be possessed: ignitability, corrosiveness, reactivity or toxicity (2872 environmental law). These types of wastes usually generated by industrial manufacturing process and presents risks to humans, animals, plants or in other words to all environment. Although wastes of many different types of organizations even household wastes can be characterized as hazardous, only manufacturing industry's hazardous waste amounts used as data in this study.

In the last five decades industrial and technological developments have created a significant hazardous waste problem in Turkey. Even though to the trend in the world is to minimize the production of hazardous waste at the beginning of the process, large amounts of hazardous waste production still continue and need to be taken care of (Basel Convention).

Everyone accepts that the increasing amount of hazardous wastes cause ecological problems, furthermore these wastes also cause problems for the local economy. Most of these wastes still have economical value but can not be integrated to the economy. They can be either reused or recycled to return to the economy.



To solve hazardous waste problem, many different disciplines study together to develop a risk free and cost effective solution (Nema, 1999), but every perspective comes with its point of view. For example for a manufacturing company, some other companies' wastes can be raw material or source of energy. Either way by taking enough precautions the risk factor and by protecting the economical value by re-using the wastes as source of energy will provide the wanted solution. For a licensed carrier firm waste means lots of goods to transfer for a fat charge as the firm has to maintain risk free operation. For a disposal facility hazardous waste means source of wealth and chance for social responsibility. For a NGO hazardous waste means cause of cancer, risk of death.

As the economical value can not underestimated, an important amount of hazardous waste merge back in to economy as raw material or source of energy if possible (Pilar and Et.al., 2006). According to Turkish laws the possibility of using hazardous waste as raw material or source of energy has limited. The inefficient measures of facilities are the main reasons of these limitations (Yılmaz, 2006).

There is not much chance to develop a solution in Turkey for hazardous waste management problems. The increasing amount of generated hazardous waste, the limitations on reusing and recycling and inefficient facilities magnify the problem. According to the academic studies yearly at least 2.118.370 tons/year hazardous waste generated all over the country (Yılmaz, 2006). The official amount is a little bit lower than this amount as official numbers are usually conservative. In the recycling industry there are only a few small size companies which specialized on specific hazardous materials. Only recycling paper, metal and glass could not be count as a datum point in this problem. The only possibility to turn the economic value back in to real economy seems re-using to generate energy. There are some cement and lime factories which use these hazardous wastes as source of energy but as the legislations put a limit on using hazardous waste as refuse-derived fuel. There is only one possible and quick solution left for Turkey to solve hazardous waste problem sending all the obsolescent hazardous wastes to disposal centers as many other countries all over the world do (Tchobanoglous, 1997).

Transferring these wastes to disposal centre seems the only solution of this problem, but this solution could generate new problems. In year 2011 there is only one disposal centre in Turkey which only can dispose the 1/27 of the all hazardous waste generated by manufacturing companies known from official documents. The real amount of hazardous waste generated from all types of business and households could be ten times bigger than this percentage. The insufficient number of disposal centers might be solved by building new centers but another problem appears at this point: NGO's not letting local authorities to build new centers. Not in my back yard (NIMBY) approach developed by NGO's to stop or delay new disposal centre projects (Erkut and Neuman, 1989). Although by using right technology and taking the right precautions the risk of influencing the environment and humans can be minimized, still all environmental NGO's work to stop all governmental efforts to solve this problem by building new facilities (Alamur, 2003).

Efficiency of disposal centers also generates other problems for many businesses. Environmental local laws and Basel convention forces the waste generating business' to take care of all the wastes

they generate. All the responsibilities about hazardous waste belong to them. Storing the hazardous waste on the plant area with enough precautions will never be enough; indeed at the beginning generating hazardous waste must be minimized so there must be no need to build a storage facility on plant area. Anyway the amount of hazardous waste generated and stored at the plant area upon all adjustments also must be transferred to recycling centers or disposal centers by qualified carriers. All this process from generating to disposing is under the responsibility of waste generating business.

Disposing seems the most preferable solution to manage hazardous waste problem, but this must be cleared at this point that, the disposal procedures most businesses prefer are neither right nor risk free. Burying the hazardous waste or throwing over to deserted areas do not mean disposing. The one and only way to dispose hazardous waste is burning them at sufficient facilities.

According to the existing pyramid the least importance given to prevention and minimizing hazardous waste generation. Turkish businesses mostly prefer manufacturing without thinking the hazardous waste generation. Indeed BASEL Convention claims that best way to solve a problem is not generating at the start.

According to proposed agreement all businesses must firstly prevent generating hazardous waste. To manage this, required technology and qualified employees must be provided. The main aspect at this point is to minimize the amount of hazardous wastes which need to be sent to disposal centers (Emek and Kara, 2007).

After working to minimize hazardous waste, there could still be some hazardous waste generation. This waste must be stored at the business plant until its transfer. This storage process also needs some requirements to be done safely. These requirements standardized and applied by local laws. Because of the inadequate technology some hazardous wastes which still have economic value also left for storing and then to disposing. In fact, this kind of hazardous wastes can be recycled as raw materials for another manufacturing process or can be reused to generate energy. By doing this, the resources spend for manufacturing can be recoverable.

The main problem about hazardous waste management is the cost and health risks. If the dangers of hazardous waste wanted to be minimized, somehow a cost effective and risk free method must be developed. Developing a prevention method can be seemed costly but it must be understood that it can never be as expensive as recovering. Minimizing the risk and stopping the negative effects of waste to nature will save money as the liable parties will not need to pay for damages (Hu and Huang, 2002). For all countries the motto is the same: "whoever contaminates has to take care of it".

After describing the up-to-date situation, it must be emphasized again that the best solution for hazardous waste problem is building new disposal facilities. Developing a new concept for hazardous waste management is a must, but there are still with huge amount of hazardous waste all over the country which has to be taken care of.

In this paper, a new model for hazardous waste management will be presented. This model will answer the following:

- How many disposal center will be needed?
- Where to open disposal centers?
- How to route hazardous wastes generated by the manufacturing business grouped by the city borders?

With this model the urgent need of disposal centers would be discovered and the placement and the number of these centers could be planned more realistically.

## Literature Review

Although it is a hot topic all around the world, hazardous waste management problem has not been studied extensively. Before being so popular by all disciplines, mostly chemists studied on hazardous wastes to analyze the nature of the substances. The generation, handling, disposing of all these kinds of wastes mostly just studied to analyze and understand the nature of texture. In fact the main point is beyond all these.

The important part of hazardous waste management problem is first handled in location decision literature for disposal facilities. The main reason academia prefers to study hazardous waste problem just for locating facilities could be totally psychological. Most of the people and NGO's prefer to ignore the real problem, but focused on the location of these types of facilities. The general name for this kind of facilities called undesirable facilities. There is an important amount of studies about these undesirable facilities. Most of these studies focused on to avoid locating these kinds of facilities around the human population (Erkut and Neuman, 1989). A new term also entered the literature "Not In My Back Yard" (NIMBY), which means this type of undesirable facilities location, should be outside the center of population (Sheu, 2008).

The first effort to model the location-routing problem simultaneously was by Zografos and Samara (1990). They propose a goal-programming model for one type of hazardous waste, which minimizes travel time, transportation risk, and disposal risk.

Later Revelle et al.(1991) presented a model that minimized a convex combination of cost and risk. The cost measure is taken as the distance traveled, and the risk measure is taken as the population exposure. Their model aims to find the location of disposal sites, the assignment of sources to disposal sites, and the routes between sources and destinations.

Jacobs and Warmerdam (1994) model the hazardous waste location-routing problem as a continuous network flow problem. Their model locates the storage and disposal facilities and determines the routing strategies while minimizing the linear combination of cost and risk in time. They define risk as the total probability of a release-causing accident during transportation, storage or disposal. Later, Current and Ratick (1995) presented a model with the addition of equity considerations. In addition to minimizing cost and risk, they maximize equity by analyzing the transportation and facility location components of risk and equity separately. Risk is measured by population exposure (Erkut and Verter, 1995) or by the risk of transportation (Verter and Kara, 2001).

The first location-routing model to consider multiple hazardous waste types is by List and Mirchandani (1991). The model has three objectives: minimization of risk, minimization of cost, and maximization of equity. In addition to locating treatment facilities, the model also locates storage and disposal facilities.

Based on the current literature, we may say that the minimization of cost and the minimization of risk are the most commonly employed objectives.

Most of the studies dealt with one type of hazardous waste, which is a significant simplification, only a few papers add the types of hazardous wastes to build a complex model (Alamur and Kara, 2007). Different risk measures are used in the papers. The most popular of these is population exposure. Another shortcoming of the literature is that it lacks large-scale application. Most of the papers present applications with small instances, such as 10- or 15-node networks and 3 or 4 candidate sites.

### **Mathematical Model**

After recycling and reusing the generated hazardous waste the left over part of all generated amount must be disposed to protect the environment. The disposal of generated hazardous waste at certain sites requires a transportation network. The nodes of this transportation network will be generation nodes and potential disposal facility. We propose a mathematical model with an aim to treat all of the generated hazardous waste and to dispose all of the generated waste residues in a safe and cost-effective manner. It is assumed in the model that the potential sites for disposal facilities have already been identified.

The hazardous waste location-routing problem can be stated as follows: given transportation network and the set of potential nodes for disposal facilities, find the location of disposal centers and the amount of shipped hazardous waste, so as to minimize the total cost and the transportation risk. There are some limitations in this study caused by the nature of waste and the environmental acts. The environmental acts all over the countries who signed BASEL Convention agreed that not more than 6 tons of hazardous wastes can be stored at the generation facility. This means all transfers from generation node to disposal facility must be at six tons limit up most. In addition to this because of chemical nature of waste two different types of wastes can not be stored or transferred together.

As mentioned above most of the previous studies had a shortage to select area and the nodes. Nearly all of them chose a small district to develop network. In this study a whole country had been chosen as the district and all cities had been specified as alternative disposal facility nodes. To choose generation nodes again all cities has been selected, according to the data gathered from the state institute of statistics. Because of the business confidence institute let to use only the hazardous waste amounts by city.

The distances between cities' data taken from Turkish General Directorate of Highways's office have been used in the model.

After gathering the information about the amount of hazardous waste generated by the city, the possible nodes which minimize the risk of exposure and the distances between generation nodes and possible disposal nodes, other important information must be found. The capacity of disposal facilities must be known. At this point İZAYDAŞ's capacity, the one and only disposal facility in Turkey, could be an example. As can be found from their websites, the disposal facility could dispose annually 35.000 tons of hazardous waste (www.izaydas.com.tr). Although this capacity could drop down because of many reasons, we prefer to use this capacity to be optimistic. According to their marketing department the real capacity usually stroll % 20 down.

The proposed model is formulated as a multi objective mixed integer programming model with two objectives: (1) minimizing total cost and (2) minimizing exposure risk.

The following indices, parameters and decision variables are used in the mathematical model:

Given;

i: generation nodes

j: potential disposal nodes

**Data:**

$a_j$  : Hazardous waste amounts by cities

$b_j$  : Capacity of facilities

$d_{ij}$  : Distances between generation nodes and disposal nodes

$c_{ij}$  : Cost of transfer between generation nodes and disposal nodes

$c_{ij} = F * d_{ij}$

F: cost of transfer per km /145/

**Decision variables:**

$x_{ij}$  : The amount of waste transferred between generation node to disposal node ( $x_{ij} \geq 0$ )

Limitations:

Amount of waste at i:  $\sum_j x_{ij} \geq a_i$  for all i;

Amount of disposed waste at j:  $\sum_i x_{ij} \leq b_j$  for all j;

**Objective:**

Decrease the cost  $\sum_i \sum_j c_{ij} x_{ij}$

### Application in Turkey

At this point as mentioned before there are two main criteria in this study. One of them, cost reduction, will be obtained by the P-median mathematical analyze given above, but the other, minimizing the exposure risk, will be obtained by heuristically. The needed population data gathered from Turkish Statistical Institute give a chance to classify all cities by population

After specifying the deserted cities the possible nodes for disposal facilities selected heuristically. After choosing the possible nodes for facility locating, the number of needed facility must be clarified. To do this, the amount of hazardous waste need to be disposed must be known. Again form the data gathered from Turkish Statistical Institute all 81 cities hazardous waste amounts could be listed

Coding the data to analyze program for solving the mathematical model, all cities must be changed to codes. At this point it must be understood that only the cities which can not reuse, recycle or dispose the hazardous waste they generate added to the model. These cities coded with “i” and add to the model as generation nodes.

The possible disposal cities selected as nodes and they coded with “j” to be added to the model. Number of both “i” and “j” cities incidentally are 45, but the cities are not the same.

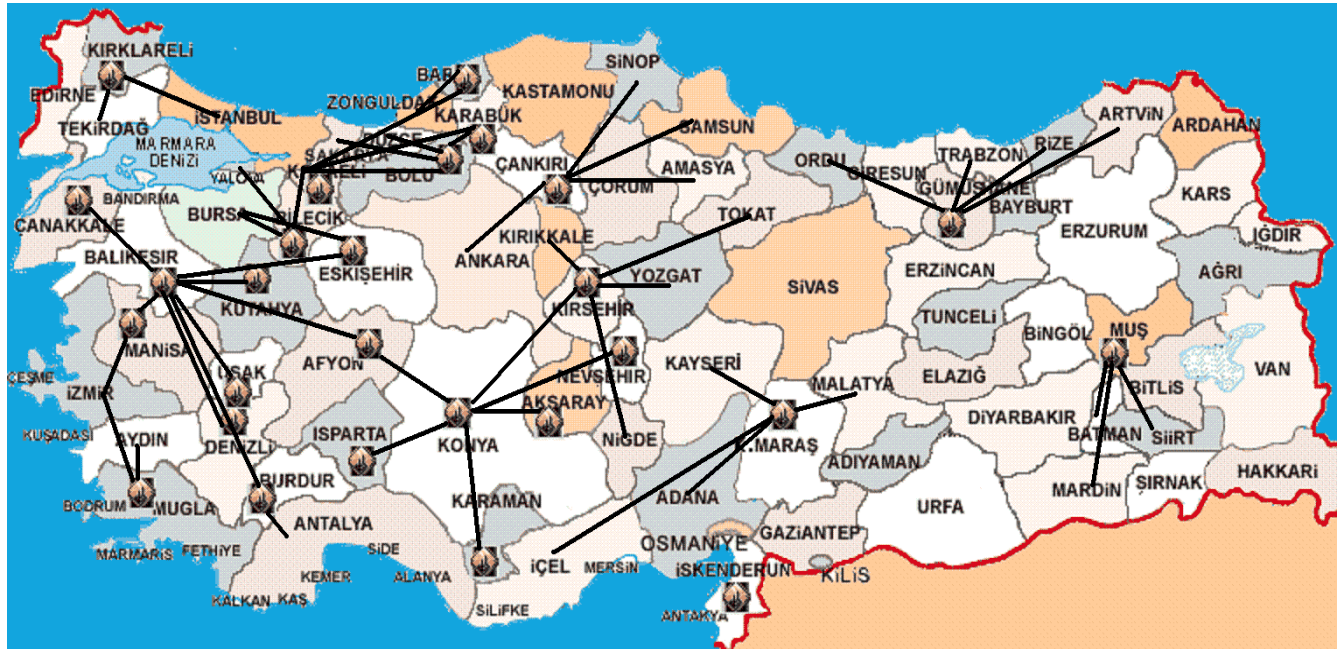
By using GAMS multi objective analyzing program, we coded the formula and the “i” and “j” cities to solve the model. After coding all needed data and running the program, the worksheet become like the table at appendix A.

When we carry all these numbers and codes to the map used the select nodes the locations of the disposal facilities can be seen more clearly. The number of possible nodes was 45 as the selection made, after analyzing this number dropped to 27. By using basic math the total amount of hazardous waste generated among the whole country was 876.768 tons/year. The maximum capacity of model disposal facility was 35.000 tons/year. The exact number of needed facility must be 25.05. At this point one of the main objectives must be remembered again. Minimizing the cost of transfer at this point caused to locate 2 more facilities. On the other hand the extra 2 facilities are also mandatory because they cover the east side of Turkey.

Just locating the facilities will not be enough to reach the objectives. The risk of exposure decreased by choosing deserted cities as disposal facility nodes. Also other objective, cost reduction, must be clear. Again from the work sheet of analyze, the transfers from generation nodes to disposal facilities

can be seen. According to this data, the new map will be formed like below. The lines show the flow to disposal facilities. The amounts of this flow can be checked from the worksheet.

Figure 1: Flow of Hazardous Waste to Disposal Facilities



## Conclusion and Future Research Directions

We proposed a mixed integrated programming model in which we combined the applicable aspect from heuristic model in the literature. Our model includes some constraints that were observed in the literature. Our aim was to answer the following questions: where to open disposal centers by paying attention to minimizing exposure risk, how to route hazardous wastes to these disposal centers and indeed how many centers could solve the problem.

We considered real-life aspects of the hazardous waste management problem and realistically implemented these aspects into the model. Especially the most prohibitive problem, “not in my back yard” approach as we believe may be resolved by choosing the deserted cities. Indeed with the boom technology the risks of exposure will not be a problem technically, but still people may believe risk is still and great. The limited number of people living around the selected nodes could minimize these inhibitive actions.

Other objective we considered was total transfer cost. Total transfer cost will carry on to minimum level by choosing the closest ranges between generation points and disposal facilities. At this point it must be understood that distances are used as a measure of cost.

The most important but the easiest objective considered as the last objective was the number of needed disposal facilities. With elementary level math's, everybody could find the solution. At this point we indeed tried to expose the current situation to alert the locals and authorities.

When we review the literature found the special issue of the journal “Computers And Operations Research” (Erkut, 2007), and believed that the only missing link could be this study at that special issue. We demonstrated that our model is manageable for a realistic and important problem of Turkey. The number of possible nodes and the range of the district may improve the value of this paper. Most of the papers studied nearly on the same topics prefer to deal with the local districts with a few nodes. The mathematical model could be much more complex for these kinds of proper studies; however when the study has to deal with the real situation, mathematical models must be simple and working. The suggested model carries both.

During the study, we noticed that these acts not only protects the nature but also generates new professions. The only facility we used as capacity model is an employer of nearly 100 skilled employees. With the new facilities, 100 times the number of facilities of people will have a job. Also with new facilities, transportation companies will need new routes, new vehicles and new skilled drivers. These disposal facilities will create noticeable skilled jobs for the economy.

While disposing the hazardous wastes, facilities also generate energy. This energy costs nothing as obtained from incineration. The waste itself has high calorie and generates high temperature which turns in to usable energy ([www.epa.gov](http://www.epa.gov)). This energy will also be a gain for the economy of the country.

For the future studies the origin of the hazardous waste may be diverted. We only covered hazardous wastes generated by the manufacturing industry. The origin of hazardous waste could be expanding. Even wastes come from our homes could contain hazardous materials. Studying on other industries' hazardous wastes will attract attention on the problem which my cause to find a way to deal with it.



**Appendix A: Work Sheet**

i\j	1	5	6	9	10	11	12	14	17	18	19	20	23	24	25	26	27	28	29	30	31	32	36	39	41	43	45	
1																			342									342
2	126																											126
3							171																					171
4							17285																					17285
5					618																							618
6										15																		15
7																				1749								1749
8	5839	35000			34382	35000		34915	28597								31493	17428					35000					257654
9			309																									309
10																										2	2	
11			1894						3386																			5280
12							21																					21
13								85																				85
14									3017																			3017
15											35000									29000								64000
16																				68								68
17													31987															31987
18																		17464		33251								50715
19																			109									109
20													1451															1451
21			28172	34790											35000											27500	34998	160460
22	29035											35000		28584		35000						35000		35000	34982			232601
23																	3507											3507
24																			30									30
25																		108										108
26																			1									1
27																					3							3
28																					15000							15000

29														8														8
30										19																		19
31										107																		107
32			3484																									3484
33							16000																					16000
34																					3							3
35							160																					160
36													279															279
37														100														100
38										946																		946
39														8														8
40																										7500		7500
41																									18			18
42														8														8
43																					63							63
44			1141																									1141
45				210																								210
	35000	35000	35000	35000	35000	35000	33637	35000	35000	1087	35000	35000	33717	28708	35000	35000	35000	35000	29550	35000	15069	35000	35000	35000	35000	35000	35000	

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## ENTREPRENEURIAL FAILURE - THE ENTREPRENEUR'S PERSONALITY: INTERFACE BETWEEN SUSTAINABLE IDEAS AND MARKET SUCCESS

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### Abstract

**Keywords:** Entrepreneurship, Entrepreneurial Failing, Entrepreneurial Characteristics, Success Factors, Sustainability

### Introduction

While worldwide organisations try to get through markets various innovations (technical, organisational, concerning utilisation systems, institutional or social) by innovation management which they contribute „to the preservation of critical natural goods and to worldwide and in the long term transferable economic styles and consumption styles and levels“ (Fichter 2005: 138), their potential does not suffice on solving the urgent questions regarding climate change and distributive justice. Thus, there is again and again a demand for a "new mindset" (Oppenheim et al. 2007). Intrapreneurs are counting to this new mind set as well as entrepreneurs.

Wagner (2010) states that a profit-maximising enterprise mutually weighs the social and private use (consumer or producer pension) of innovation alternatives: Hence, a higher private use of alternative A compensates a possibly much higher social use of alternative B, so that it comes to a displacement of innovation alternative B. Intrapreneurs have to follow the strategically alignment of their enterprise; hence, it is to be supposed that they also (must) decide in a profit-maximising way which runs counter to a potential social welfare. The question arises to which extent entrepreneurs act as profit-maximising as enterprises do and if they are defeated therefore by these displacement laws by the decision. If there are clues that open the possibility that entrepreneurs do not or do less decide and act in a profit-maximising way, a big potential lies in entrepreneurship for sustainable innovations with high social use.

When entrepreneurs are the key persons to make sustainability come true, a distinction has to be made between invention and innovation. Innovations possess market potential and imply success. That is the reason why entrepreneurs have to transform their ideas into implementable innovations to meet market potentials. Thus, sustainability can be socially, ecologically and economically profitable and realizable. The economic advantage generates a long-term approach for sustainability management in organizations as well.

To supply a market potential and generate market success through innovation it is important to know which factors make an entrepreneur successful in his business. There is a

huge amount of literature that already covers this topic and gives advice for starting a successful business or organisation. In entrepreneurial society, whereas, it is common knowledge that most start-ups fail in their first years. Most ideas are not 'innovative', hence not realizable, and let high failing rate of start-ups grow. Some experts are even saying that about 80% of enterprises fail in their first ten years (Faltin, 2009). In Germany, on which our study about failing entrepreneurs focused, enterprise failure in 2009 increased up to 11.6% (Statistisches Bundesamt, 2010) in comparison to the year before, which might be, in part, due to the financial crisis but still shows a tendency for the huge failure rate of business foundations.

These huge numbers lead us to the question why so many entrepreneurs are failing and if it was not more helpful to find possible factors of failure in addition to already depicted factors of success. Keeping factors of failure in mind and avoiding them could help entrepreneurs to successfully drive their ideas regarding sustainable business to innovation, which is realizable (regarding the definition that innovation is defined by the existence of a realized market potential).

### **Definition of Entrepreneurship**

We see the entrepreneur as a person who comes to a new idea by a creatively constructive force (Schumpeter). The entrepreneur draws his energy and power by his immense intrinsic motivation and a nearly addiction to his job. Nevertheless, the entrepreneur also realizes this idea within his economic environment by a well-elaborated concept. Besides, one has to differ the entrepreneur's characteristics from a technician or from a manager by his tasks (Gerber 1995). An entrepreneur works *on* his enterprise and on his ideas in a forward-looking way (Faltin 2009, Merath 2009), seeing the strategy and purpose of his business and its actions in a broader way. While a technician acts on demand on the businesses' tasks (e.g. baking bread if you run a bakery) and a manager's responsibilities are more by administrative means. In total, all characteristics that we find to be part of the entrepreneur's person are mentioned in figure 1.

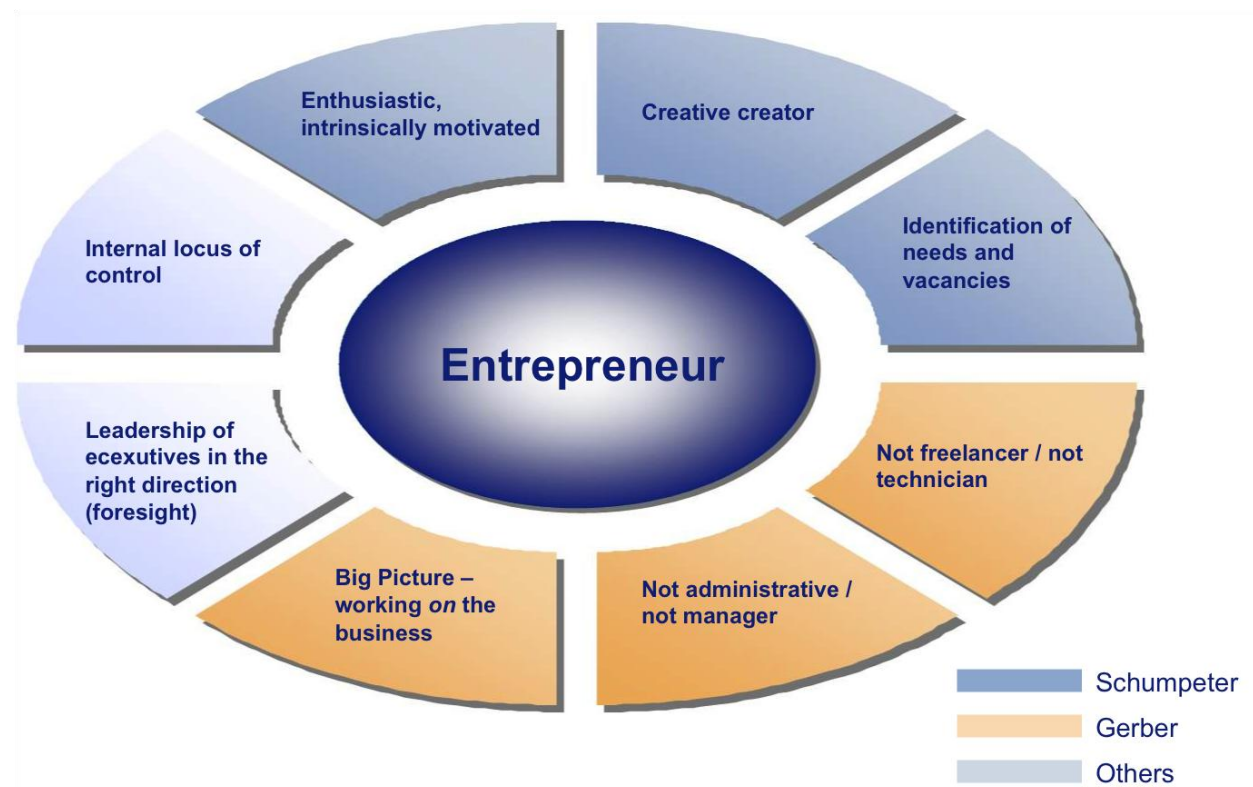


Figure 1: Characteristics of an entrepreneur

### Possible Factors of Entrepreneurial Failing

In our study 'Failure of Entrepreneurs – An analysis of possible factors for the breakdown of start-up enterprises by means of biographical-narrative interviews' we analysed the qualitative interviews of two failed entrepreneurs. As a working method, the biographic-narrative interview after Fritz Schütze was chosen. This interview method is based on the linguistic-sociological analysis of the inner mechanisms of action, in particular ad hock narration (Küsters 2009: 17) and provided us a profound insight into the personal affairs and problems the interviewees had with their enterprises. In the analysis of these interviews we differentiated between possible internal and external factors for failure that were taken into consideration with each other. In the following, the main results of this analysis will be pictured:

As one of the main external factors for failure the interviewees depicted the enterprises' cash-out due to the decline of customer demand, the missing of customer receivables and small or even no reserves held. Besides, the complicated bank systems and high account interest lead to overextension that increased the desperation and insecurity of the interviewees. In addition, the external, social pressure as well as the loss of the backing fall of family and friends increased the feeling of having failed personally. Georg Simmel describes this as the 'tragedy of culture', where culture and society requires constant objectivity and perfection in every action. This compulsory leads individuals into failure, as they will never

be able to satisfy the requirements of objectivity (Simmel 1987: 234). Thus, the requirements of society and culture enhance the feeling of having personally failed.

In total, several external factors of failure could be viewed in terms of environmental change to which the failed entrepreneurs could not adapt. Such as for instance, the German reunion and its change in the whole German economy, which affected one of the interviewees. As well as the impact of a new business partner whose interests and ideas did not fit into the whole culture of the enterprise and hence changed it dramatically, with respect of the second interviewee. Hence, regarding the external factors, it could be seen that there is a huge variety and we can just name some of many examples.

More interesting, whereas, is the fact that although the external factors are quite distinct, a huge coherence between the internal factors could be faced. In addition, most of the external factors can be interpreted as being caused from internal factors, which is why the focus of the study was given predominantly to the internal ones.

As one of the main internal factors it could worked out, that both interviewees were too occupied with the technical work of their business itself and did not have any time left to work on its future development. After Michael E. Gerber, who differentiated between 'Technician', 'Manager' and 'Entrepreneur', both interviewees were too much of a 'Technician' or 'Manager' than 'Entrepreneur'. Mentally, the 'Entrepreneur' should focus on his business regarding its look in 20 or even 50 years, working on its values and goals and maintaining an overview about it (Gerber 1995: 19 – 32 and Merath 2009: 32 - 37). Nevertheless, both interviewees only focused on the present, obvious situation. Instead of going into new, interesting markets or opening some (pull-situation), they were pushed by the market situation, to which they – finally – could not adapt.

In addition, the inability to give up responsibility to the employees, as well as the anxiety to take responsibility through leadership, could be seen as two main factors contributing to failed ventures. As a causa cosa it appears that without the ability to give up responsibility and daily business tasks the entrepreneur will never have the time to prepare and develop the business for the future. In accordance to this, the ideas of most start-ups are fairly developed and elaborated, which is also a cause to the huge failure rate.

Beside the inability to lead employees and develop a realizable idea and business strategy, the lack of financial knowledge was also a fundamental cause for the failure of the interviewee's business.

Further problems the interviewees had to face – and it is very likely that this issue is faced by a lot of entrepreneurs - was their ego and their 'Internal Locus of Control', after the psychologist Julian B. Rotter (Rotter/Hochreich 1979: 185). According to Rotter, a person with an Internal Locus of Control believes that he is in total control of all his actions. Hence, he believes in the image: the more I work the more I gain - and likewise. He develops a strong

internal understanding of control. On the one hand this seems to be a necessary characteristic for an entrepreneur to build up a business, as it seems quite unlikely that a person with an External Locus of Control - regarding everything that appears to him as forced by the exterior, which he cannot control - can start a business. On the other hand, an internal understanding of control makes it even harder for the entrepreneur to accept, that there are also a lot of external factors that he cannot influence. As there will be always changes of the environment and external factors that he cannot influence (as for instance a financial crisis, recession, war etc.) he only can fail by regarding everything as depending on his own will and ability.

Likewise, the ego of the entrepreneur comprises a lot of values, ideas and conceptions and thus defines his character. Nuttin defines this as 'das Ziel, das der Mensch sich setzt, [...] in der seine Persönlichkeit sich entfaltet.'<sup>79</sup> (Nuttin 1987: 274). Vice versa, that means that the entrepreneur's ego is defined by his values and experienced patterns of conception, which he is rarely able to abandon. With these patterns of conception he might be successful for a certain period of time. Nevertheless, our environment is constantly changing (as mentioned above) and conceptions and/or innovative ideas that could supply a market before suddenly do not satisfy the customer demand anymore. The entrepreneur must get off his fix ideas but that also includes that he has to abandon a part of the ego he created. That requires a lot of self-reflection and sometimes can be painful. Besides, reflecting the own actions, values and conceptions constantly is also a necessary part of 'maintaining an overview', as mentioned above.

Taking the external factors in consideration with the internal ones, we can see that those could explain them quite clearly.

For instance, the enterprise of one of the interviewees mainly failed because of the influence of an external consultant who became a new member of the team. His influence changes the enterprise culture and separated the founder team. His influence can be definitively regarded as an external influence or factor but the reason how he could influence the team lies mainly in the ability to lead and to overview the future development of the entrepreneur. If he had defined the culture and had communicated the company's goals for the future to his team, he could have avoided the uncertainty and separation of the team. Instead, he was far too occupied with day-to-day work and rather needed advice himself than to lead others.

One other example gives the external influence the German reunion had on the development of the business of the other interviewee (private bankruptcy). For sure nobody could foreseen the reunion but nevertheless the interviewee tried to continue his business with his experienced methods although the whole economical situation had changed. He was convinces about having everything under control and was not able to adapt his patterns of

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<sup>79</sup> Translation by the authors: 'the goal, set by men, [...] in which his personality is developed.'



conceptions to the new situation. Especially in this case, the interviewee showed a good example for the mean of an Internal Locus of Control (Interviewee: 'Also mein Motto war ja wie gesagt, wenn ich fleißig bin muss es mir gut gehen, wenn ich fleißig bin krieg' ich alles hin.'<sup>80</sup>). Hence, the German reunion and its change of the whole economical situation was the effect on which the failure was based but its real cause was the inflexibility of the interviewee's conceptions. His adherence to his business idea, the disregarding of new impacts from economy or customer needs and his inability to adapt to the new situation, finally lead to business failure.

## Conclusion

In our study we worked out possible factors why so many enterprises are failing in their first years. Besides a variety of external factors, we could see an interesting coherence between the internal factors, concerning the character of the Entrepreneur. Thus, we draw as conclusion that by avoiding these characteristics or at least keeping them in mind, the possibility for entrepreneurial failure might not be as high. On the contrary, what kind of characteristics can an entrepreneur develop to avoid these kinds of failure characteristics? Looking at our definition of Entrepreneurs there has to exist an internal motivation by Schumpeter, but without Gerber's foresight we see a thread that the entrepreneurial idea is not fitting to sustainability and its capability to satisfy an innovative market potential. Furthermore, certain flexibility is essential to rethink an idea, to shape it marketable and to convert it into a "real innovation".

Hence, for the development of a sustainable business idea that can more constantly lead to success, the continuous work and enhancement on the business idea could be recommendable. So, we can bear in mind that these factors of failure might as well be factors to success on the contrary. They could help entrepreneurs to develop their personality and characteristics and enhance their ability for a better development of sustainable business ideas and – even more relevant for us - their implementation into real innovation that can satisfy and supply customer needs, hence market potential.

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<sup>80</sup> Translation by the authors: 'Well, my motto was, as I already mentioned, when I am hard working, I must do fine, when I am hard working, I can do everything.'

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## INNOVATIVE STRATEGIES OF ELECTRONIC COMMUNICATION IN THE GREEK BANKING SECTOR

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### Abstract

In an attempt to remain effective, flexible and competitive in today's rapidly developing technological environment, banks increasingly recognize the benefits of the Internet to meet the needs of the modern consumer. Bank management aim and develop their costumer base by implementing strategies that achieves and equilibrium between physical and virtual present. While online banking (e-banking, mobile banking,ATM's) has increased immensely in Greece there is insufficient evidence concerning its acceptance by consumers.

The purpose of the present study is to examine the impact of the implementation of innovative electronic communication strategies to attract new customers and to satisfy the existing ones. Another objective of this paper is to investigate the impact on quality of online banking services on customer's e-loyalty and overall satisfaction. The research sample is consisted of 153 customers of various banks in the region of Central and Eastern Macedonia in Greece. The formulated questionnaire was administered personally and through the Internet between February and April of 2011.

The results of this study indicate that there is a statistically significant relationship between implementation of innovative technological applications, trust and the dedication to online banking. On the other hand, the research provides insufficient evidence about the relationship among the quality of service, the overall satisfaction and the adoption of online banking.

**Keywords:** innovation, strategies, internet banking, customer behavior

### Introduction

Information technology (IT) is extensively used in the global economic competitive environment, to deliver banking services to the demanding consumers (Ganguli and Roy, 2011). The continuing widespread technologies have encouraged many financial organizations to offer more convenient methods of banking, in order to retain their competitive advantage, to lower costs, to enhance their customers overall satisfaction and keep them loyal (Peevers et al.,2011). As Calisir and Gumussoy (2008) support, developing

alternative e-banking channels (SST-self-service technology) in order to retain the existing customers as well as attract new ones is a key element for financial organizations. In reality, rise of information technologies have changed the consumption process of retail banking as human to human interactions in service delivery is becoming increasingly redundant (Bitner et al., 2000). The existing literature has suggested that technological innovations particularly those that involve learning efforts and require of customers willingness to learn and that inadequate provision of relevant information or possible misinformation will discourage innovation adoption (Laukkanen, 2009). Moreover, there is proof of growing customer frustration while interacting with the new technologies (Parasuraman, 2000).

On the other hand e-loyalty enhancement is crucial for an effective and dynamic on-line presence of a bank in order to make profits and succeed (Casalo et al., 2008; French and Springett, 2007). In order to investigate the importance of e-loyalty, the identification of variables influencing repetition in purchasing and recommendation is a crucial area of research (Floh and Treiblmaier, 2006; Bhattacharjee, 2001). The perceived quality and security of alternative banking e-channels, the usability, the ease of use and the perceived pleasure, the previous technology and banking experience, the willingness to use or not the Internet, the personal skills, the trust and the overall satisfaction are some of the most important factors which demonstrate user's intention to remain loyal (French and Springett, 2007).

Furthermore in order for e-banking to be successful in Greece, users should be willing to adopt the innovative technologies that banks apply. Therefore while there have been a lot of investigations of how new e-banking technologies can influence the perceived customer behaviors, preferences, satisfaction and purchase intention, to our knowledge, few studies have examined in Greece the effect that have trust, overall satisfaction, quality of banking service and alternative e-banking networks to e-loyalty. Hence, in an attempt to fill this gap, this study following as a reference model the one that has been developed by Floh, A. and Treiblmaier, H. (2006) seeks to determine whether the findings of this investigation are valid in Greece and particularly in the region of Central and Eastern Macedonia.

The aims of this study include:

- Examining the impact of the implementation of innovative electronic communication strategies to attract new customers and to satisfy the existing ones.
- Investigating the impact on quality of online banking services on customer's e-loyalty and overall satisfaction.

The remainder of the paper is organized as follows: first we review the existing literature on the constructs of alternative e-banking channels, service quality, overall customer satisfaction trust and customer e-loyalty, and the impact of overall satisfaction and trust on e-loyalty. Additional variables, such as gender, age, are hypothesized to have an influence on e-loyalty. Next, the article discusses the research methodology used in the paper as well as the

survey instrument used in data collection. Finally, we present the results of our analysis followed by a discussion of the findings and managerial implications.

## **Conceptual Development & Hypotheses**

### **Alternative e-banking channels**

Internet evolution is changing the way people communicate with others. Therefore, financial services in order to meet customer's expectations are pursuing alternative channels to increase customer convenience, and maintain profitable. Phone banking and ATMs' are already widely used by financial institutions (Püschel et al., 2010). It is notable that in Greece where this study was carried out, the use of alternative distribution channels of banking products is tremendous. The increase in the number of ATM's over the last decade reached 120%, while according to the U.G.B. (Union of Greek Banks) in the first half of 2010, more than 1,929,800 individuals and legal persons were registered users of electronic banking services, an annual increase of 12%. Moreover, at approximately 1500 APS who have installed banks, are carried out yearly payments of 500million € (Lidorikis, 2011). Furthermore mobile banking follows on the success of internet banking and it became an alternative to other traditional bank channels such as ATMs, internet banking and physical branches (Brown et al., 2003). M-banking (mobile banking), can be applied to a number of methods for enabling customers to use their mobile device to perform banking transactions (Peevers et al., 20011). The mobile phone can be used by banks as an alternative channel because of their ubiquity, the accessibility no matter what the location or time, its efficiency and also can help financial organizations to retain existing technology-savvy customers by providing innovative services whilst at the same time attracting new customers (Tiwari et al., 2007). On the other hand the perceived complexity of m-banking, the perceived cost, the security of the service, is argued to be causes of low usage levels and furthermore that trust is the factor that most impacts the level of adoption (Lee and Chung, 2009). Although the current offline branch remains the most common method for conducting banking transactions, internet banking has changed the way personal financial services are delivered to customers (Wang et al., 2003). For those customers who have access on the Internet, e-banking provides incomparable convenience, speed, efficiency, services and products specificity, charges reduction, transactions security, while at the same time, it is available and accessible on a 24-hour basis in any part of the world (Yousafzai et al., 2005, Hertzum et al., 2004). Past studies on technology adoption have showed that perceived usefulness has a strong impact on users' intention to adopt the technology (Jeyaraj et al., 2006, Chong et al., 2010). And moreover, many researchers support that, perceived usefulness is one of the most significant influence on the intention to use e-banking among the consumers (Pikkarainen et al., 2004: Gounaris and Koritos, 2008: Celik,2008). Perceived ease of use has also been validated as important determinant in adoption of an online banking service (Wang et al., 2003). Last but not least, trust is an important factor that affects consumer's behavior and influences the adoption of e-banking.

Many researchers assert that, security and privacy increase the level of consumers' trust also (Yousafzai et al.,2003;Grabner-krauter and Faullant, 2008: Jahangir and Begum, 2008;Koenig-Lewis et al.,2010).

Consequently, we hypothesize that the quality of alternative e-banking channels can positively influence the perceived overall satisfaction and trust, whereas alternative e-banking channels are antecedents of service quality. Thus the following hypotheses are formulated:

H1. Quality of alternative e- banking channels positively influences overall satisfaction.

H2. Quality of alternative e-banking channels has a positively effect on trust.

H3. Quality of alternative e-banking channels can be seen as an antecedent of service quality

#### **Service quality & customer overall satisfaction**

The perception of customers regarding service quality of technology banking has gained importance because service quality has been shown to be a strong predictor of customer satisfaction and trust (Dabholkar et al., 2000, Zeithaml et al., 1996). So, there is a need to identify the service quality dimensions, as perceived by customers, in case of technology based banking irrespective of technology being used and how these dimensions affect customer satisfaction and trust (Canguli & Roy, 2011). Perceived service quality is believed to be resulting from comparison between customer's prior expectations about the service and their perceptions after actual experience of service performance (Parasuraman et al., 1985). E-service quality can also be measured by other dimensions such as, website appearance, ease of use, linkage, layout and content, reliability, efficiency, support, security, feature, serviceability, ATM quality, telephone banking, customer perception of price and services, customer satisfaction, trust, responsiveness, reputation, assurance and web store policies (Johnson et al.,2001;Madu and Madu, 2002, Yang et al.,2004;Al-Hawari et al. 2005;Gupta and Zeithaml, 2006). Service quality is found to be a strong predictor of customer satisfaction (Cronin et al., 2000) Hence, this research provides a significant contribution for service quality and observing its hypothesized positively impact on customer satisfaction and trust. Thus, the following hypotheses are formulated:

H4. Service quality positively influences overall satisfaction.

H5. Service quality has a positive effect on trust.

#### **Concept of trust**

Many researchers define trust as a belief in a persons' competence to perform a specific task or as a willingness to rely on or to depend on an exchange partner in whom one has confidence (Morgan and Hunt, 1994: Kim and Prabhakar, 2002: Dimitriadis, 2011) The belief-sense of trust is the most important factor that influences a user to use e-banking, while a

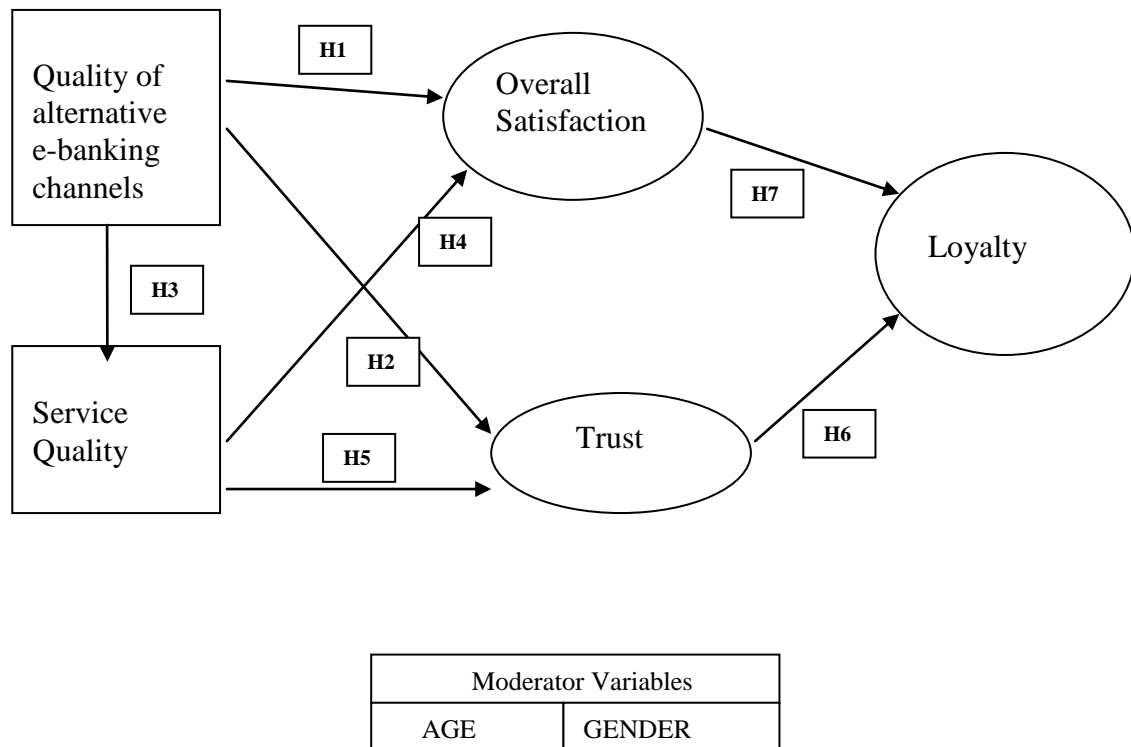
second factor is the quality of overall service that a bank offers. In addition, a constant service and infrastructure delivery assurance (Structural assurance/situational normality) as well as friendliness and reputation positively affect the sense of trust (Mols, 1998; Pavlou, 2002). Finally, Law (2007) reports additional factors such as corporate identity, marketing strategies and means of communication underlying the security and communication speed features. For many practitioners trust is a key variable shaping attitudes, behavioral intentions and tendency for recurring purchases towards e-banking services and specifically SST (Self-Service Technology) bank channels (Yang et al. 2006; Dimitriadis et al., 2011). Lowering perceived risks associated with online transactions as well as strengthening the trust of customers' that the transactions are secure and safe is the key components to attract and retain customers loyal (Floh and Treiblmaier, 2006). Based on this background and following Floh and Treiblmaier, the present study poses the following research hypothesis:

H6. Trust has a positive impact on customer e-loyalty

### **E-loyalty**

Oliver (1999) refers to customer loyalty as "a deeply held commitment to re-buy or re-patronize a preferred product or service consistently in the future, despite situational influences and marketing efforts having the potential to cause switching behavior". In addition e-loyalty is defined by Chang and Chen, 2008 as a favorable customer's attitude toward the e-store that predisposes the customer to repeat buying behavior. A number of practitioners support that internet firms have a growing ability to tailor their services to specific customers' needs through personalization technologies with the expectation that these technologies will lock the customer and remain loyal to them (Srinivasan et al., 2002; Chang and Chen, 2008). Additionally, the concept of loyalty has been the subject of several investigations, which assert that on the Internet apply the same rules as in the offline market. Specifically, early losses, which are caused by expenses for acquiring new customers, are followed by rising profits, due to the high ratio of repeat sales, and the tendency of loyal customers to recommend their online provider to other customers (Reichheld and Scheffer, 2000; Zeithaml et al., 1996; Gefen, 2000; Floh and Treiblmaier, 2006). Finally, several factors are found to moderate attitude towards intention to adopt e-banking services and remain e-loyal namely age, gender, involvement, technology readiness and social influence (Kleijnen et al., 2004; Floh and Treiblmaier, 2006). Based on the studies referenced above, this study suggests that customer satisfaction affects e-loyalty. Thus, this study hypothesizes that:

H7. Customer satisfaction has a positive impact on customer e-loyalty.

**Graph 1****(Floh & Treiblmaier, 2006)**

## Research Methodology & Data

This study is an empirical investigation using a structured questionnaire that was delivered by email mostly to internet users randomly selected during February and April 2011. The scope of the study was explained in a cover letter and the sample of the research consists of 153 customers of various banks who reside in the region of Eastern and Central Macedonia in Greece. As a whole, the questionnaire consists of 41 questions. The first 10 questions extract information for the characteristics of the people who fill in the questionnaire and the other 31 are used for the measurement of several variables of the research. The measurement of, quality of alternative e-banking channels, service quality and overall satisfaction was carried out using a 5-grade Likert scale, from (1) to (5), where (1) stands for strongly disagree and (5) stands for strongly agree, while the measurements of factors such as trust and loyalty were carried out using bisecting questions. Before the conduct of the research, the questionnaire was tested for its content validity, its reliability and internal consistency.

Additionally, a test of the unidimensionality structure of the elements that comprise every factor and a reliability test of every single variable were carried out to determine the construct validity of research variables. An Exploratory Factor Analysis was applied to carry out this specific test. Among 24 determinant variables used for the measurement of quality alternative e-banking channels, quality service, overall satisfaction factor and the trust factor in the Correlation Matrix table, seven items were found inappropriate and were excluded as Sig.(1-



tailed) $>0,05$ . Then, the reliability, the relevance and the stability of variables measurements were tested using the Cronbach's  $\alpha$  coefficient. The concluded results are shown in the following Table 1:

*Table 1: Reliability & Unidimensionality Structure Test*

<i>Factors</i>	<i>Cronbach Alpha</i>	<i>Kaiser-Meyer-Olkin</i>	<i>Bartlett's Test of Sphericity</i>	<i>Eigen ValuesS</i>	<i>% of Variance</i>
<i>e-banking channels</i>	<i>0.848</i>	<i>0.799</i>	<i>1.352E3/ p=0.001</i>	<i>5.350</i>	<i>22.84%</i>
<i>Satisfaction</i>	<i>0.790</i>			<i>3.236</i>	<i>18.83%</i>
<i>Trust</i>	<i>0.744</i>			<i>1.672</i>	<i>13.73%</i>
<i>Q.- service</i>	<i>0.701</i>			<i>1.058</i>	<i>11.15%</i>

Furthermore, T- tests used to calculate whether the averages of two sets of observations differ significantly from each other. The difference between two samples is considered statistically significant in T-tests when is such that it can not be due to random sampling factors. Moreover,  $X^2$  was used to compare the frequency of cases in the sample of participants (men and women of various ages), if they differ significantly from each other. Finally, logit analysis was used in order to construct a prediction model for the adoption and loyalty of e-banking by consumers. Logit analysis is the logistic transformation of the ordinary regression model used for the prediction of the probability  $\pi$  of success (prediction of loyalty) when the dependent variable is a binary variable. The logistic regression model has the following form:

$$\text{logit}(\pi) = \log[\pi / (1-\pi)] = a + b_1X_1 + b_2X_2 + b_3X_3 + \dots + b_nX_n = Z$$

where  $\pi/(1-\pi)$  is the odds ratio,  $a$  represents the intercept,  $x$  represents  $n$  independent variables and  $b$  represents  $n$  regression coefficients. The formula expressing the logistic regression model directly in terms of  $\pi$  is

$$\pi = e^z / (1 + e^z) = 1 / (1 + e^{-z})$$

where the probability  $\pi$  of success (prediction of loyalty) falls between zero and one when the value of  $Z$  ranges from  $-\infty$  to  $+\infty$  for all  $x_n$  values (Agresti and Finlay, 1997). The relationship between the dependent variable and the independent variables is a non-linear sigmoid relationship.

## Results and Discussion

In the following section we report the descriptive statistics of our survey and the results of our survey. First, Table 2 presents the most important variables of the descriptive statistics. Second, the measurement model is evaluated and local fit indices are discussed. Finally, we present the logit analysis to examine the pattern of variables that best distinguish loyal consumers to e-banking from those who are not.

Table 2: Descriptive Statistics

Variables		N	%
Gender	Male	65	42.5%
	Female	88	57.5%
Age (18-54)	25-34	98	64.1%
	35-44	42	27.5%
	45-54	12	7.8%
Education	High School	10	6.5%
	University	74	48.4%
	Master	69	45.1%
Computer Knowledge	Medium	30	19.6%
	Very Good	104	68%
	Excellent	19	12.4%
Frequency of use	3-10 Hours/ Week	46	30.1%
	10-20 Hours/ Week	38	24.8%
	20+ Hours/ Week	60	39.2%
Reasons of use	Ease of Use	115	61.25%
	Accurate Info	26	13.8%
Frequent transactions	Bill Payments	88	34.0%
	Money transfer	69	26.6%
	Question of Balance	38	14.7%

As can be seen in Table 3, it is concluded that there is a statistical significant difference between the mean value of Quality of e-banking channels of those who are overall satisfied and those who are not. In other words, the people who are overall satisfied is due to satisfaction from the provision of simplicity in their transactions, speed, pleasant content, ease of use, immediacy and time saving from the use of alternative e-banking channels than those who are not willing to use e-banking. Moreover, there is a statistical significant difference between the mean value of Quality of e-banking channels of those who are filling trust and those who are not. Hence, the people who are filling trust consider Quality of e-banking channels far more important than the people who are not filling trust.

Furthermore, there is not a statistical significant difference between the mean value of Quality of e-banking channels and the mean value of service quality. Additionally, there is not a statistical significant difference between the mean value of service quality and the mean value of overall satisfaction. Evidently, those who are overall satisfied and those who are

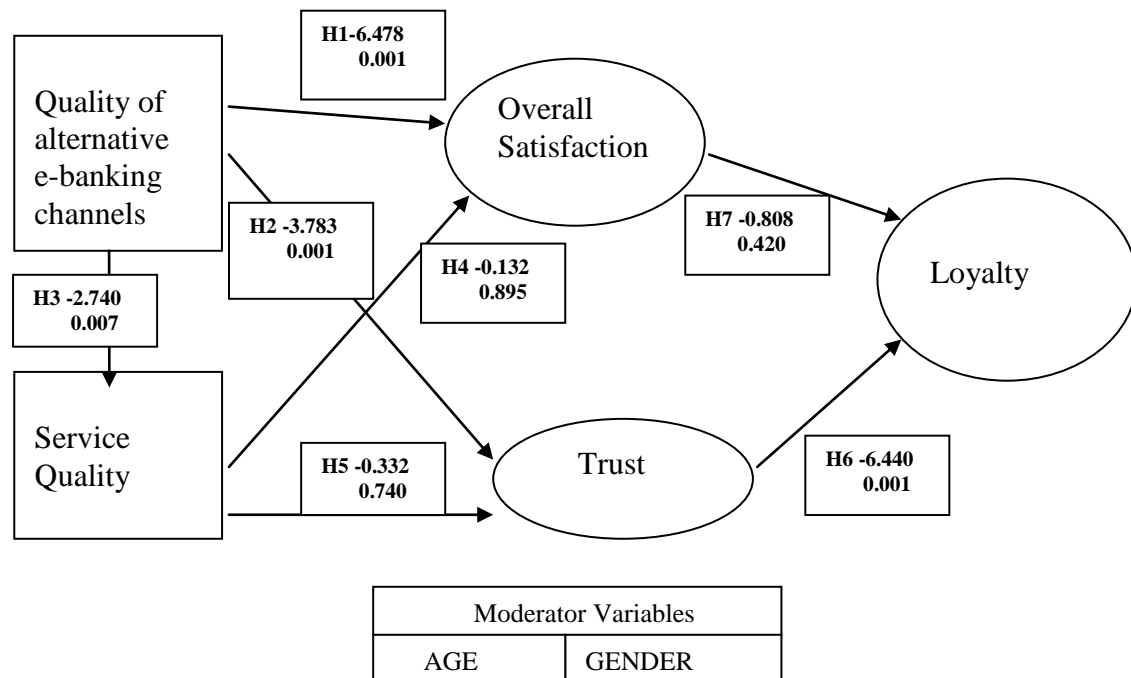
dissatisfied, their opinion do not affect from the quality of service. Moreover, there is not a statistical significant difference between the mean value of service quality and the mean value of trust. Therefore, service quality has no influence over consumers who trust or not, the use of internet banking. Furthermore, there is a statistical significant difference between the mean value of trust of those who are loyal and those who are not. That means, that consumers who are loyal towards a bank, consider trust as an important factor to conduct their banking transactions through its e-banking channels and vice versa. Finally, there is not a statistical significant difference between the mean value of overall satisfaction of those who are loyal and those who are not. In other words, overall satisfaction has no effect on those who are loyal or not towards a bank organization.

Table 3: Results of Independent Samples T Test

			<i>t</i>	<i>DF</i>	<i>Sig.(2-Tailed</i>	<i>Mean Diff.</i>	<i>Std.Error Diff.</i>
	<i>Dependent</i>	<i>Independent</i>					
H1	Overall satisfaction	Quality of e-banking channels	-6.478	151	<i>p</i> =0.001	-0.395	0.061
H2	Trust	Quality of e-banking channels	-3.783	151	<i>p</i> =0.001	-0.368	0.097
H3	Service Quality	Quality of e-banking channels	-2.740	151	<i>p</i> =0.007	-0.791	0.288
H4	Overall satisfaction	Service Quality	-0.132	151	<i>p</i> =0.895	-0.009	0.071
H5	Trust	Service Quality	-0.332	151	<i>p</i> =0.740	-0.035	0.105
H6	Loyalty	Trust	-6.440	42.60	<i>p</i> =0.001	-0.279	0.043
H7	Loyalty	Overall satisfaction	-0.081	151	<i>p</i> =0.420	-0.118	0.146

Graph 2

(Floh &amp; Treiblmaier, 2006)



In Table 4, there was a significant dependence on gender and preference for using or not the internet banking ( $X^2 = 10.88$ ,  $df=1$ ,  $p=0.001$ ). While on the other hand, there was not found a significant difference between observed and expected frequencies of ages in their preference to use or not internet banking

Table 4: Results of $X^2$ Analysis					
	Male	Female	$X^2$	DF	Sig.(2-Tailed)
Use I. B	56	56	10.882	1	0.001
Non-Use I.B.	8	32			

Vis-à-vis model construction, the independent variables of trust, quality of alternative e-banking channels and gender are statistically significant for the prediction of e-loyalty. The preceding independent variables of the logit model predict 97,3% of the loyal customers and 75,6% of the customers who are not loyal leading to a weighted average of 91,5% accuracy ratio. Accordingly, the probability to classify a disloyal customer as a loyal one (Type I error)

is 24,4% while the probability to classify a loyal customer as a disloyal one (Type II error) decreases to 2,7%. The robustness of the logit model can be perceived as adequate since the Nagelkerke R<sup>2</sup> is 60,7%. Nagelkerke R<sup>2</sup> is a pseudo R<sup>2</sup> statistic which is an approximation of R<sup>2</sup> for the linear models when the dependent variable (consumer's e-loyalty) is categorical. A summary of the preceding analysis is embedded in Table 5.

<i>Table 5</i>		<i>Logit model</i>	
<i>Variables</i>	<i>Coefficients</i>	<i>Significance</i>	
<i>Intercept</i>	-19,351	0,000	
<i>TRUST</i>	8,029	0,000	***
<i>QUALITY ALTER</i>	2,728	0,001	***
<i>GENDER</i>	-2,582	0,000	***
<i>Nagelkerke R<sup>2</sup></i>	0,607		
<i>Overall Accuracy</i>	0,915		
<i>Type I error</i>	0,244		
<i>Type II error</i>	0,027		

Note: \*\*\*  $P < 0,01$ .

## Managerial Implications and Conclusions

The goal of this study was to examine the impact of the implementation of innovative electronic communication strategies to attract new customers and to satisfy the existing ones and to investigate the impact on quality of online banking services on customer's e-loyalty and overall satisfaction.

Toward that goal, the research model of Floh and Treiblmaier, was adapted, in order to assess its parameters and investigate how they change and if they are applicable on the Greek banking sector. Data collected by email mostly to internet users provided empirical support for this aim. The evidence obtained showed that, the model was partially confirmed, the researchers asserted that "loyalty of e-banking customers is directly affected by satisfaction and trust in an online bank, which in turn are determined by Web site quality and service quality. Moderating variables such as gender, age, involvement, variety seeking behavior and technophobia exert a significant influence on some relationships".

Comparing the results of this study, with the empirical findings of Floh and Treiblmaier, we similarly concluded that, trust is a critical key factor on the establishment of e-loyalty of e-banking customers while not confirmed the correlation of overall satisfaction with e-loyalty. Researchers support that, determinants such as security and privacy policy of the e-banking include, personal data being transferred to others without permission, unprotected transactions and personal information being stolen by hackers have a negative effect on trust and the intention to conduct transactions (Pavlou, 2003; Lee, 2009; Lu et al., 2011). Therefore to

create e-loyalty, bank organizations must meet the potential needs of customers and increase their confidence to discourage their switching to competitors. Moreover, the results indicate that trust is affected by quality of alternative e-banking channels whereas service quality has no influence on overall satisfaction. Some customers seem to perceive no relative satisfaction in switching from offline banking to online alternative banking channels. Many prefer the old habits or consider mobile banking, web-banking, ATM's, inconvenient, complex, difficult in use and most important unsafe and sometimes costly. Despite the advantages of the web channel, some customers exhibit resistance due to both psychological and functional reasons, to high purchasing costs of a computer and internet connection and also to learning requirements of the new channel, (Ram and Sheth, 1989). Understanding the nature of lack of satisfaction and of resisting to internet banking service, is of value to banks and it is imperative for them to take this into account early enough when they create tactics to implement new internet banking service channels (Kuisma et al., 2007).

Additionally, effects of quality of alternative e-banking channels on overall satisfaction were observed. The acceptance of alternative e-banking channels depend on user performance whether they accomplish their operations or not, and the characteristics of online banking concerning, ease of use, access, validity, immediacy, accuracy, pleasant content, easy navigation, timely and comprehensive information, high technology infrastructure, time savings and simplicity in processing transactions. On the other hand, quality of alternative e-banking channels had no influence on service quality which in turn had no effect on trust. The existing literature has suggested that, for adoption of internet banking, customers should be aware of the availability of quality services. Moreover, banks should, actively offer guidance education and free access to a trial, related to online banking services and explain how they add value relative to other ways of conducting offline transactions through different communication strategies such as active one-to-one marketing actions (e.x., word-of-mouth advertisements, opinion leadership, incentive programmes) or mass media actions (publicity releases, media reports and other) (Laukkanen et al., 2009). In addition, as more and more customers trust to conduct their banking transactions through alternative e-banking channels, and internet banking becomes popular and has diffused to a large proportion of the population even the sceptical non users will differentiate their views and converge to this of the users. Finally, the moderating variable of gender had a significant influence over the use or not of internet banking whereas age had no effect. In particular males have different preferences from females; therefore banks in order to attract customers should offer more alternative services through e-banking channel and highlight the benefits that affect the intention to use for its sex, using customized marketing communication strategies.

A number of issues remain to be addressed. The discussed findings were obtained from one study that targeted a specific group, thus continued research is needed to generalize our findings. Further investigation is needed for additional variables that can predict more

accurately the intention of e-loyalty. Additional research is a necessary next step to evaluate the validity of our findings and enhance our understanding of the correlations between variables that are important for consumer's loyalty towards internet banking

The adoption of innovations accepts resistance thus it requires the bank organizations to continue provide the existing services to customers. Regardless the ease of use, the lower costs and the financial benefits of adopting the internet banking, banks still have to offer traditional payment services in order to meet the needs of those customers that are not ready to accept the new channels. Finally, future research can explore additional antecedents and factors shaping customer attitudes, behaviors and intentions to use e-banking different services.

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## A PRELIMINARY STRATEGIC MARKETING FRAMEWORK FOR NEW PRODUCT DEVELOPMENT

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### Abstract

This article responds to the identified considerations and gaps in existing research on the way a new idea is transformed into a market-accepted new product. Utilizing the findings of an extensive theoretical analysis and empirical investigation on the subject, this research studies new product development within a wider strategic marketing context. The research interrelates three different perspectives: the 'process-defining' perspective, that identifies and refines the managerial implications and theoretical considerations; the 'value-defining' perspective, which investigates the various types and stakeholders of value; and the 'context-defining' (contemporary consumer behavior and strategic marketing) perspective, which positions the entire innovation process within the comprehensive set of environmental and organizational processes and factors. The paper concludes with the development of a preliminary 'Contemporary Strategic Framework for New Product Development'. The framework answers the various theoretical considerations on the subject, incorporating the various processes' stages and interrelationships within a single descriptive system. Additionally, it provides constructive functional managerial value through potential practical implementation and prescriptive interpretation.

**Keywords:** New Product Development, Strategy, Marketing, Value, Framework, Innovation, Idea, Creativity, Exploration

### Introduction

The first part of this research (Yahiaoui et al., 2011) has undertaken theoretical and empirical research that improved our understanding of the process, through which new market-accepted products are developed; identifying in parallel its theoretical underpinnings and managerial implications.

The research's findings have expanded our knowledge on the subject, and made the various aspects of the process more distinct. As it often occurs in such cases though, the findings also gave rise to the need for substantial considerations in the overall manner that organizations practically deal with the wider process of new product development (NPD). Further to these managerial implications, considerations of a scholarly/scientific nature were

also identified. Considerations, which become the focus of this paper; and which constitute the first exploratory step towards the construction of a comprehensive Contemporary Strategic Marketing Framework for New Product Development.

Perhaps, more importantly than any other issue on the subject though, is the realization that the epicenter of innovation is 'value' and that this also has a context. A context shaped by consumer behavior and all the macro- and micro-environmental factors affecting it (Thrassou, 2007; Vrontis and Thrassou, 2007; Thrassou and Vrontis, 2009). Instead of, therefore, continuing to focus on the various NPD processes and sub-processes, this paper follows a 'zoom-out' path. This reverse direction allows the understanding and definition of the factors that create the value offered to value stakeholders (Vrontis and Thrassou, 2010) and thus, ultimately, 'add value to value itself' (Yahiaoui et al., 2011).

The aim of this research is to examine the new product development process through different perspectives, and to resynthesize it within a wider strategic marketing context.

Towards this aim, five objectives have been set:

- To present an extensive literature review, that will set the research's theoretical foundations and will help define and interrelate the various product development process concepts and sub-processes.
- To identify and refine the 'process-defining' perspective managerial implications and theoretical considerations (gaps).
- To describe the 'context-defining' (contemporary consumer behavior and strategic marketing) perspective, that will position the entire innovation process within a comprehensive set of organizational processes and forces.
- To examine and define the 'value-defining' perspective, that will identify and interrelate the various types and stakeholders of innovation value.
- To develop a comprehensive preliminary 'Contemporary Strategic Framework for New Product Development', that will answer the various theoretical considerations on the subject, and provide constructive functional managerial value.

## **The Process-Defining Perspective (Objectives 1 and 2)**

### **Introduction**

Reviewing existing research on creativity and innovation, depicts that these two fields are often studied separately and that their understanding and definition among researchers, are frequently ambiguous. Indeed, the innovation process has, for a long time, been described as sequential and linear since it creates value through the implementation and use of one or several ideas (Van de Ven et al., 1989). Criticized by evolutionists (Nelson and Winter, 1982; Dosi, 1982) and neo-Schumpeterians (Kline and Rosenberg, 1986), innovation became a part of an interactive process based on learning (Roozenburg and Eekels, 1995; Hatchuel and Weil,

2003). Thus, we can consider innovation as a process of value creation, through the implementation and setting of one or several ideas. Certainly, this evolution bestows a central role to the conception and birth of ideas, but it does not integrate creativity into the innovation process. Several researchers who studied the characteristics of individual and collective creativity (Pelz and Andrew, 1966; Amabile, 1997; Woodman et al., 1993; Majaro, 1992; Styhre and Sundgren, 2005) consider creativity to be a process in itself, independent of the innovation process. The first part of this research though (Yahiaoui et al., 2011), concluded that this does not necessarily relate to the existing, practically implemented, innovation process in organisations; and that very little research has studied the path from creativity to innovation (Staw, 1990, Flynn et al, 2003, Hatchuel et al. 2003).

### **Creativity**

The researchers in the fields of individual and organizational creativity endeavor to answer the question, “How are ideas born?” This question is linked with the genesis of novelty, as introduced by Lecoivre and Verstraete (1998). The generation of ideas is a matter of creativity, and several authors have accented the confusing border between it and innovation (Woodman et al., 1993; West and Farr, 1989; Ford, 1996; Hauch, 2002). Creativity has been studied at the individual level (Pelz and Andrew, 1966; Amabile, 1997) or the collective and organizational level (Woodman et al., 1993) in connection with the management of innovation. These authors define organizational creativity as the creation of new products, services, ideas or useful processes on behalf of individuals working together in a complex social system (Woodman and Sawyer, 1993).

Creativity can be different according to the situation (Majaro, 1992). As Flynn et al. (2003) underlined, creativity can be reactive and answer to a specific need. Also, it can be exploratory and proactive, generating a large spectrum of ideas, not necessarily bound to demands or previous situations. In general, researchers converge to underline that creativity leads to the collection of information (preparation) and analysis (Incubation/Illumination) before being tested in the real world (Verification). Researchers have also studied the factors that encourage creativity (McFadzean, 1988) such as wishful thinking, unrelated stimuli and mind mapping.

Some researchers tried to link creativity with innovation. Amabile (1997), for example, suggested that creativity permits the production of new products, ideas, and services that could be implemented through an innovation. It was also suggested that creativity is connected to socio-cultural validation or even to acceptance by the social environment (Crompton, 1999). However, this research found that it is important to think about the modes that can be used to structure ideas and identify the axes of values, before moving on to the development. To make this possible, an intermediate phase seems necessary to study the path from creativity to innovation.

**From creativity to the innovation**

To think about the uphill phases of the innovation process, we have to study the generation, selection and assessment of ideas. Thus, creativity and the transition to innovation can take on a truly strategic character for all innovating firms. Some authors have attempted to integrate creativity into the process of innovation. Staw (1990), for example, proposed a model that considers innovation as the result of developing ideas in a specific context. Getz (2002) suggests that research and development (R&D) activity is removed from the reality of the market. That is why it should be included in what he called “the execution of the idea”. Creativity can even be considered as the first step toward “intrapreneurship” (Carrier, 1997) by making innovation more dynamic. Another important work has been presented by Flynn et al. (2003), who distinguish two main ‘innovation funnels’: one concerning the creative process and another transforming creative ideas into real innovations.

In spite all, the first part of this is research underlined the lack of operationalisation of the ideas’ transformation steps. According to Stoycheva and Lubart (2001), this transient phase is strategic because it can be included within a “pre-conception” logic: selecting projects, reducing risks and time to market (TTM). This research’s extensive review has encountered only one work (Hatchuel and Weil, 2003) that really covers this phenomenon. They showed that each enterprise must think about new creative tracks, without cutting down on planned objectives. Thus, they developed the R-I-D (Research-Innovation-Development) model. Embedded in collective action theory, this model marks the passage of the reflections dealing with innovation to those studying the innovating organizations. Their so-named “I” function consists of managing the “fields of innovation, which are conducive to new programs of product developments and new questions for research”. It creates value and manages the process of the emergence and structuring of new knowledge.

However, two remarks deserve to be looked at in more detail. Firstly, the authors evoke the “I” function (innovation) between the research and development stages. Secondly, they present this phase as a supplementary organizational system to establish innovation in less structured situations. Certainly the “I” function is important, but it focuses only on one dimension of this strategic activity. Thus, it is necessary to develop a deeper study of the modes of the transition from idea to product. It is in this setting that the first part of this research (Yahiaoui et al., 2011) undertook its empirical study.

**The Gaps – Managerial Implications and Theoretical Considerations  
(Objective 2)**

The findings of this research concluded that the concepts of ‘idea’, ‘creativity’, ‘innovation’ and others, are relatively extensively researched. At the same time there appear to be a number of matters that demand further research into these subjects.

As Yahiaoui et al. (2011) note, 'firstly, the various concepts are not defined, nor utilized in the same manner by the researchers. Secondly, a gap appears to exist in terms of the way that these concepts are transformed from the one into the other, especially the leap from 'new idea' to 'market-accepted product', or essentially, 'creativity' to 'innovation'. Thirdly, these concepts are not adequately intra-related i.e. their linkage within a defined process is still not distinct. Finally, these concepts are not adequately inter-related i.e. their relationship with other critical organizational functions, such as market/consumer research and R&D, within the wider strategic/marketing contexts, is also still not distinct'.

Through their empirical exploration into the creativity-to-innovation process, they found that the development of an idea into a real innovation (accepted by the market) must take place in the setting of a structured and organized process (also, Le Masson et al., 2006). The potential paths of innovation though, do not emerge in a spontaneous way. The ideas are studied in a pre-conceived way within the business test (market opportunity) phase. Customers play a very important role in testing the commercial feasibility of new ideas. This role recalls the notion of "lead user" introduced by Von Hippel (1978, 1986). In this setting, a distinction is made between the customers who think and conceive new products, from the "early adopters" or precocious purchasers.

The exploration of new tracks of innovation requires the mobilization of customers, as well as partners from different fields: research, development, marketing and design. Based on this finding, it is indicated that for the best results from this intermediate step, works must better be project-based (also, Midler, 1993; Azan and Mayrhofer, 2003; Garel et al., 2004). Finally, the ideas become "pre-concepts" that are better refined and enriched with potential business value. This approach can be called piloting by learning (also, Hatchuel and Weil, 2003). Adjacent to the project mode, a second organizational feature characterizes exploration: the creation of a structure exclusively dedicated to this activity. Its importance deserves to be emphasized, noting also the thin and obscure line that divides technological and organizational innovation (also, Damanpour, 1991).

The main features of the exploration process are summarized in the table 1.

<i>The exploration criteria</i>	<i>New concepts with business potential: risks of use, business case (target, business model, positioning), design, technology</i>
<i>The actors (participants)</i>	<i>Customers (creative users and ambassadors), designers, ergonomists, marketing managers, partners, R&amp;D engineers...</i>
<i>Structure and organization of the activity</i>	<i>New structure : The explocenter Projects and co-localized teams (Core team &amp; Circle 2) Trial-and-error process Coordination through the exploration file (DEX)</i>
<i>Governance</i>	<i>Method of governance «venture capital» Sponsor from the technocenter (development)</i>
<i>Added value to the innovation process</i>	<i>Accelerating the transformation of ideas (more mature concepts) Improved view of the relationship between projects and the strategy of the company Better selection of concepts with great business potential</i>
<i>Results and concepts</i>	<i>Swarmed concepts Capitalized concepts Transformed concepts</i>

Table 1: Synthesis of the characteristics of the exploration activity (Source: Yahiaoui et al., 2011)

The research underlines the importance of interconnecting creativity and conception within the innovation process. It further proposes an operationalization of this strategic step for firms. On the theoretical level, it links two fields of research that have been disconnected until now.

For managers, this research highlights the necessity of creating exploration activity in order to bring to maturity the ideas and concepts for organisations. This “pre-conception” step can be organized at several levels: the axes of exploration (technology, business), the participants (customers, managers), the organizational pattern (new structure, standardization of the procedures, project) and the mode of governance.

Most importantly though, the research has pointed out the the need for substantial considerations in the overall manner that organizations practically deal with the wider process of new product development. Regarding these managerial implications, Yahiaoui et al. (2011) state that: ‘irrespective of the theoretical taxonomy, classification and categorization of the components and steps comprising the ‘idea to innovation’ and wider NPD processes; individual organizations need to redefine and reorganize their processes based on their individual characteristics, resources and strategic aims. The refinement of the processes at a scholarly level is a useful knowledge foundation; on which nonetheless, organizations need to build their own practical implementation’.

This, second part of the research, has combined the theoretical and managerial gaps, implications and considerations developed by Yahiaoui et al. (2011); and reorganized them into three categories of research perspective requirements regarding the wider NPD process:

the 'Value-defining' ones, the 'Process-defining' ones, and the 'Context-defining' ones (table 2).

	<i>Research Perspective Category</i>	<i>Requirement</i>
	<i>Value-Defining</i>	<i>Breakdown the concept of 'value' in relation to each of the value stakeholders, both within and outside the organization e.g. value to existing customers, potential customers, employees, associates, departments, the public, society, the industry etc</i>
		<i>Breakdown the concept of 'value' in terms of value type e.g. financial, time, effort, psychological, image, social/ethical, functional, technological, infrastructural, knowledge etc.</i>
		<i>'Evaluate value' i.e. develop a way to decide on the absolute and relative importance of each value type and for each value stakeholder.</i>
		<i>'Transcribe value' into a single currency i.e. develop a way to objectively and if possible quantitatively measure each value type in a manner that allows direct comparison between benefits/options.</i>
	<i>Process-Defining</i>	<i>Focus even more greatly on the NPD process and its potential constituent components, such as innovation, creativity, exploration, R&amp;D etc.</i>
		<i>Understand these components, place them within a single, unified and comprehensive process, and define the role and function for each, specifically for each organization at hand.</i>
		<i>Organize the practical implementation of the whole transition process, in a manner that makes both practical and economic sense.</i>
		<i>Theoretically position and test the 'idea to innovation' sub-process, within the more specific NPD process.</i>
		<i>Investigate the features of the 'exploration activity' presented earlier (Criteria, Actors, Governance etc), separately and adjacent to economic factors</i>
	<i>Context-Defining</i>	<i>Interrelate and 'synergise' the whole 'idea to innovation' sub-process with (and if needed incorporate into) the marketing research, R&amp;D and consumer analysis processes.</i>
		<i>Position and test the 'idea to innovation' process, within the wider strategic marketing context.</i>
		<i>Interrelate and 'synergise' the 'idea to innovation' process with the management and human resource contexts, as the value stakeholders of innovations / new products are often internal ones</i>
		<i>Answer the ultimately defining strategic-level question, adjacent to organizational culture: whether innovation / NPD are more consequent of abstract human qualities (creativity, vision, imagination, inspiration, ingenuity, inventiveness, resourcefulness), or methodical and mechanistic processes (market research, consumer profiling and analysis, idea filtering systems, etc).</i>

Table 2: The New Product Development Process-defining gaps (Developed Based on Yahiaoui et al., 2011)



## **The Context-Defining Perspective (Objectives 1 and 3)**

### **The Contemporary Markets' Consumer Behaviour**

The significance of consumer behaviour knowledge rests on the foundation of modern marketing philosophy which recognises the consumer as being the focus of marketing activity. In contemporary markets, consumers' influence on business has been steadily increasing over the past few decades, empowering and crowning them sovereigns among the forces shaping business environments (Schiffman and Kanuk, 2004; Kotler et al., 2005; Blackwell et al., 2006). The contemporary markets bear a number of characteristics that facilitate this phenomenon: high economic productivity and prosperity, the freedom that largely characterises business activity, high education and administration levels, technological superiority, the comparative importance of knowledge and information versus other economic factors, and a socio-cultural environment that supports personal and collective development and expression (Steiner and Steiner, 2000; Keegan and Schlegelmilch, 2001; Chan and Chui, 2004; Thrassou, 2007).

Furthermore, the usual cultural diversity of their population, the high per-capita-income and low inflation, the high labour costs and quality, the organisation of labour into powerful groups and the increased regulation of working conditions, the strengthening role of services (Keegan and Schlegelmilch, 2001; Fitzsimmons and Fitzsimmons, 2001; Paladino, 2005), the excellent infrastructure, the comparatively low/stable inflation and their stability and law supremacy are other characteristics that should be highlighted. The effect of these on behaviour is profound in every step of the consumer decision process, which distinguishes itself from the reciprocal ones in other countries on a number of factors (Laroche et al., 2003; Teng et al., 2007).

Additionally, contemporary developed markets differ with regards to personality influence on consumer behaviour chiefly in terms of attitudes and values in relation to social and personal freedom and dignity, respect toward the natural and built environments, the drive for achievement and others (Cronin et al., 2000; Mukherjee and Hoyer, 2001; Laroche, 2002; Maniyiwa and Crawford, 2002; Robbins, 2003; Laroche et al., 2003; McEachern et al., 2007; Thrassou, 2007).

Cultural and social factors are equally important and among developed countries there are commonly shared characteristics. Family influences are diminishing (Kotler et al., 2005; Blackwell et al., 2006; Thrassou, 2007), as are religious influences; though this pattern is neither absolute, nor clear, nor constant (Solomon, 2007). In developed countries, national culture is another factor with diminishing influences; this being a distinctly separate phenomenon to nationalist feelings/tendencies and their observed increase or decrease. On the other hand cultural diversity within developed countries has in fact increased the effect on behaviour of nationality-based subcultures (Schiffman and Kanuk, 2004; Angelis et al., 2005).

Finally, the influence of education on consumers is increasing, not only because of rising standards, but also because of the nature of education in contemporary markets. Education walks hand in hand with empowerment and the perception that citizens self-develop both as individuals and in their capacity as consumers (Vittell, 2003; Henry, 2005; Blackwell et al., 2006; Vrontis and Thrassou, 2007). Finally, reference groups tend to significantly influence an individual's behaviour through socialisation, self-concept, comparison, conformity and role models (Maniyiwa et al., 2002; Laroche et al., 2003; Kotler et al., 2005; Zeithaml et al., 2006).

These differences not only result in different motivators (Rayner and Easthope, 2001), but also in considerably more complex motivational processes; themselves resulting in both quantitative and qualitative upgrades in the consumer decision-making process (CDP) of a developed-country consumer (Yi and Baumgartner, 2004; Esch et al., 2006). The contemporary markets' CDP therefore, is found to differentiate itself in three ways: its complexity, its upgraded significance to marketers, and the fact that the majority of consumption relates to the satisfaction of 'higher' needs (Rayner and Easthope, 2001; Blackwell et al., 2006; Zeithaml et al., 2006).

The findings show that the causal factors of behaviour are embedded in all collective levels and dimensions (social, cultural, economic etc), but that their effect is direct on the beliefs, attitudes, perceptions, feelings, actions and all other components of individual behaviour. For developed markets, with few concerns for immediate needs towards survival, consumerism appears to have become an end in itself, and through it, consumers find a voice of expression, the way to promote their understanding of a better society, an abstract escape from the predetermined, and the means to build an identity for themselves. The choice belongs to the consumer and the consumer alone, but the context and content belongs to the businesses. The above lead to the conclusion that exhibited individual consumer behaviour is moulded by its social context, but also by the reciprocal businesses' behaviour. So although the social context may be similar, businesses' behaviour is in fact a critical factor of individual consumer behavior.

This relationship therefore, between consumers and businesses, is one that must be better understood if the context-defining (as well as the value-defining) perspectives are to be truly understood.

#### **Business Versus Consumers: a Balance-of-Power Relationship Interpretation**

Vrontis and Thrassou (2007) found that the highly competitive environment necessitates for businesses, both the understanding of the nature of demand and the ability to satisfy it. Intense competition means that greater value is frequently offered through means such as innovation (Mukherjee and Hoyer, 2001), augmented products/services/ideas, customisation, personal attention, convenience and others (Naumann et al., 2001; Thøgersen and Olander, 2002). Furthermore, simply meeting expectations is often not enough. Organisations have to surpass expectation to meet the prerequisites of quality (Foreman, 2000; Naumann et al., 2001;

Gupta and Lehmann, 2002; Blackwell et al., 2006). An additional option is the ability of organisations to create value through the building of an appropriate brand image that is perceived as transferable to the individual. In a developed world dominated by media and other communication channels, perception often becomes a more critical parameter than reality itself (Naumann et al., 2001; Palmer and Ponsonby, 2002; McCullough, 2004).

Thus, consumers and businesses co-exist in a dynamic equilibrium of influence and interdependence. The question no longer is 'how can organisations utilise marketing knowledge to affect individual behaviour', but rather 'how can organisations understand and predict individual behaviour in order to sustain a two-directional value-adding relationship'.

Vrontis and Thrassou (2007) proposed the 'fundamentals' of the evolving organisation-individual relationship in developed countries as being:

- individuals will be in an even better position to demand what they want, both in terms of quality and customisation
- the incessant change means that strategic marketing will probably rest its construction of the relationship, not so much on foresight as much as on reflex-like adoption to occurring changes
- individual 'Needs' are all the more manifested into 'Wants' which are intangible, of obscure value, affective in nature and of course naturally much more vulnerable to marketing communications and other techniques that shift power back towards the business end
- ethics and social responsibility will continue to become stronger and more integrated into organisational behaviour, but overwhelmingly in the most 'visible' areas of organisational activity
- organisations will strive to add value to products and services through the creation of 'brand personalities' and the building of associations with lifestyles and other anthropomorphic characteristics.
- Differentiation and added value will potentially be partial results of marketing approaches aiming to create perceptions rather than tangible effects.

They schematically portrayed the present (parallel existence) of businesses and consumers and continued to construct a predictive framework that encompasses the two entities into a new co-existence. The latter portrays consumers and businesses acting continuously as equal and opposite forces, resulting in a centrifugal equilibrium whereby 'balance' is the 'spinal column that acts as the prerequisite, the aim and the consequence of the relationship' (figure 1).



though, Kotler et al (2005) as well as most other 'principles of marketing' and 'strategic marketing' books provide all the needed material toward the construction of the Contemporary Strategic Framework for New Product Development. Instead, more effectively, this paper is confined to presenting existing theory on services marketing small firm marketing; two subjects which individually or combined relate to the majority of businesses. The consideration of their marketing differentiating attributes therefore, within the proposed framework, should be considered an imperative and not a contingency. Additionally, special emphasis is placed on the marketing communications of these firms as this has been found (above) to be a primary tool towards consumer understanding and perception management.

The review of services marketing theory, as developed by many authors, including Guttman (1987), Lovelock (1996), Lovelock and Wright (2002) and Zeithaml et al. (2006), surfaces a number of important points. The first one is the intense perception of the environment as physical and non-physical with the latter naturally presenting complications both in its definition and analysis. The second point is the internal marketing's upgraded value which is directly related to the emphasis placed on the non-physical environment. The third and most significant point though, is the importance placed on quality, the audiences' perception of quality and the organisation's management perception of target audiences' expectations. One cannot fail to observe that services have a strongly intangible nature, whose quality and essence relates considerably to perceptions; to a degree in fact, that strategic and marketing aspects of an organisation might be concentrated on communication of impressions as much as they should on the service itself. Additionally, McDonald and Payne (2006) support that only a minority of service organisations truly understand their audiences and have a strategic plan based on this understanding. They furthermore call for a dramatic need for improvement in their marketing effectiveness.

Zeithaml et al. (2006) identify the key reasons for service marketing problems as being: inadequate management of promises, inadequate management of customer expectations, inadequate customer education, and inadequate internal marketing. Additionally, the researches by Herrington et al (1996) and McArthur and Griffin (1997) concluded that instead of generically applying idealised planning procedures, the individual managerial attributes and organisational resources need to be considered in the development of strategic marketing planning activities.

Thrassou and Vrontis (2006) find that the complex and specialised nature of professional services' SMEs necessitates a marketing mix that will primarily inform, educate and consult audiences. Furthermore, marketing communications stipulated as the means of both receiving the necessary information and transmitting it successfully, towards controlling consumers' attitudes, beliefs and feelings. Finally, word-of-mouth is found to be relatively more important to small organisations while the reliance on opinion leaders appears to also

be more frequent. Similar conclusions are drawn through the review of work by Schiffman and Kanuk (2004), Hawkins et al (2004) and Solomon (2007).

Longenecker et al (2003) conclude that small businesses are limited in their design of the marketing mix by the limits of their resources and that the higher the value offered by the product to the audience, the greater the importance of personal communication. Said (2000), identifies a number of SME generic marketing characteristics, including: a lack of proper marketing practices; a market competitive situation that is becoming more vulnerable to liberal trends; and a contradiction between the realisation of the need for more, faster and better market (and marketing) knowledge and information on the one hand, and an apparent unwillingness to pursue this on the other.

A review of “classical” theories on small businesses, including the authors Beckhard et al (1987), Burns et al (1989); Stevenson (1991), Sahlman and Stevenson (1992), Barrow (1993), Julien (1993), Dewhurst et al (1993), Ballantine (1993), Fuller,(1994), Storey (1997), Shutt (1998), Wickham (1998) and Longenecker et al (2003), further gave rise to two critical questions. The first relates to the degree to which a small business is able to affect its market, which varies according to the structure of the specific market; and second is whether the business is small as a matter of choice or ability. Additional issues identified include the market size, the concentration of small businesses and the degree and nature of cooperation between businesses.

Finally, Thrassou and Vrontis (2006), relying also on the work of Yisa et al. (1996), McArthur and Griffin (1997), Kitchen (2001), Pickton and Broderick (2001), Smith and Taylor (2002); Fill (2002), Reedy and Schullo (2004), Thrassou (2005), and Thrassou and Lijo (2007) pinpoint a number of attributes that largely define small service businesses marketing communications. Specifically, they note that personal communication tools should bear greater relative weight and elements that can substitute for the intangibility deficiencies should be given greater relative attention. Client education and training should be a primary aim, owing to the audiences’ subjectivity of attitudes and beliefs. Internal communication should be an integral part of the marketing mix, though not necessarily a separate tool. Focus is noted as a primary means to achieving stronger and more effective communication, and electronic communications and word-of-mouth should be at the same time tools, but also targets. In SME-dominated environments, small businesses may undertake competitive roles such as ‘leadership’ which are normally unattainable. Finally, but most importantly, although communications are normally a process within the wider marketing strategy, for small businesses communication capabilities may actually dictate the strategy.

### **The Value-Defining Perspective – Towards a Preliminary NPD Framework (Objectives 4 and 5)**

Having examined the new product development process and its context, this research appears ready to propose a preliminary Contemporary Strategic Framework for New Product

Development. At the same time though, the factor of 'value', which originally figured as just another parameter, keeps emerging as a critical and defining one. The above works and models have consistently revolved around the concept of 'value' as both the cause and effect of new product development, both from the consumers' side and the producers'. Though the evidence is there, this research has not uncovered any taxonomy or categorization of 'value' that incorporates both the 'type' and 'stakeholders' of value regarding the NPD process.

It is therefore an imperative, that before the construction of a preliminary Contemporary Strategic Framework for New Product Development, the research should bring forward the evidence in existing literature regarding 'value'; and attempt its theoretical amalgamation and ultimately its integration into the proposed framework. One observation regarding the subject, is that 'value', while being frequently referred to, is rarely defined. This is understandable since to define value one needs a context; and research concentrating on NPD would not shift focus nor 'de-focus' to define contexts. Thus the value of this specific research which aims exactly for that, thus allowing the definition of value in terms of types and stakeholders, within a wider strategic and macro environmental context.

Drawing from the literature review therefore this research is able to identify seven different main types of value stemming from the NPD process, and seven different main stakeholders (three external and four internal ones). Presenting the former vertically and the latter horizontally, along with the transcription of each interrelationship (table 3):

TYPICAL POTENTIAL VALUE THROUGH		EXTERNAL VALUE STAKEHOLDERS		
		Existing Customers	Targeted Customers	Society
V A L U E  T Y P E S	Financial	Lower price; lower running costs; lower replacement costs	Lower price; lower running costs; lower replacement costs	Indirect / ripple effect
	Time	Efficiency; speed; punctuality; multi-tasking; dual time utilisation	Efficiency; speed; punctuality; multi-tasking; dual time utilisation	Indirect / ripple effect
	Physical/ Sensory	Ease; comfort; noise and odors limitation; physical environment improvements	Ease; comfort; noise and odors limitation; physical environment improvements; physical ease of switching / joining	Indirect / ripple effect
	Mental	Simplification in information / selection / usage / support stages	Simplification in information / selection / usage / support stages	Indirect / ripple effect
	Psychological	Comfort; sensory positive stimulation; pressure minimization; safety; security; assurance / guarantees	Comfort; sensory positive stimulation; pressure minimization; safety; security; assurance / guarantees; switching / joining guilt elimination	Indirect / ripple effect
	Image	Status; prestige; self-image	Status; prestige; self-image	Indirect / ripple effect
	Function	Effectiveness; quality; multi- tasking; durability	Effectiveness; quality; multi- tasking; durability	Indirect / ripple effect

Table 3a: Integrated Value Types and External Stakeholders in the New Product Development Process Context  
(theory based - research composed)



TYPICAL POTENTIAL VALUE THROUGH		INTERNAL VALUE STAKEHOLDERS			
		Company – the employees	Company – the organizational system	Company – the economic entity	Company – the brand
V A L U E  T Y P E S	Financial	Higher income; improved benefits	Improved processes; higher human resource moral	Higher profitability; lower risk	Branding investment
	Time	Efficiency; task simplification	Efficiency; improved planning	Economic efficiency	Indirect branding attribute
	Physical/ Sensory	Improved environment	Improved quality; human resource efficiency / effectiveness / moral	Economic efficiency	Indirect branding attribute
	Mental	Stimulation; knowledge; experience	Improved quality; human resource efficiency / effectiveness	Higher profitability	Indirect branding attribute
	Psychological	High moral; internal social benefits	Improved quality; human resource efficiency / effectiveness	Economic efficiency	Indirect branding attribute
	Image	High moral;	Improved quality; human resource efficiency / effectiveness	Economic efficiency	Indirect branding attribute
	Function	Efficiency; effectiveness; quality	Efficiency; effectiveness; quality	Higher profitability; lower risk	Indirect branding attribute

Table 3b: Integrated Value Types and Internal Stakeholders in the New Product Development Process Context  
(theory based – research composed)

With the concept of ‘value’ more defined within the New Product Development Process context. It is now possible for this research to integrate the three perspectives of ‘process’, ‘context’ and ‘value’ within a single, comprehensive, preliminary Contemporary Strategic Framework for New Product Development

The framework, for practical purposes, avoids the detailed presentation of the steps and factors which are already much researched and are widely considered as orthodox and mainstream. The strategic marketing and planning steps are denoted as single points, although there are of course complex interrelationships between these. Instead, the framework stresses the elements and factors that are more rarely met in literature and of course those interrelationships that have surfaced through this research.

Specifically, ‘marketing and consumer research’ is slightly differentiated from mainstream literature in the sense that it has a ‘cyclical’ relationship with the new product development process, being both its starting point and its end result; with the concept of value being the intermediate catalyst of the circular motion.

The new product development process itself has also been presented excluding the standard steps of 'idea generation', 'filtering' etc. to present the critical intermediate elements of 'exploration criteria', 'actors' (participants), 'activity structure & organization', 'governance', 'added value', and 'results and swarmed, capitalized and transformed concepts' (as described earlier). The new product development process is depicted as leading to a single (in reality the most important) critical concept: that of 'value'. Contrary to past models though, this proposed framework breaks down the generic idea of 'value' into seven specific types of value that appear as most dominant in literature of contemporary markets (see above sections): financial, time, physical/sensory, mental, psychological, image and functional value. In parallel to these, this preliminary framework distinguishes also the potential stakeholders of value: the internal ones (the employees, the organizational system, the economic entity and the brand) and the external ones (existing customers, targeted new customers and society).

Further to the above, this proposed framework deviates from classical literature by introducing the matter of 'context' into the system. The context, largely relying on contemporary consumer behaviour analysis, revolves also around the question of 'power' between the consumer and the business. The consequent effect on the framework is noticeable within the 'post-NPD strategic marketing processes', and more specifically through the introduction of marketing communications as crucial in the definition of value in the eyes of stakeholders. Additionally and within the same context, 'perception management' is termed as a primary sub-process of the system, with 'branding' its primary 'vehicle'.

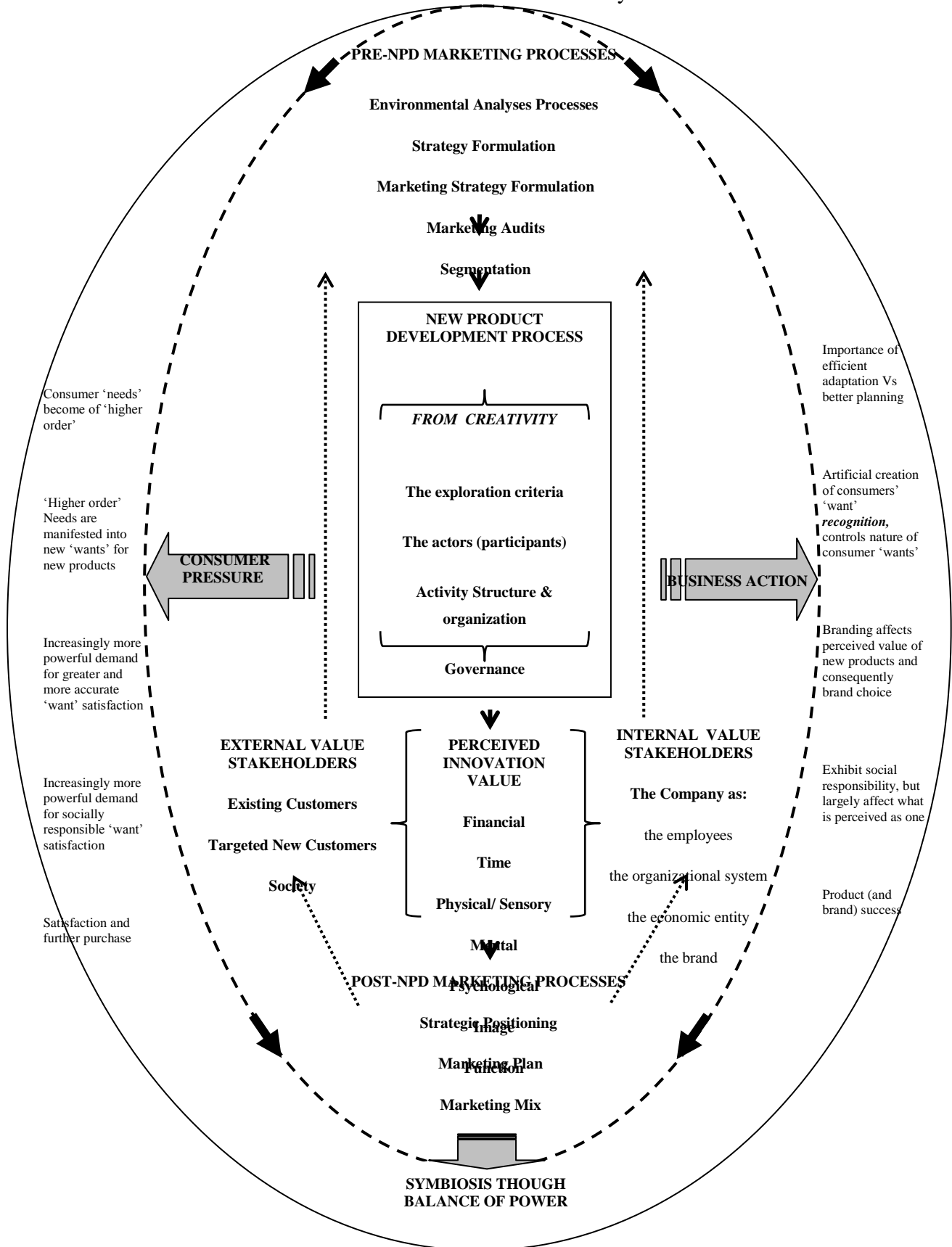


Figure 2: A Preliminary Contemporary Strategic Framework for New Product Development

## Catalexis, Limitations and Further Research

This research has reversed the trend in research direction on new product development, to focus out of the various sub-processes. Specifically, the research has investigated the context of new product development, within contemporary developed economies, and through three distinct perspectives: the process itself, the consumer and macro-environmental context, and the concept of value. It has ultimately developed a preliminary framework to descriptively and prescriptively assist both researchers and practitioners in comprehending the multi-dimensionality of the subject.

The findings are largely conceptual and based on theoretical research. The research therefore does not claim that its findings or framework are unquestionable or final. On the contrary, the research calls for further and especially empirical work to take place, on the subject of NPD context and interrelationships. The currently presented work, provides a solid and scientific foundation on which researchers can build. Moreover, the same foundation can be utilized by practitioners in designing their new product development process.

The ultimate challenge though, both for researchers and practitioners, as it surfaces through this research, is not a matter NPD process definition, its sub-processes or functions. It is a matter of interrelating the various components within the wider organizational activities without creating unnecessary inefficiencies and complexities. Moreover, both researchers and practitioners must master two very difficult concepts, in the context of new product development: on the one hand, the interdependencies between the business and the consumer needs, and on the other, the notion of value and its role in the development of new products. There is no magic formula or specific model that fits all organizations; and balancing and utilizing these challenging concepts for the benefit of individual organisations is an art, as much as it is a science. Irrespective of theoretical modeling and past practices, it is, as it often is, a matter of theoretical knowledge, of practical experience, of instinct and trial and error. New product development, as a process, does not 'fit in a box', as rarely do business processes that contain the term 'new'.

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## IS THERE A NEED FOR NEW MARKETING COMMUNICATIONS PERFORMANCE METRICS FOR SOCIAL MEDIA?

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### Abstract

The objective of this paper is to develop a conceptual framework for measuring the effectiveness of social media marketing communications. Specifically, we study whether the existing marketing communications performance metrics are still valid in the changing communications landscape or whether it is time to rethink them or even to devise entirely new metrics.

The study examines reviews and combines the discourse of social media marketing, social media metrics, and marketing performance measurement. Literature is collected from newest social media books and articles, and marketing performance measurement studies.

This study attempts to contribute to a better understanding of marketing communications measurement in social media era by incorporating marketing performance and social media marketing literatures. Recent advances in information technology marketing bring a need to re-examine measurement models. We combine two important research topics and set directions for potential future research.

The results reveal that metrics to measure marketing communications performance have developed towards a customer orientation. According to this study there is no broadly accepted opinion of a single critical performance indicator. The findings suggest that social media marketing metrics have been classified in three groups: qualitative, quantitative and financial. The shift towards a digitized interactive marketing environment does not necessarily mean that a whole array of new measurement metrics is needed.

**Keywords:** Marketing Communications, Social Media, Marketing Performance Measurement, Marketing Communication Metrics

### Introduction

In recent years social media has gained significant interest among marketing practitioners and academicians. It is increasingly being argued that we are in the midst of a new communication landscape (e.g. Kietzmann et al. 2011) as the roles of customer interaction and user-generated content (UGC) are emphasized in marketing communications (Dennis et al., 2009; Liu et al., 2011). This shift towards interactive communications is transforming the landscape from one-way to two-way communications in which customers are actively

participating, or at least being asked to participate, in the communications loop. Thus, customer engagement has been recently listed as a top research priority for marketing academics (MSI, 2010).

In addition to customer engagement, the changing media landscape has led the Marketing Science Institute to call for research to create new frameworks and methods that link existing marketing metrics and marketing performance measures with new media (MSI, 2010, for research priorities concerning metrics see also MSI, 2000; 2002; 2004; 2008). Thus there is a real need for research related to marketing communications performance measurement in social media context, as researchers and managers pay increasingly attention to social media without a clear understanding of how effective the media is or how to measure it.

In this article we attempt to develop a framework for measuring the effectiveness of social media marketing communications. Specifically, our objective is to discuss whether the existing marketing communications performance metrics are still valid in the changing communications landscape. An interesting research question we ask is whether there is a need to rethink them or even to devise entirely new metrics? In order to answer this question, the study reviews and collates the literature on social media marketing, social media metrics, and marketing performance measurement. Literature is collected from the most recent social media books and articles, and from marketing performance measurement studies. A detailed study of this phenomenon is important insofar as it can throw light on a number of processes involved in scientific activity and the growth of knowledge in this field in general.

This paper is structured as follows. First, we trace the development of the academic marketing discussion related to social media and its main topics. Second, we review the literature on marketing performance measurement and state how increasing use of social media creates a strong need for both marketing performance measurement research and marketing performance measurement implementation in practice. We conclude with a discussion of the implications of our findings and outline possible topics for further research.

## **Marketing Measurement in Social Media Era**

### **Social media in marketing communications**

Companies have taken social media seriously on a strategy level and a large number of companies have begun to set a budget for social media marketing. Organizations sense that social media is a new, but permanent, environment for marketing (Weinberg and Pehlivan, 2011). Social media has changed marketing practices tremendously and constantly. While in the traditional online environment large media budgets were typically targetted at catching the customers' attention, in the new social media age power structures are different as power has shifted increasingly towards the media consumers. Against this backdrop, large media budgets no longer directly and positively correlate with large audiences and effective business in the world of user-generated content and multidimensional interaction. Hanna et

al. (2011) hit the nail on the head when stating that social media has transformed the internet from a platform for information to a platform for influence.

Business is expected to invest \$6 billion in social media in 2011 (Aho Williamson, 2011) and inevitably the academic marketing literature has shown a growing interest in this new media landscape. Marketing journals have published special issues on social media (e.g. *Business Horizons*, 2011) and many top marketing journals (e.g. *Journal of Marketing*; *European Journal of Marketing*; *Journal of Business Research*; *Journal of Advertising Research*) have recently published articles covering social media.

Social media marketing has been investigated in marketing literature from various perspectives, including the viewpoints of viral marketing (Kaplan and Haenlaine, 2010; Ho and Dempsey, 2009), word of mouth (Steffes and Burgee, 2009; Cheung and Rabjohn, 2008; Brown et al., 2007), ecosystem (Hanna et al., 2011), customer engagement and participation (Parent et al., 2011; Muñiz and Schau, 2011; Kaplan and Haenlaine, 2011), marketing budgeting (Weinberg and Pehlivan, 2011), corporate internal communications (Hearn et al., 2009), organizational knowledge management (van Zyl, 2008), history and development (Boyd and Ellison, 2008; Kambil, 2008; Schibrowsky et al., 2007), conceptual studies (Karakas, 2009; Constantidines and Fountain, 2008), relationship marketing and customer interaction (Quinton and Harridge-March, 2010; Ozuem et al., 2008), and direct marketing (Palmer and Koenig-Lewis, 2009).

Social media is collaboratively produced and shared content published through the internet. The term refers to networked digital platforms, which are used in communication between human beings (Hearn et al., 2009). Parent et al. (2011) suggest that social media platforms differ from traditional Web applications by offering users a place for content creation, content upload, networking, conversing, media sharing and bookmarking. According to Kietzmann et al. (2011) social media is interactive sharing, co-creating, discussing and modifying user-generated content through mobile and web-based technologies. To sum up, compared to the first generation online media or to the offline media, with social media one could equally be a content creator and a content consumer. In social media, neither the customer nor the company is a king. The king is content.

Social media is often used as a synonym for the term “Web 2.0” (Palmer and Koenig-Lewis, 2009; Riegner, 2007; Weinberg and Pehlivan, 2011). According to Constantidines and Fountain (2008) the term “Web 2.0” refers to digital communication platforms, while the term “social media” refers to the social characteristics (participation, openness, conversation, seamless, communal) of those platforms. However, they state that the term “Web 2.0” should be used as an umbrella term to include both technical features and characteristics. Kaplan and Haenlaine (2010) suggest that although the term “Web 2.0” was not originally meant to describe a new technical era of the internet, it later acquired that meaning. According to them, because of the later development trend of the term “Web 2.0”, the term “social media” should

be preferred. On this basis, it seems that social media is similarly more than just Web 2.0. As Weinberg and Pehlivan (2011) discover, Web 2.0 consists of computer network-based platforms upon which social media applications run.

The two key characteristics of social media are user-generated content and customer interaction (van Zyl, 2009; Riegner, 2007), which should be considered as a goal for marketing communication in social media. Muñiz and Schau (2011) prefer the term consumer-generated content (CGC). The interrelationship between UGC and interaction is quite logical as without any interaction there is no UGC. Thus, content is the result of interaction.

Palmer and Koenig-Lewis (2009) propose that UGC is an opportunity for a new kind of marketing communication, but it also challenges companies to give power to customers and loosen their own control over the discussion. In the same vein, Hennig-Thurau et al. (2010) argue that in traditional media, companies may formulate and control their marketing communication messages in the way they wish, but in social media they may only participate in the conversation and interaction with customers. Weinberg and Pehlivan (2011) state that social media has properties to empower consumers and give them influence, enabling relationship building between organizations and customers. Kietzmann et al. (2011) argue that in the age of social media, corporate communication has been democratized as the power has been taken from companies' marketing and PR by individuals and communities.

Why should an organization encourage customers to create content? First, marketing communication created by customers has been proved to be more credible in customers' eyes than the messages promoted by an organization, and so to have a more powerful impact on decision making (Riegner, 2007). Second, UGC may increase customers' value experience, because of interactive and fluent customer service and better opportunities to participate in product and service creation process (Muñiz and Schau, 2011). Third, active interaction and customer based content creation helps companies to build long-term competitive advantages (Parent et al., 2011).

### **Marketing communications performance measurement**

Marketing performance in its narrow sense refers to gaining calculable and provable results from marketing activities. Ambler et al. (2001) for example state that "performance" refers to the financial results gained from business activities. In this study performance is however seen as not only related to financial results (something to be measured in currency e.g. sales, profits, increase in shareholder value, cash flow), but also inclusive of non-financial (e.g. brand awareness, customer satisfaction, customer loyalty / retention) results from marketing activities.

"Marketing" in turn refers to what the company does to turn prospects into customers and to satisfy customers and so create shareholder value (Ambler and Roberts, 2008). In the marketing literature, marketing performance measurement (or like Morgan et al. 2002 and

Donthu and Yoo 1998 state, marketing performance assessment), has been discussed mainly from two angles: marketing productivity (the efficiency approach) and the marketing audit concept (the effectiveness approach) (Morgan et al., 2002). Although marketing performance measurement has long been a concern in marketing literature, productivity and measurement analyses in marketing have advanced only sporadically in academic research (Morgan et al., 2002). The history of marketing performance literature dates back to the 1940s. According to Sheth and Sisodia (2002) in its early years marketing productivity analysis focused mainly on cost analysis. The same trend continued in the 1950s and 1960s, when marketing performance was still analysed mainly from a cost accounting point of view (Seth and Sisodia, 2002). Later, market-oriented and especially customer-oriented objectives came under the spotlight (Rust et al., 2004). In the 1990s, the marketing measurability discussion exploded (Greenyer, 2006) and after the millennium the same trend has continued.

Companies have long attempted to identify marketing key performance indicators (KPI) in order to measure the impact and success of marketing (Hanna et al., 2011). Sidhu and Roberts (2008) argue that in marketing literature little is known about the need for marketing to work more closely with the reported accounting performance of the firm. According to their research, marketing and accounting should have a morphological relationship and both of them should play an important role in a company's business strategy. There have been several calls for research on how marketing and accounting interrelate in both theory and practice (Inglis, 2008). In future, marketers should gain financial discipline and derive credibility from accountants, while accountants should learn about the nature of the organization's assets from marketers.

Ambler et al. (2004) state that both practitioners and academics have shown an increasing interest in the assessment of marketing performance. The growing interest is understandable, because according to O'Sullivan et al. (2007) and O'Sullivan et al. (2009), the ability to measure marketing performance positively affects firm performance and reporting frequency mediates the relationship. On the other hand, as Seth and Sisodia (2001) state, marketing's fundamental problem is low productivity and especially lack of accountability. So although the strong connection between business strategy, marketing strategy and marketing performance measurement with firm performance is recommended and proven by marketing literature (see e.g. Vorhies and Morgan, 2003), in practice, marketing measurement is quite fragmented and non-systematic (Amler et al., 2004). Vorhies and Morgan (2003) write that organizing marketing activities in ways that fit the business's strategic type is associated with marketing effectiveness and with marketing efficiency.

Lukas et al. (2005) state that marketing literature's failure to incorporate current financial valuation techniques and properly demonstrate its contribution to accounting research, suggest that future research is needed. According to McManus and Guilding (2008) it appears that there is also considerable potential for accountants to draw on points of focus raised in

the marketing literature to further advance marketing-focused accounting measures of performance. So marketing should collaborate with accounting both in academic research and business practice. According to Seth and Sisodia (2002) marketers can learn sophisticated cost accounting methods and the value of having well-defined rules and regulations governing its functions from accounting. They state that this could help marketers to become more productive and more effective. While this is a reasonable assertion, we would suggest that due to marketing being focused on generating future income, as compared to accounting being focused on the past, audit-based practices applying well-defined rules and regulations do not necessarily fit in with future-oriented marketing planning.

Recent advances in technology have created new opportunities for marketing and accounting integration (Phillips and Halliday, 2008). The digitized world has radically altered the ways in which firms can monitor their customers and collect data from their marketing communications. Gleaves et al. (2008) suggest that recent developments in marketing accounting measures, recent technological advancements in database management and increasing pressure on marketers to prove their worth are contributing to a need for more effective marketing / accounting synergy. Also according to O'Sullivan and Abela (2007) there have been several high-profile calls for more research in the area of marketing performance measurement. Modern corporations must adopt new technologies to build competitive advantage.

Hanna et al. (2011) raise an important point in saying that the social media era has changed companies' marketing communication as consumers increasingly adopt active roles in co-creating marketing. On the other hand, companies do not understand what performance indicators they should be measuring and how they should measure the new kind of interactive marketing communications. Even though the benefits of social media communication, UGC and digitized customer-seller interaction are proven and often accepted, practitioners are still insecure of how to measure the effects of the growth in interactive communication. Thus, business managers are uncertain how to allocate marketing effort and budget to social media (Weinberg and Pehlivan, 2011).

### **Marketing communications metrics**

Ambler et al. (2001) propose that "metrics" should be limited to performance measures which are high level, necessary, sufficient, unambiguous, and ideally, predictive. Thus, marketing metrics should be calculable, in quantitative form, and auditable – in other words, reliable and professionally sourced (Ambler, 2002).

When discussing marketing performance measurement metrics, we often realize that marketing inputs (costs) are much easier to track than the outputs of marketing. It is important to note that there is no universally applicable way to measure marketing performance (Seth and Sisodia, 2002). Even if the main metrics were common between companies, the measurement strategy has to be customized to comply with the company's

strategy and marketing tactics. Marketing performance measurement has to be company related.

In general, marketing tactics should be based on objectives arising from marketing strategy. Furthermore, marketing strategy should be strongly based on company-level objectives and on business strategy. Marketing performance measurement has to be seen in the context of the whole company (Phillips and Halliday, 2008). To know whether the marketing objectives or whole company's business objectives are met or not, the company needs regular marketing measurement. As Ambler and Roberts (2008) propose, the first step in marketing performance measurement is to make the company's long and short term objectives explicit.

One challenge related to marketing performance measurement metrics relates to the short and long term effects of marketing actions. Some marketing actions may generate rapid short term outputs, while other actions may have an outcome only seen after a longer time. Ambler et al. (2004) suggest that brand equity could bridge this challenge. On the other hand, they point out that brand equity is often measured but rarely integrated into a formal measurement system.

Seth and Sisodia (2002) raise an essential observation related to continuous change in business environments. They state that in marketing performance measurement, it is important to ensure that metrics do not yield spurious relationships. For example a firm's market share could increase because its competitor lost its customers and not because of an improvement in the firm's marketing communications. That is why it is important for a company to have multiple metrics.

As stated above, better marketing performance measurement means more cooperation with the accounting department. Sidhu and Roberts (2008) notice that because of the lack of shared marketing-accounting language, different objectives, different tools and different metrics, the cooperation demands special care. A major challenge is that the financial accounting domain is dominated by rules and law, unlike the marketing domain that does not even have commonly accepted basics.

Ambler et al. (2004) state that the simplest measurement model includes actions (inputs) and profits (outputs). In the real world however the links between action and results are often difficult to prove. That is why marketing a measurement model also needs intermediate metrics (e.g. awareness, attitudes, satisfaction), behaviours (e.g. purchases, loyalty, word of mouth) and competitive metrics (e.g. market share) (Ambler et al., 2004). Ambler et al. (2001) found 19 primary general metrics: awareness, perceived quality, consumer satisfaction, relevance to consumer, perceived differentiation, brand / product knowledge, number of new customers, loyalty / retention, conversions, (trade) customer satisfaction, perceived quality, number of new products, revenue of new products, margin of new products, sales, gross margins, profitability. These 19 metrics they categorize in 6 groups: consumer attitudes, consumer behaviour, trade customer, relative to competitor, innovation and accounting.

The metrics that best summarize brand equity and market performance are sales information, market share, marketing investment (into the brand), relevant end user satisfaction, relative price, perceived product quality, customer retention, sales to new customers, share of turnover of the previous three years' products launched, product availability/distribution, a glossary of marketing and brand terminology, and relevant measures chosen by directors (Ambler, 2002).

During the 21st century both academics and practitioners have sought the best single financial indicator for marketing performance measurement. Peppers and Rogers (2005) argue that return on customer (ROC) is the best key performance indicator. Reichheld (2003) in turn proposes a new loyalty metric called promoter, which measures the likelihood of a company's customers recommending the company to another person. Other candidates for the single solution or "silver metric" include shareholder value, discounted cash flow (also used as a synonym for net present value, brand valuation, customer lifetime value, and customer equity), or return on marketing investment (Ambler and Roberts, 2008). According to Ambler and Roberts (2008), any single silver metric is inadequate and marketing performance measurement always requires more than one indicator.

Many recent managerial marketing measurement publications are positive about marketing ROI (see e.g. Jeffery, 2010; Sterne, 2010; Lenskold, 2003; Powell et al., 2011; Blanchard, 2011; Thomas and Barlow, 2011; Turner and Shah, 2011; Moeller and Landry, 2009; Arikan, 2008), but Ambler and Roberts (2008) for example criticize the usage of the ROI concept related to marketing measurement. They state that ROI is a good tool for comparing alternative investments and even the American Marketing Association (AMA 2005:8) identifies six ROI measures (incremental sales revenue, ratio of cost to revenue, cost per sale generated, changes of financial value of sales generated, cost of new customer, cost of old customer retention), but, according to Ambler and Roberts, none of those is really an ROI metric. They claim that ROI metrics promote underperformance and short-termism.

In our opinion this depends on how we look at the question of ROI. As ROI is the net return divided by the investment, and if taken literally, Ambler's and Robert's (2008) critique of the AMA's list is apt. On the other hand, if we consider ROI as an umbrella metric or more like a title for a financial metric category to track the performance of marketing actions in currency, ROI is a usable term in marketing performance discussion. In the same way, Rust et al. (2004) support the terms ROI and ROMI (Return on Marketing Investment), when they propose a conceptual marketing measurement model called "return on marketing".

Zahay and Griffin (2010) examine customer based performance metrics (such as customer lifetime value, customer retention and share of wallet) in association with the choice of generic positioning and segmentation strategies, while strategic positioning choices are indirectly associated with business growth performance. They further propose that



companies should focus on long-term customer metrics (for example customer retention and customer lifetime value) to maximize the growth of the company.

Rust et al. (2004) point out that the past 40 years of customer-centred marketing theory and practice also reflects on marketing metrics, by adding the measures of customer satisfaction, market orientation, customer value, and customer lifetime value. They also note that in recent years the concept of brand equity has been challenged by a more customer-oriented concept, that is, customer equity. For example Gleaves et al. (2008) propose customer profitability (CP) as a metric that links accounting and marketing.

In addition, Lukas et al. (2005) emphasize that marketing managers should pay attention to long-term measurement. However they accentuate that instead of customer-oriented metrics, marketers should focus more on shareholder value measurement using metrics like free cash flow, shareholder value added, economic value added, market value added, cash flow, return on investment, and cash value added. Although the shareholder value point of view is important in the marketing performance measurement context, the links between action and results are often difficult to prove and shareholder value difficult to directly quantify and measure. Thus marketing measurement models demand intermediate metrics (c.f. Ambler et al., 2004).

Customer profitability (CP) is one of the keys to effective marketing and it has been a subject of increasing attention in recent years (McManus and Guilding, 2008; Sidhu and Roberts, 2008). CP is associated with the concepts of customer lifetime value and customer equity (Sidhu and Roberts, 2008). Sidhu and Roberts (2008) condenses the link between these three concepts as follows: "If, as is proposed in this paper, CP can be considered, with some adjustments, equivalent to the CLV over a period of one accounting year, it is possible to see the inter-relation of these two terms. Since CE is defined as the sum of all current and future customers' lifetime values, we can clearly link CE with CLV by adding the NPV of future customers to the sum of the individual CLVs of all existing customers."

McManus and Guilding (2008) found in their literature review that increased customer satisfaction will have a beneficial impact on a firm's financial performance especially in a long-term context. In our opinion this is a well-defined reason to measure customer satisfaction and to implement metrics like customer equity, customer profitability, customer lifetime value, and customer retention.

### **Social media marketing metrics**

From the company's point of view listening is even more important in social media than talking. After well-defined objectives and goal setting, which is the first phase of social media marketing (Powel et al., 2011; Thomas and Barlow, 2011; Blanchard, 2011; Turner and Shah, 2011; Sterne, 2010; Delahaye Paine, 2011), listening is the second step towards social media marketing measurement. Social media offers companies a new kind of environment for

listening (Thomas and Barlow, 2011; Blanchard, 2011). Barlow and Thomas (2011) state that companies can listen to social media in five ways: searching (manually used search engines), monitoring (automated methods to search), alerting (automated alert based search), measuring (quantitative manual and automated monitoring), and mining (research based search).

Barlow and Thomas (2011) state that social media analytics is a fresh concept, but it is based on the old principles of business analytics: if you can analyse what is being said about your company, its products and services in its business environment, you can reset your marketing objectives more precisely and plan your marketing actions more carefully.

Social media marketing ROI is a topic much discussed in managerial marketing literature. Blanchard (2011) draws a clear distinction between financial and non-financial outcomes of social media marketing. Financial outcomes are cost reductions or increased revenue, which must be measured in currency. ROI measurement is always a measurement of financial outcomes. Turner and Shah (2001) additionally propose that ROI must be measured in currency, but their opinion is slightly broader. To ease ROI measurement they propose companies use metrics such as customer lifetime value and cost per acquisition (CPA). They argue that by knowing CLV and CPA it is easy to calculate ROI. Arikian (2008) underlines that qualitative and quantitative metrics are intermediary indicators, while ROI metrics are the only truly reliable performance indicators. Delahaye Paine (2011) lists five ways to measure social media marketing ROI: sales or revenue, cost savings, paid versus earned search rankings, cost avoidance, and social capital (cost savings for example through customer service in social media).

Hanna et al. (2011) propose that social media marketers should focus on conversion tracking of downstream metrics such as sales and brand engagement. This means that marketing managers should define the key outcomes of a certain marketing campaign and quantify the relevant metrics (e.g., sales, reach, brand mentions, leads) to measure those outcomes. To avoid the situation where a company measures only the results they are seeking, it is worth remembering that marketing objectives should be considered as a starting point of the measurement process. If the measurement process focuses straight in on conversion tracking, the broader picture might be overlooked.

Barlow and Thomas (2011) present 22 social media marketing metrics in five categories. The categories are based on a five step sales funnel: exposure, influence, engagement, action / conversion, retention. Blanchard (2011) lists 55 metrics and sub-metrics to measure social media marketing and ten metrics (total volume of mentions, sentiment mix for mentions, SMS/text activity data, email activity data, traditional mail response data, retail store traffic, net transacting customers, net number of transactions, net revenue, and other conversion data) as management level key performance indicators. He underlines that all data the company gathers should measure the impact of the company's marketing activities on

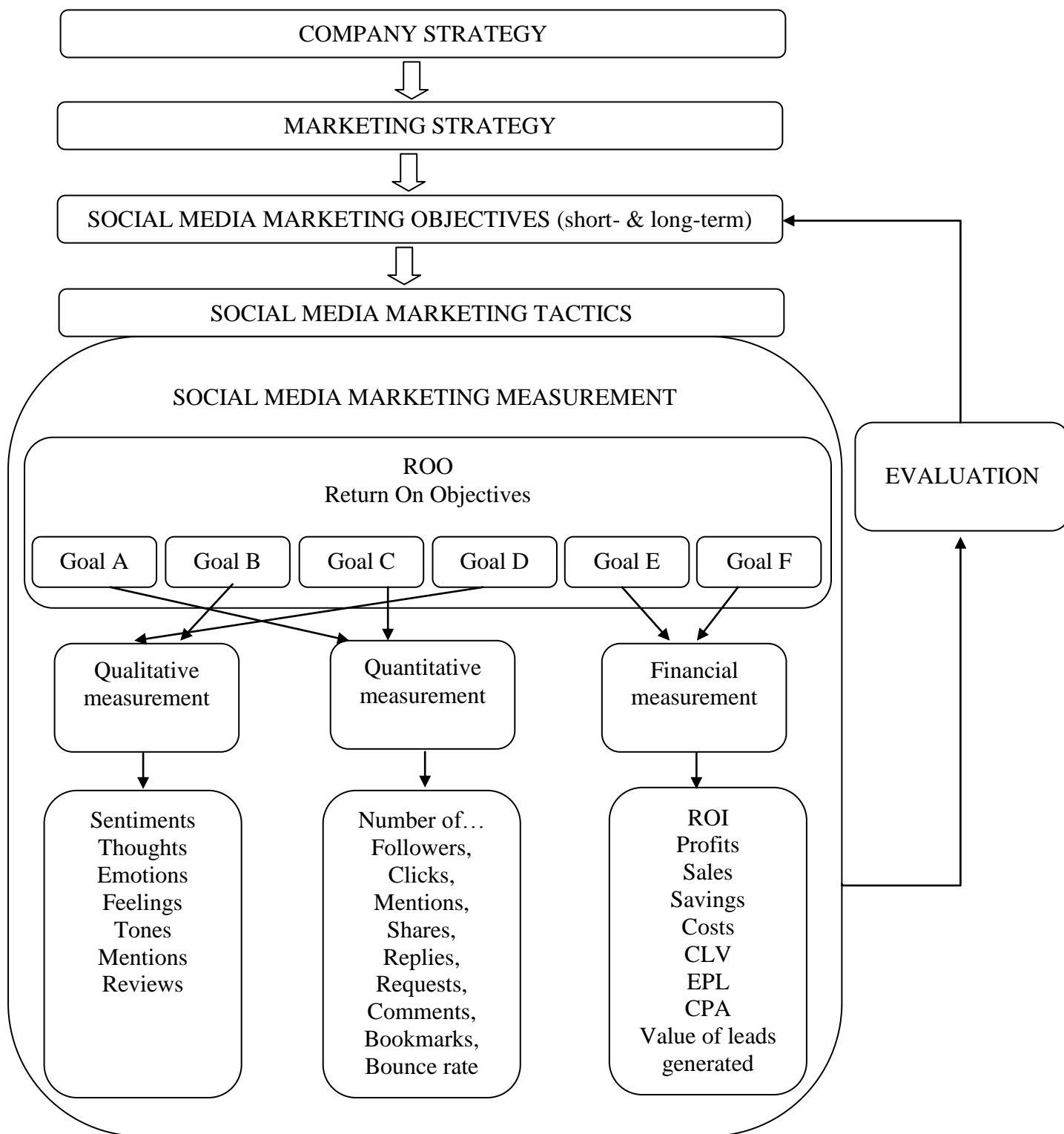
consumer behaviour. Turner and Shah (2011) list 20 metrics for social media marketing, but they note that those are only some of the metrics available. They categorize social media measurement metrics in three groups: measurement of quantity (e.g. number of followers, number of links, click-through rates), measurement of quality (e.g. sentiments, thoughts, emotions, feelings), and measurement of ROI (e.g. leads generated, customers retained, prospects converted, profits generated). Similarly, Arikan (2008) categorizes 17 online marketing metrics in three groups (qualitative, quantitative, ROI). Against this backdrop, we unify the metrics lists of Barlow and Thomas (2011), Blanchard (2011), Turner and Shah (2011), and propose 33 different metric to measure social media marketing (Table 1).

Table 1

<i>Qualitative Metrics</i>	<i>Quantitative Metrics</i>	<i>Financial Metrics</i>
<i>Negative mentions</i>	<i>Number of shares</i>	<i>Average buy</i>
<i>Positive mentions</i>	<i>Number of retweets generated</i>	<i>Average yield per transaction</i>
<i>Recommendations</i>	<i>Number of outbound replies</i>	<i>ROI</i>
<i>Product reviews</i>	<i>Number of click-throughs</i>	<i>EPL = earnings per lead</i>
<i>Geographic distribution of mentions</i>	<i>Number of customer service requests</i>	<i>Customer lifetime value</i>
<i>Consumers thoughts</i>	<i>Number of comments</i>	<i>Cost per acquisition</i>
<i>Consumers feelings</i>	<i>Frequency of transaction</i>	<i>Value of online transactions</i>
	<i>Number of bookmarks</i>	<i>Value of sales</i>
	<i>Number of inbound visits</i>	<i>Value of conversions</i>
	<i>Number of subscribers</i>	<i>CPM</i>
	<i>Number of event attendees</i>	<i>Value of leads generated</i>
	<i>Bounce rate</i>	<i>Value of prospects converted</i>
	<i>Conversions</i>	<i>Value of customer retained</i>
		<i>Costs</i>

Most marketing managers struggle to analyse a large number of metrics on a weekly basis, so a company has to choose the best metrics for each objective and situation. To do that it is important to categorize the metrics in groups. Based on our conceptual discussion, we categorize the different social media marketing performance metrics in Figure 1 in three groups labelled qualitative, quantitative and financial (ROI).

Figure 1 Conceptual model of social media marketing measurement



## Conclusion

The objective of this study was to create a framework for measuring the effectiveness of social media marketing communications. We asked whether the existing marketing communications performance metrics are still valid measures of the effectiveness of social media marketing. By drawing upon literature on marketing performance metrics, social media marketing, and social media metrics we proposed a framework (Figure 1) for assessing the available social media marketing performance metrics.

Social media has become a popular research topic among marketing academics in a short time (e.g. Kietzman et al., 2011; Dennis et al., 2009; Liu et al., 2011). Although the concept of social media is still in its infancy, during the last ten years the topic has been studied from several standpoints. Our review of the literature reveals that social media marketing is customer-centred – its key elements being UGC and customer interaction (van Zyl, 2009; Riegner, 2007). It seems obvious that social media literature is constantly growing and enhances its popularity among business practitioners and academics in future.

When companies engage with their customers, the focus of their marketing measurement should be on the customer reaction to the tactics employed by their marketers. The digitized environment facilitates reaction tracking and marketing communications measurement. In the light of the findings of the study, we propose that marketing measurement models developed in the past 40 years are still usable, and even more important than ever. The shift towards a digitized interactive marketing environment does not necessarily mean that a whole array of new measurement metrics is needed.

Discussion of marketing performance measurement has deep roots in marketing history. Since the 1940s, writers have searched for the best ways to establish the results and benefits accruing from marketing actions (Seth and Sisodia, 2002). The marketing performance measurement discussion was initially focused on cost analysis and auditing (Seth and Sisodia, 2002), but later shifted to market orientation and especially customer orientation (Rust et al., 2004). The typical metrics employed in cost analysis are profits and savings; with market orientation, they are shareholder value, brand equity and market share; while with customer orientation they are CLV, CP and customer satisfaction.

The digitalization and social media technologies have enlivened the discussion around marketing performance measurement during the last ten years (Gleaves et al., 2008; Phillips and Halliday, 2008). New technologies enable more precise qualitative and quantitative marketing communications measurement and on the other hand executive boards want tangible results from marketing actions. The latter might be also the reason why many marketing authors have asked for more synergy between marketing and accounting (e.g. McManus and Guilding, 2008; Seth and Sisodia, 2002; Lukas et al., 2005; Phillips and Halliday, 2008).

We found that the marketing communications measurement must be company specific (Seth and Sisodia, 2002) and have its roots in the company's business strategy (Phillips and Halliday, 2008). Measurement practices should examine how both long-term objectives and short term objectives are met (Ambler and Roberts, 2008). Especially in the social media context, but also in a broader sense, marketing performance should be measured with several metrics. Metrics should be high level, necessary, sufficient, unambiguous, and ideally, predictive. Thus, marketing metrics should be calculable, in quantitative form, and auditable – that is, reliable and professionally sourced (Ambler, 2002).

According to our research there is no broadly accepted opinion of a single critical performance indicator (CPI). Many authors have classified social media marketing metrics in three groups: qualitative, quantitative and financial (ROI) (see e.g. Arikan, 2008; Turner and Shah, 2011). Based on our literature review this classification could be useful, but more research is needed in the future. In any case, through social media measuring, monitoring and searching, companies can gather both quantitative and qualitative data. The relationship between qualitative metrics and ROI metrics should be investigated carefully.

Because marketing communications in social media is customer-oriented (or even customer driven), marketing measurement metrics should also be customer oriented. In our literature review we noticed that metrics to measure marketing communications performance has developed towards a customer orientation. Metrics like CP, CLV and CE have won favour from many authors (see e.g. McManus and Guilding, 2008; Sidhu and Roberts, 2008; Zahay and Griffin, 2010; Arikan, 2008; Blanchard, 2011).

### **Limitations and further research**

It is necessary to point out that our analysis is not without its limitations. For example, a large share of the literature concerning social media marketing measurement is managerial in nature. Our study can also be considered as a pioneering study attempting to combine traditional marketing performance literature and social media marketing literature. Thus, the results presented are merely indicative rather than conclusive. Given the early stages of the literature concerning the measurement of social media marketing, it was also difficult to draw robust conclusions about the best metrics everyone should use.

In an attempt to mitigate these limitations, we identify several fertile avenues for further research in this domain. As stated above, marketing communications performance measurement in the era of social media is a growing research topic for both academics and practitioners. For example social media monitoring, web analytics, cloud-based customer service and e-commerce might strongly develop marketing performance measurement potential. It would be interesting to study how companies have combined the increased interest both in social media and in marketing performance measurement in practice. How has the movement towards social media changed measurement practices?

In future, empirical research is needed to examine and validate social media marketing performance measurement. Empirical studies could specify and evaluate the most common metrics employed to measure marketing performance in the social media era. Further research could examine how marketers formulate their key performance metrics for social media marketing communications. An interesting question is whether the popularity of marketing accounting will continue to increase or perhaps we are moving towards more qualitative type of measures, or a mix of the two forms.

We believe, in line with Morgan et al. (2002) that marketing practitioners are often unable to prove and support cause and effect relationships between marketing inputs (money), tactics (actions) and outcomes (e.g. growth in profit). On the other hand, the increased research interest, the greater demand for more precise reporting from marketing managers, and especially the recent movement towards a digitized interactive business environment, make possible remarkable changes in marketing communications performance measurement. The theoretical discussion on marketing performance measurement should continue and step by step transform into practice.

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## GEOGRAPHIC SALES DIVERSIFICATION FROM THE LENS OF REAL OPTIONS, MANAGERIAL DISCRETION AND CONTINGENCY VIEWS

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### Abstract

Geographic sales diversification or exports is a multi-dimensional phenomenon that has been examined primarily using a single theoretical perspective from either the international trade or organizational strategy. We draw on the insights of managerial discretion, innovation and real options literatures and examine the role of managers, context and environment to explain an industry's reliance on exporting. We find that a combination of managerial discretion, innovation and uncertainty leads to increased levels of exports. We contribute to the literature by highlighting that a combination of managerial discretion, the capacity to offer innovative products, and uncertainty in the external environment motivate internationalization.

**Keywords:** International business strategy, Internationalization, Industry exports, Managerial discretion, Industry innovations

### Introduction

Although the diversification of sales markets through exports is a complex strategic decision that is influenced by many factors, this phenomenon has been analyzed primarily using a single theoretical lens from either the international trade or organizational strategy literatures. One such perspective that has been influential in explaining exports as part of the internationalization process is the sequential approach to internationalization (Cavusgil, 1984; Johanson & Wiedersheim-Paul, 1975; Johanson & Vahlne, 1990). The sequential theory of internationalization builds on product life cycle and international trade concepts to explain the process of internationalization (Mudambi & Zahra, 2007). This theory suggests that firms with innovative products will first establish themselves in their respective domestic markets before expanding internationally; usually beginning with exporting to foreign markets (Johanson & Vahlne, 1990; Mudambi & Zahra, 2007).

Organizational strategy literature, conversely, has historically relied on transaction cost economics to explain the process of geographic sales diversification as part of the internationalization strategy (Boisot

& Child, 1996; Chi & McGuire, 1996). Transaction cost economics (TCE) highlights the difficulties in writing, executing, and monitoring contractual arrangements with international partners (Oxley, 1999; Williamson, 1985). Transaction cost economics focuses on contractual hazards and opportunistic behavior that could surface among exchange partners because of uncertainty, information asymmetry and difficulty in enforcing contracts (Verwaal & Donkers, 2002; Zacharakis 1997).

Though each of these perspectives has contributed to explaining the choice of modes for internationalization, a consensus is emerging among scholars that internationalization is a complex, multidimensional phenomenon; and a more complete picture of the phenomenon would emerge by incorporating the role of managerial discretion in the analysis (Chi & McGuire, 1996; Crossland & Hambrick, 2007, 2010; Oviatt & McDougall, 2005; Reuer & Tong, 2005). Indeed, the role of the top management team (TMT) cannot be underscored enough in strategic decisions such as internationalization—managers need high levels of discretion to pursue internationalization (Crossland & Hambrick, 2010; Hambrick & Finkelstein, 1987). Concomitantly, literature is yet to focus its attention on how managers with decision-making latitude leverage contextual factors such as innovation levels in combination with environmental pressures to pursue geographic sales diversification (Leonidou, 1998; Zahra et al., 2000). The role of managerial discretion in combination with contextual and environmental factors remains mostly understudied in the literature (Crossland & Hambrick, 2010; Leonidou & Katsikeas, 1996; Salomon & Shaver, 2005).

In this study, we draw upon managerial discretion, real options and innovations literature to examine the role of managerial discretion, industry context and environment in motivating geographic sales diversification or exports. We develop our theoretical framework around the following overarching theme: Managerial discretion in combination with industry contextual and environmental variables motivates greater reliance on exports as a growth option. As such, we propose that the industries where levels of managerial discretion, innovation and uncertainty are high will display greater geographic sales diversification. By integrating these variables into our theoretical framework, we respond to the calls for a deeper examination of the role of managers and innovation in the internationalization process (Bernard & Jensen, 2004; Leonidou, 2004; Lohrke & Bruton, 1997; Salomon & Shaver, 2005).

We test our hypotheses using a large sample of U.S. manufacturing industries. Industry-level analysis is used because firms in an industry often share attributes that allow for the aggregation of firm effects and the development of a composition model (Klein, Dansereau & Hall 1994). This is particularly valid for various modes of geographic diversification, such as industry exports. Industry exports are a key international trade metric that is reported universally by the national economic agencies (e.g., U.S. Bureau

of Economic Analysis or the U.K. Office for National Statistics (ONS)). We use the notion of homogeneity to view firms embedded at the industry level of analysis because key strategies initiated by the firms, for example, exporting innovative products to diverse international markets, often spill over to other firms. Firms within an industry learn about each other's key strategies through business intelligence, industry conferences, trade publications, forums and shows, and employee mobility (Ahmadjian, 2004; Henderson & Cockburn, 1996). They often mimic one-another's strategies for rent generation in isomorphic manner as industry is a collective, group level entity composed of a number of firms and their managers (Aldrich, 1999; Appleyard, 1996).

We use a sample of U.S. industries because there is a high degree of variance among U.S. industries, both in terms of managerial discretion and innovation (Hambrick & Abrahamson, 1995; Silverman, 1999), and this presents an opportunity to test our theoretical model in this setting. The U.S. business environment is one of the most technologically progressive environments in the global marketplace because U.S. firms have been at the forefront in punctuating equilibrium with cutting-edge innovations (Segal, 2004). In addition to being the largest producer of knowledge-based products, the U.S. is also the largest consumer of innovative products (Cateora & Graham, 2002; Segal, 2004). Indeed, with every industry turning global and value chain integration within industries and across geographical boundaries (Inkpen & Ramaswamy, 2007), U.S. managers continually face the challenge of finding an optimal balance between boundary expansion strategies in large domestic versus international markets (U.S. Department of Commerce, 2000). Thus, we believe that the U.S. industry environment provides an ideal setting for analyzing the role of innovations and managerial discretion in influencing industry exports in the presence of uncertainty.

We contribute to the extant literature by developing an integrated theoretical model that examines the role of managers, context (i.e., innovations) and environmental pressures (i.e., technological change) in explaining variance in the geographical diversification via exports. We begin with a brief review of the real options, managerial discretion and innovations literatures and discuss their relevance in the context of internationalization particularly industry exports. Next, we develop hypotheses and subsequently present the methods, results, discussion, and implications sections.

## **Literature Review**

In the context of geographic sales diversification, the use of real options lens is particularly applicable because exports is generally an entry-level strategy that further provides an option for enhancing commitment using modes such as international joint ventures (IJV), foreign direct investments (FDI), and acquisitions of foreign firms—these modes are fraught with higher levels of uncertainty and complexity

than exports (Johnason & Vahlne, 1990; Leonidou & Katsikeas, 1996; Oviatt & McDougall, 2005). However, exporting itself is a complex strategic decision that is influenced by various uncertainties in foreign markets because these often have different social, political, monetary and legal systems (Oxley, 1999; Salomon & Shaver, 2005; Zacharakis, 1997). For the domestic U.S. managers, it is relatively more challenging to weigh trade-offs between risk and expected returns from less familiar and geographically distant product-markets because the U.S. is not only the largest global producer of most innovative products but also the largest consumer of them (Segal, 2004). For them, another viable alternative to industry exports is an increased focus on the large U.S. home market (Bernard & Jensen, 2004; Salomon & Shaver, 2005). Overall, managers have a number of options for boundary expansion in lieu of exports – for example, use of other modes and a greater focus on domestic U.S. market.

### **Industry Exports, Uncertainty and Real Options View**

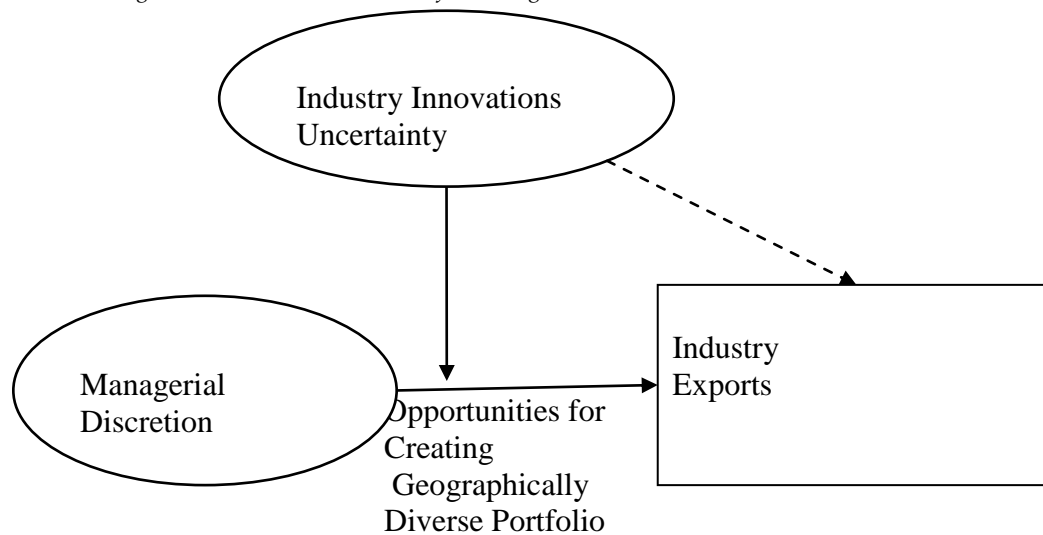
Real options<sup>81</sup> represent investment opportunities that allow managerial response in a contingent fashion by conferring managers the right, but not the obligation, to undertake specific actions in the future for claiming upside opportunities (Kogut & Kulatilaka, 2001; McGrath & Nerkar, 2004). In the presence of uncertainties such as those associated with venturing in foreign markets, real options reflect managers' flexibility in adapting their future actions (for example, by enhancing their investment and commitment for international boundary expansion when successful else reducing these if results are not commensurate with efforts) (Bowman & Hurry, 1993; Reuer & Tong, 2005).

Under conditions of uncertainty, managers employ a stepping-stone approach by exercising the option of expanding sequentially into new foreign markets rather than making huge commitments upfront (Chi & McGuire, 1996; Su et al., 2009). They may further weigh strategic positioning in the familiar home market against risks and uncertainties in the distant foreign markets. In essence, we focus exclusively on exports because export-strategies are based on managers' informational and experiential knowledge relevant to exports market as they are often the first stage of the internationalization process (Morgan et.al, 2003). Further, from the lens of real options, exports provide firms with high levels of flexibility and opportunity to limit large losses at early stages of internationalization while simultaneously retaining the option to reap additional rents by committing further if expected payoffs are realized over time. Figure 1 depicts the research model.

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*81 Su and colleagues (2009) state that the options view has been applied to a diverse set of managerial decisions including global manufacturing coordination, joint venture termination, venture capital investment, technology expenditure, and outsourcing contracting from both the client's and the vendor's perspectives.*

Figure 1: Theoretical Framework for Managerial Discretion, Context, Environment and Industry Exports



### Managerial Discretion

Though geographical diversification provides options for reaping additional rents with minimal upfront investment as discussed above, it is the managers who must ultimately pursue such opportunities. Managers need high levels of discretion for taking such policy decisions because the development of an exporting strategy and its operationalization involves streamlining export channels, marketing networks, workforce skills, and credit providing ability—these involve not only monetary but long-term social, political, and legal commitments (Nolle, 1991). Consistent with the literature, ‘managers’ in our context are the executives in key hierarchical positions with differential authority. These managers have the potential to influence the actions and outcomes of their firms as they provide direction by making strategic choices from available options.

Managers have latitude of action or discretion when there is a relative absence of constraints and when multiple plausible alternatives are available to influence strategic outcomes. Managerial discretion, or their latitude for action, is an indicator of their relative influence on strategic decision making and consequent organizational outcomes (Hambrick and Finkelstein, 1987; Hambrick and Abrahamson, 1995). Managers differ substantially in the degree of discretion they possess in their industries; indeed, they have greater decision-making freedom in some industries than in others (Adner and Helfat, 2003; Hambrick and Abrahamson, 1995; Finkelstein et al., 2009, pp. 26-28). We develop our theoretical model<sup>82</sup>

<sup>82</sup> Finkelstein and Boyd (1998, p.179) state: “Although it is conceivable to study discretion in terms of specific actions of managers, such an approach is problematic because it requires clear knowledge of whether a specific strategic move is managerially driven or externally motivated. Without in-depth, clinical examination of managerial actions and the context surrounding those actions, such an approach to the study of

drawing upon the determinants of managerial discretion emanating from the task environment because a number of empirical studies demonstrate that variance in the levels of discretion emanating from task environment is strongly associated with the differences in the top managers' influence on strategic decisions (e.g., Datta & Rajagopalan, 1998; Finkelstein & Boyd, 1998; Finkelstein & Hambrick, 1990; Finkelstein & Hambrick, 1996; Hambrick & Abrahamson, 1995; Rajagopalan & Finkelstein, 1992).

We begin with a premise that a differential in levels of discretion affects managerial choices and strategic decisions, such as pursuing geographical diversification. Both the development and operationalization of geographic sales strategies involve certain risks (e.g., legal, supply-chain, liability of foreignness etc.) and managers need latitude for pursuing such activities outside not only firm boundaries but also geographic boundaries (Hambrick & Finkelstein, 1987; Sanders & Carpenter, 1998). Further, managers need leeway to adapt in the face of environmental pressures and opportunities as they pursue geographic diversification strategies.

#### Industry Innovations

Innovations motivate boundary expansion as firms tend to enter markets where their innovations could provide both competitive and comparative advantages (Anand, Oriani, and Vassolo, 2010; Sahaym et al., 2007). Industry innovations reflect the application and exploitation of tacit and explicit knowledge and resource bundles for developing outcomes that are both unique and tangible (Afuah, 2003; Hunt, 1997; Kogut & Zander, 1993; Martin & Salomon, 2003). Prior studies have found that greater the similarity of firms' pre-entry technological products to the requirements of other markets, the greater is the likelihood of firms' entry in those markets (Anand 2004, Silverman 1999). Managers with innovative product offerings based on superior knowledge have more leeway to pursue internationalization because such products have the potential to deliver competitive and comparative advantages in world-wide markets (Hitt, Hoskisson & Kim, 1997; Porter, 1998). Such products often create their own niche, and if radical, such innovative offerings have the potential to create new segments in the global marketplace (Conner & Prahalad, 1996; Porter, 1998; Tushman & Anderson, 1986). Managers with innovations also venture into international markets to redeploy their innovative products to the demands of the foreign markets in an effort to obtain economies of scope (Anand, Oriani, and Vassolo, 2010). Further, such products meet the demands of 'technology-savvy' market segments worldwide. In essence, innovative product offerings motivate geographic sales diversification.

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*discretion is quite problematic. By focusing on the determinants of discretion, it is possible to assess in a more objective manner the potential latitude of action facing a manager, an approach that also enables larger-sample studies of discretion and its consequences...(e.g., Finkelstein & Hambrick, 1990; Hambrick, Geletkanycz, & Fredrickson, 1993)."*



Summarizing, we build on the insights of real options, managerial discretion and innovations literatures because ultimately, we examine whether managerial discretion in combination with industry contextual and environmental variables motivates geographic diversification via exports. Real options view highlights the value of flexibility and adaptability for managers as they gain the right to reaping additional rents with minimal upfront investment in their pursuit of internationalization, whereas managerial discretion underscores the latitude that managers have in pursuing internationalization strategies while bearing risks and uncertainties associated with these. We begin with a premise that a combination of higher levels of discretion, innovativeness and environmental pressures motivates geographic sales diversification using exports.

## **Hypotheses and development**

### **Managerial Discretion and Industry Exports**

Managerial discretion, as discussed above, is managers' latitude for action and reflects their influence on strategic decision making and consequent organizational outcomes (Hambrick and Finkelstein, 1987; Hambrick and Abrahamson, 1995). Managerial decisions regarding geographic sales diversification are complex and uncertain requiring managerial risk-taking and concrete decision making. Such decisions involve commitment of resources and risk-bearing associated with the process (Hunt, 1997; Sanders & Carpenter, 1998). Further, geographic sales diversification demands streamlining of export channels, creation of marketing networks, developing workforce skills, and credit providing ability—each of these involve uncertainty, complexity and not only monetary but long-term social, political, and legal commitments (Nolle, 1991; Sanders & Carpenter, 1998). However, a key premise is that in the face of globalization, expansion outside geographic boundaries and developing geographically diverse options are critical for long-term growth (Crossland and Hambrick, 2010; Hambrick & Finkelstein, 1987; Ramamurti, 2009; Sanders & Carpenter, 1998).

Though internationalization provides geographically diverse options for long-term growth in global markets, it also exposes managers to numerous hazards due to unpredictability stemming from differences in legal, political and social systems, property rights, differing languages, norms and religions, monetary policies and fluctuating exchange rates (Hymer, 1976; Williamson, 1985). In essence, global expansion increases opportunities, risks and complexity simultaneously; and to contend with such challenges, managers must have significant latitude, authority and control for benefitting from opportunities while bearing risks and managing complexity (Sanders & Carpenter, 1998; Hunt, 1997). Firms need to develop various competitive assets to become successful exporters, including extensive export channels, marketing networks, workforce skills, and the ability to provide credits to buyers (Nolle,

1991). Strategic relationships for dealing with different legal, political and social systems, social norms, property rights and monetary policies need to be established to overcome the inherent liabilities of operating in an unfamiliar setting (Hymer, 1976). Managers require high levels of freedom to simultaneously manage multiple product-markets involving different regulatory systems and market needs.

Managerial discretion view proposes that industries differ substantially in terms of managerial freedom to make key strategic decisions such as internationalization (Finkelstein & Hambrick, 1990; Shimizu & Hitt, 2004). In some industries, managers have high levels of discretion in taking such strategic initiatives, due to the presence of strategic alternatives and the relative absence of decision-making constraints (Hambrick & Abrahamson, 1995); in other industries, managers are relatively constrained to pursue internationalization. In industries where managerial discretion is high, managers have greater authority and control over organizational resources, structure, and performance. In these situations, they can assert more direct influence over important organizational decisions, such as internationalization (Finkelstein & Hambrick, 1990). Constraints in the task environment are generally less severe and managers have resource alternatives (Hambrick & Finkelstein, 1987). Boards in such industries are generally more receptive to bold managerial decisions, such as the decision to internationalize operations. Thus, managers are able to assert their decision choices on boards relatively easily (Finkelstein & Hambrick, 1990). In sum, managers have the latitude to pursue industry exports for organizational growth and to earn additional revenues in global markets in industries where levels of discretion are high. As such, our base hypothesis is:

Hypothesis 1. High levels of managerial discretion in an industry will be positively associated with industry exports.

### **Managerial Discretion and Innovation**

In the presence of managerial discretion, innovative product offerings facilitate the process of geographic sales diversification. Innovation requires the integration and application of tacit and explicit dimensions of knowledge for the creation of unique product offerings (Afuah, 2003; Hunt, 1997; Kogut & Zander, 1993; Martin & Salomon, 2003). Further, firms within industries engage in continual reconfiguration, recombination and exploitation of unique bundles of resources for generating valuable product offerings; and certain industries are more knowledge intensive and generate more innovations than others (Afuah, 2003; Grant, 1996; Utterback & Afuah, 1998). Both competitive and comparative advantages result from differences in the nature of knowledge that firms possess (e.g., patents) and their ability to exploit that knowledge in relevant foreign markets (Morgan et.al, 2003; Steensma & Lyles, 2000;

Tallman & Phene, 2007). Indeed, managers with unique product offerings based on superior knowledge and competencies have more leeway to pursue internationalization because such products have the potential to deliver competitive and comparative advantages in the global marketplace (Hitt, Hoskisson & Kim, 1997; Porter, 1998).

Managers with high levels of discretion particularly benefit from innovative product offerings because such products often create their own niche, and if radical, such innovative offerings have the potential to create new segments in the global marketplace (Conner & Prahalad, 1996; Porter, 1998; Tushman & Anderson, 1986). Moreover, innovative product offerings diffuse quickly in worldwide markets because there is homogeneity for innovative products in major export markets and knowledge swiftly flows across geographic boundaries (Ohmae, 2005; Tallman & Phene, 2007). Firms with cutting-edge innovations find markets not only in developed countries but also in 'technology-savvy' market segments worldwide.

Managerial decision making for internationalization with such products becomes less challenging as the uncertainties associated with introducing such products in the global market attenuate. With innovations showing promise in the global market, stakeholders are generally more amenable to following managerial decisions for geographic sales diversification—they provide greater authority to the managers for asserting their decisions on the firm despite the risks and uncertainties associated with them. This is crucial for the managers because geographic sales diversification involves myriad uncertainties associated with macroeconomic, global, legal, socio-cultural and political environment (Gupta, Smith and Shally, 2006; Porter, 1998).

In essence, managers with high levels of discretion are further motivated to develop export markets in the presence of innovative product offerings based on superior knowledge and technological competencies as these have high potential to deliver competitive and comparative advantages in the global marketplace (Afuah, 2003; Autio et al., 2000; Kotabe, 1990; Miller & Friesen, 1984; Zahra et al., 2000).

Hypothesis 2. The relationship between managerial discretion and industry exports will be stronger when levels of innovations are high.

### **Uncertainty and Real Options Perspective**

Uncertainty is the difficulty in predicting or foreseeing future events and advances—uncertainty arises when a decision maker cannot reliably forecast events based on available information (Anderson & Tushman, 2001). It has been argued that the less foreseeable the future state of the environment, and the

higher its level of uncertainty, the more difficult strategic decisions will be (Steensma & Corley, 2001; Tushman & Anderson, 1986). Industries vary in the extent to which predictions can be made regarding the future, with some being closer to equilibrium than others. A primary source of environmental uncertainty is technological change (Schilling & Steensma, 2001; Teece, 1986; Tushman & Anderson, 1986). In fact, technological change has been found to create high levels of uncertainty in the overall market environment (Anderson & Tushman, 2001). Technological change and uncertainty disrupt the underlying equilibrium of an industry (Schumpeter, 1942). Firms may lose both competitive and comparative advantage in the face of uncertainty because uncertainty has the potential to render the existing resources of a firm obsolete (Leonard-Barton, 1992).

Conversely, technological uncertainty provides an impetus for both the product and geographic diversification (Anderson & Tushman, 2001; Schumpeter, 1942). On one hand, firms may focus on the use of internal modes for developing new technologies; on the other hand, they may diversify geographically to exploit their existing products and technologies (Anderson & Tushman, 2001; Tushman & Rosenkopf, 1992). Firms may also venture into international markets for the creation of a portfolio of 'geographic' growth options—geographic diversification provides benefits such as resource sharing and risk distribution in geographically diverse markets while allowing for a stepping-stone approach in terms of future investments (McGrath & Nerkar, 2004; Reuer & Tong, 2005). A stepping-stone approach makes managers' investments flexible for deploying as opportunities arise in various locations—they avoid any huge commitment outright thereby limiting large losses at any step while retaining the option to reap positive gains by committing further in select locations if the expected payoffs are delivered. They can increase involvement in select geographic markets as the markets evolve, information asymmetries attenuate, and uncertainty resolves over time (McGrath & Nerkar, 2004; Reuer & Tong, 2005).

#### **Uncertainty, Managerial Discretion and Industry Exports**

Managers require considerable freedom and authority over organizational resources, structure, and performance to adequately influence and implement strategic decisions (Hambrick & Abrahamson, 1995). When managerial discretion is high, managers have significant authority and control over their firms and this leverage enables them to pursue industry exports for worldwide growth (Bettis & Hitt, 1995; Finkelstein & Hambrick, 1990).

In the presence of uncertainty in the domestic market, managers may seek opportunities for sharing investments and distributing risks outside geographic boundaries. They require high levels of discretion to create growth options by entering into diverse international markets for hedging against uncertainty in the domestic market (Kogut & Kulatilaka, 2001). In the industries with high levels of managerial

discretion, managers possess the freedom to build a geographically diverse portfolio of growth options – they can call for the option to grow and expand internationally rather than remaining constrained and tied only to the domestic market. Uncertainty pressures managers to exercise their discretion, authority and control to diversify into potentially profitable international markets to maximize rents. In essence, under conditions of uncertainty, managers with high levels of discretion will face pressures to use their latitude and power to distribute risk by diversifying into international markets. Pressures applied by uncertainty, on one hand, drive managers to explore international markets for creating a portfolio of growth options. High levels of managerial discretion, on the other hand, provide managers with the authority, control and power to distribute risk by creating a portfolio of growth options by entering into diverse international markets. The presence of both uncertainty and managerial discretion in the industry context serves as an impetus for internationalization in general, and exports in particular.

In contrast, when uncertainty is low, despite having high levels of discretion, managers operating exclusively in domestic markets do not face significant pressure for distributing risks and hedging uncertainty by creating geographically diverse growth options. Under this scenario, managers may not feel enough pressure to explore international markets for building a geographically diverse portfolio of growth options. As such, they will continue to allocate resources domestically to satisfy local managerial hubris and agency by focusing on home market rather than exploring new international markets that involve search costs and risks (Christensen & Bower, 1996; Zahra, 1996).

In summary, managers with high levels of discretion feel greater pressures to pursue international markets in the face of uncertainty, thereby distributing risk and sharing resources.

Hypothesis 3. The relationship between managerial discretion and industry exports will be stronger when the levels of uncertainty are high.

### **Innovations, Discretion, Uncertainty and Industry Exports**

In the presence of managerial discretion, conditions will be particularly ripe for internationalization via exporting when both the levels of innovations and uncertainty are high. Managers with high levels of discretion particularly benefit from innovative product offerings because such product offerings are based on superior knowledge and competencies and provide opportunities for entering new markets. When the levels of managerial discretion are high, managers will have the latitude to build a geographically diverse portfolio of options with innovative products for entering into international markets for growth purposes in lieu of facing uncertainty in the domestic market (Kogut & Kulatilaka, 2001; Tong, Reuer & Peng, 2007). Further, uncertainty in the domestic market develops pressure on the managers for hedging through geographic sales diversification, especially because levels

of technological change and uncertainty vary in different nations (Kogut & Kulatilaka, 2001; Tong, Reuer & Peng, 2007). Managers may also explore international markets for enriching their portfolio of 'geographic' growth options. In sum, when the levels of both the innovations and uncertainty are high, managers with high levels of discretion are induced to use their latitude for diversifying into potentially profitable international markets with their innovations for maximizing rents and for hedging against risks and uncertainty.

In spite of the presence of managerial discretion, conditions will be especially detrimental for geographic sales diversification when levels of innovations as well as uncertainty are low. In the absence of innovative product offerings, managers will be highly constrained due to the lack of novel, cutting-edge technology that could help them in penetrating international markets. They would hardly reap any benefits of differentiation that generally provides competitive and comparative advantage to foreign firms in the global markets (Hitt, Hoskisson & Kim, 1997; Porter, 1998). The stakeholders would not have as much faith in the managerial decision to expand internationally and it is plausible that they may resist such move. International markets have certain hunger for innovative products and reaching those markets with relatively obsolete, unexciting product offerings may be detrimental in the long run (Afuah, 2003; Hitt, Hoskisson & Kim, 1997). Further, when levels of uncertainty are low, such managers face neither significant pressure for growth by exploring international markets nor the need to distribute risks and hedge uncertainty by creating geographically diverse growth options. In the absence of innovative products, they do not have anything substantial to offer to global markets—as such, inertia would likely set in with regard to geographic expansion. Overall, managers would limit themselves to continue with routine and typical products to generate more rent in familiar home markets to satisfy local managerial hubris and agency rather than exploring international markets (Christensen & Bower, 1998; Zahra, 1996).

When the levels of innovation are high but uncertainty is low, managerial discretion may not necessarily motivate managers to create a geographically diverse portfolio of growth options. In relatively stable environments, firms will face limited pressure to venture outside of their boundaries regardless of the levels of innovation. Under such conditions, managers may not feel the pressure to venture into international markets—they may continue to pursue more familiar domestic markets that generate expected returns (Aldrich, 1999). In the absence of pressures, managers may not prefer bringing on and facing uncertainties associated with international markets and would rather reap the rents of their innovations in domestic settings. Under these conditions, the potential for innovations to facilitate the creation of a portfolio of geographically diverse growth options remains underutilized.

In contrast, when the levels of uncertainty are high but levels of innovation are low, managers with discretion will be under pressure to venture in the international markets, however, they will not have unique products that they could offer to the international markets. In the absence of differentiated products, it would be difficult to penetrate international markets for any competitive and comparative advantage (Hitt, Hoskisson & Kim, 1997; Porter, 1998). Managers may not want to commit resources and take risks associated with geographic sales diversification unless they have compelling product offerings (Afuah, 1998; Hitt, Hoskisson & Kim, 1997). In addition, such an environment will shift managerial attention toward mastering threats in the fast changing environment, survival, resource acquisition and competition rather than focusing on internationalization for growth (Aldrich, 1999). Managers will pursue routine domestic growth with relatively typical product offerings in familiar domestic markets because pre-existing markets already have a pipeline for such products rather than trying to venture internationally.

Summarizing the above, in the presence of managerial discretion, the “ideal” conditions for motivating geographic sales diversification develop when the levels of both uncertainty and innovation are high. In the mixed environments, that is, in the presence of high uncertainty and low levels of innovation and low uncertainty and high levels of innovation, conditions are moderately favorable for industry exports. However, conditions are particularly detrimental for geographic sales diversification when both the technological uncertainty and innovation are minimal. In essence,

Hypothesis 4a. The relationship between managerial discretion and industry exports will be particularly strong when the levels of innovations and uncertainty are high.

Hypothesis 4b. The relationship between managerial discretion and industry exports will be particularly weak when the levels of innovations and uncertainty are low.

## Methods

We gathered data on every U.S. manufacturing industry at the four-digit SIC level. Our sample consists of those industries that fall under the Manufacturer Standard Industrial Classification (SIC) Codes—2000 through 3999. According to U.S. Census bureau, firms in these industries must be primarily engaged in the chemical or mechanical transformation of raw materials or processed substances into new products. There are 459 industries in the manufacturing sector (i.e., between SIC codes 2000 to 3999) (e.g., Bartelsman, Becker, and Gray, 2000). As per our database, there were 357,984 firms in the 459 SIC industries in 1997 with about 778 firms on average per industry.

After eliminating those industries for which data were not available for every variable, we were left with 203 industries. The resulting database contains information on financial and industry-level data from U.S. Census Bureau, U.S. Bureau of Economic Analysis, Carnegie-Mellon Survey (CMS) of industrial R&D, Schonfeld and Associates, and Standard and Poor's Compustat.

### **Dependent Measure**

Industry exports measured as Export Intensity. To measure industry exports via export intensity, we use the U.S. Bureau of Economic Analysis data. Arithmetic averages of financial data attenuate annual fluctuations and have been used for this reason in prior research (Rothaermel, 2001; Rothaermel, Kotha & Steensma, 2005). Export intensity is defined as the total value of industry exports expressed as a percentage of net sales averaged for the years 1996-1998 for each industry.

### **Independent Measures**

Managerial discretion. Consistent with past operationalizations of managerial discretion, we conceptualize managerial discretion as an aggregate construct comprised of the following dimensions emanating from the task environment (Hambrick & Abrahamson, 1995; Finkelstein & Hambrick, 1990):

Industry munificence. Industry growth results in greater decision-making freedom for managers (Hambrick & Finkelstein, 1987), providing them greater latitude for geographic sales diversification by enhancing growth prospects and minimizing constraints. We measure industry munificence in terms of growth in sales (Li & Mahoney, 2009). Following the methodology employed by Keats and Hitt (1988), we acquired industry sales for the years 1990 to 1994 from the U.S. Census Bureau's Annual Survey of Manufactures. The natural logarithms of these sales figures were entered into quasi-time series regressions with time serving as the independent variable. The antilogs of the resulting regression slope capture industry growth.

Industry product differentiation. In highly differentiated industries, managers have more freedom to develop innovative product offerings and to meet global, heterogeneous demand with different product recombinations (Schilling & Steensma, 2001). Managers develop innovative product offerings that stand out in the international product-markets based on their features, quality, and design among others. They also have the opportunity to explore myriad ways to meet demands based on worldwide customer preferences. Thus, industries with higher levels of differentiation provide more avenues for using discretion because means-end linkages are relatively ambiguous (Finkelstein & Boyd, 1998; Hambrick & Abrahamson, 1995). We assess product differentiability using advertising intensity of an industry. Advertising intensity reflects firms' attempts to differentiate themselves and gain market attention (Balasubramanian & Lieberman, 2010; Erickson & Jacobson, 1992) and according to Finkelstein and Boyd



(1998, p.183), “advertising intensity (Rajagopalan & Prescott, 1990)...(is a) standard indicator of product differentiability.” Advertising intensity is measured as the advertising budget as a percentage of net sales and averaged for the period 1990 to 1994. We get this data from Schonfeld and Associates (1990-1994).

Capital intensity. Firms in capital intensive industries are generally committed to a course of action due to the high investment in fixed assets. This leads to a high degree of continuity of past practices and decisions in the present that are often constrained by past resource commitments. Capital intensity creates strategic rigidity. Due to high fixed costs, any deviations from existing routines could prove very expensive (Datta & Rajagopalan, 1998). Managers follow past routines as safe bets for avoiding costly mistakes. They focus on cost and efficiency considerations. Managers face limitations in their pursuit of geographic sales diversification because of the presence of strategic rigidity and relatively high constraints in exploring international markets (Hambrick and Finkelstein, 1987). Capital intensity is associated with lower incentives for experimentation in decision-making and innovation, and higher needs for following routines. Thus, we use the inverse of capital intensity as an indicator of industry-level discretion that facilitates venturing into international markets. Capital intensity is measured as the ratio of the industry’s gross book value of assets to value of annual shipments. We use the arithmetic average of 1990 to 1994 data that were obtained from the U.S. Census Bureau’s Annual Survey of Manufactures.

Industry structure. In highly competitive or fragmented industries, managers generally experiment with diverse strategies for reaping rents to counter their competitors. They try to beat the competition by exploring international markets in order to gain first-mover advantage. This stands in contrast to the strategies deployed by oligopolists who are constrained by their responsiveness and reaction to the behavior of rivals (Hambrick & Finkelstein, 1987). We used a comprehensive and widely used measure to capture competitive intensity: the inverse of the Herfindahl-Hirschmann opportunities index of market share (Curry & George, 1983; Morgan & Rego, 2006; Palmer & Wiseman, 1999). This index addresses both the number of firms in an industry and relative inequalities in the market share of firms in an industry. The ‘H index’ is the sum of the squared market shares of all the firms in an industry. This index ranges between 0 to 1, with 0 being perfect competition and 1 monopoly. Score of 0 represents infinite number of firms with equally infinitesimal market shares. A score of 1 represents perfect monopoly, single firm controls whole market. Any entry of additional firms moves the score towards 0, and any disproportionate possession of market shares moves the score towards 1 (Boyd 1990). The U.S. Census Bureau releases this data every five years. These measures were obtained from the data released for the 1990 to 1994 timeframe in the 1992 Economic Census by the U.S. Census Bureau.

**Overall Managerial Discretion.** Consistent with the conceptualization of ‘Managerial Discretion’ as an aggregate of the above variables (e.g., Hambrick & Abrahamson, 1995; Hambrick & Finkelstein, 1987; Law, Wong & Mobley, 1998), we standardize each of these variables and combine them to develop a composite measure to capture the levels of discretion managers have in their industry. Moreover, we used updated data for each of the above variables to conduct robustness checks and analysis.

**Industry innovations.** Industry innovations reflect the application and exploitation of tacit and explicit knowledge and resource bundles for developing outcomes that are both unique and tangible. Industry innovations are measured as the origination of patents in each SIC industry between 1990-1994 (Silverman, 1996; Silverman, 1999). This measure is based on the probabilistic distribution of patenting activity in the SIC of origin during this timeframe (Silverman, 1996; Silverman, 1999). Silverman (1996, 1999) developed an algorithm for associating patents in different U.S. patent classes with industry SICs. He adapted a Canadian patent office concordance system that assigns Canadian patents to the appropriate 4-digit Canadian SIC of use. Silverman then calculated a probability distribution derived from the Canadian data, and associated each patent issued in the U.S. to its corresponding probability-weighted U.S. SIC. This is the most robust data available on the assignment of U.S. patent distributions for innovations by each SIC category. This patent-industry concordance has been used in a number of studies that require linkages between U.S. patent classes and four-digit SIC classifications of U.S. industries (McGahan & Silverman, 2001; Silverman, 1996, 1999).

**Technological change and uncertainty.** We use a version of the Solow residual, namely total factor productivity growth (TFP), to measure industry-level rates of technological change and uncertainty (Solow, 1957). A series of studies of economic growth conducted by the National Bureau of Economic Research showed that the historic rate of economic growth in GDP could not be explained entirely by growth in labor and capital inputs (Jorgenson, 1984; Schilling & Steensma, 2001). A consensus has emerged that the residual largely captured technological change and uncertainty (Crafts, 1996; Terleckyj, 1980; Schilling & Steensma, 2001; Siegel & Griliches, 1991). A number of researchers have used TFP growth at the industry level (e.g., Griliches & Lichtenberg, 1983; Jorgenson, 1984; Schilling & Steensma, 2001; Siegel & Griliches, 1991). The Bartelsman-Gray manufacturing productivity database tracks TFP growth for every four-digit manufacturing SIC code from 1958-2005. This measure is based on a five-factor production function: capital, production worker hours, non-production workers, non-energy materials and energy. The TFP growth index is calculated as the growth rate of output (real shipments) minus the revenue-share-weighted average of the growth rates of each of the five inputs (Bartelsman, Becker & Gray, 2000; <http://www.nber.org/nberces/>). The measure used in the present study is the five year average TFP growth rate: 1990 through 1994.



Table 1  
Key Measures with Description

<i>Variable Name</i>	<i>Brief Description</i>	<i>Time-Period and Source</i>
<i>Dependent Variable</i>		
<i>Industry exports</i>	<i>Total value of industry exports expressed as a percentage of net sales averaged for each industry</i>	<i>1996-1998</i>
<i>Independent Variables</i>		
<i>Managerial discretion</i>	<i>Aggregate construct of the following variables that were standardized and combined to create a composite measure (e.g., Hambrick &amp; Abrahamson, 1995; Hambrick &amp; Finkelstein, 1987; Law, Wong &amp; Mobley, 1998).</i>	<i>See below</i>
<i>Industry munificence</i>	<i>Natural logarithms of sales figures entered into quasi-time series regressions</i>	<i>1990 to 1994 from the U.S. Census Bureau's Annual Survey of Manufactures.</i>
<i>Industry product differentiation</i>	<i>Captured by advertising intensity is measured as the advertising budget as a percentage of net sales</i>	<i>1990 to 1994 from the directory by Schonfeld and Associates</i>
<i>Capital intensity</i>	<i>Ratio of the industry's gross book value of assets to value of annual shipments</i>	<i>1990 to 1994 from the U.S. Census Bureau's Annual Survey of Manufactures.</i>
<i>Industry structure</i>	<i>Inverse of the Herfindahl-Hirschmann opportunities index of market share or H-index</i>	<i>1992 and 1997 Economic Census by the U.S. Census Bureau—largely time invariant nature of data published every five years (<a href="http://www.census.gov/mcd/historic/mc92cr.txt">http://www.census.gov/mcd/historic/mc92cr.txt</a>)</i>
<i>Industry innovations</i>	<i>Probabilistic distribution of patenting activity in the SIC of origin during this timeframe</i>	<i>1990-1994 by Silverman (1996) and Silverman (1999).</i>
<i>Technological change and uncertainty</i>	<i>The TFP growth index is calculated as the growth rate of output (real shipments) minus the revenue-share-weighted average of the growth rates of each of the five inputs</i>	<i>1990-1994: Five year average TFP growth rate as discussed by Bartelsman, Becker &amp; Gray, (2005) and <a href="http://www.nber.org/nberces/">http://www.nber.org/nberces/</a></i>

### Control Variables

Diversity of demand. The nature of certain industries is such that customers demand products of greater variety as well as products with greater features. In such industries, under pressures of diverse

demand from global customers, managers have greater latitude to develop such products using different recombinations and to reach a diverse set of customers worldwide (Porter, 1998). The benchmark input-output data which are measured every five years captures, at a detailed level, how each industry uses the outputs of other industries. It is the most carefully and consistently measured data on the outputs used by each industry (Schilling & Steensma, 2001). To measure diversity of demand for each industry, we use the 1997 Benchmark Input Output data which covers heterogeneity during 1993-1997 periods because this timeframe is most applicable to our sample. First, all commodity categories produced by each industry were identified. Then, for each of those commodity categories, all purchasing industries of the commodity were identified. Thus, the resulting count measure includes every industry customer of every commodity category produced by each industry. Our measure explicitly accounts for variety of products by industry by tracking every product-to-industry sales relationship.

Diversity of inputs. Industries that use a variety of inputs are capable of developing a number of valuable recombinations and reconfigurations that could potentially serve various niches in different international markets. To measure input diversity for each industry, we used the 1997 Benchmark Input Output data. We used counts of every commodity category used by a given industry to measure diversity of inputs.

We control for the diversity of demand and inputs by standardizing both measures and aggregating them to create a multidimensional construct (Law, Wong & Mobley, 1998).

Slack. Slack is an important determinant of industry exports. Slack serves as a cushion of excess resources that can be used in a discretionary manner for the creation of export channels (Bourgeois, 1981). We operationalize slack as the current ratio, or the ability of firms within industries to meet current obligations averaged for the 1990-1994 data (current assets/current liabilities).

Industry standards. The development of technology standards within an industry further facilitates internationalization. Standards mitigate fear and confusion regarding new technological trajectories, reduce barriers to entry and develop common platforms for collaborative partnerships worldwide (Sahaym, Steensma & Schilling, 2007). We used a database of organization standards provided by the American National Standards Institute (ANSI) to capture whether standards are available in the industry. A dummy variable (0, 1) was employed to indicate whether the industry has a registered member of the ANSI for 1994 that develops and administers standards.

Industry appropriability. We control for industry appropriability because we measure industry innovations based on industry-level patenting, and industries vary in their propensity for using different appropriability mechanisms, such as patents and secrecy. We measure strength of the appropriability

regime in an industry as the percentage of process and product innovations in the industry that patents effectively protect from imitation (e.g., Basu et al, 2006; Sakakibara, 2002; Cockburn & Griliches, 1988). We obtained these data from the Carnegie-Mellon Survey (CMS) of industrial R&D (Cohen et al., 2002). In the CMS, 1,478 R&D managers estimated the effectiveness of different intellectual property protection mechanisms in protecting product and process innovations in their industry. The CMS was administered in 1994.

**Average firm size.** We control for average firm size of the industry measured as average assets held by firms in each industry for 1994. This measure parses out the amount of variance in exporting that could be present due to a firm's scope and scale. Average firm size in terms of assets is based on data from NBER-US Census Bureau.

**Industry size.** We control for industry size in terms of the number of firms in each industry for 1994. We acquire these data from the U.S. Census Bureau's CenStats databases.

#### Model Specification

We used Hierarchical Moderated Regression model with the following specification (e.g., Hair et al. 1995; Arnold, 1982; Sharma et al. 1981; Schoonhoven 1981):

$$Y = a + b_1X_1 \dots + b_8 X_8 + b_{10} X_7X_9 \dots + b_{13}X_7X_8 X_9 + e$$

where Y denotes the dependent variable: Geographic Sales Diversification; X1 through X6 correspond to control variables, while X7, X8 and X9 correspond to main effects of Discretion, Innovations and Uncertainty. In addition, X7\* X 9 , X7\* X 8, and X8\* X 9 are the two-way multiplicative interaction terms (the cross product of the predictor and the moderator variables), and, X7\* X8\*X 9 is the three-way interaction term. In essence,

$$\begin{aligned} \text{Geographic Sales Diversification} = & \alpha + \beta_1 \text{Firm assets} + \beta_2 \text{Industry size} + \beta_3 \text{Standard} + \beta_4 \\ & \text{Appropriability} + \beta_5 \text{Diversity} + \beta_6 \text{Slack} + \beta_7 \text{Managerial discretion} + \beta_8 \text{Innovations} + \beta_9 \text{Uncertainty} + \\ & \beta_{10} \text{Discretion*Uncertainty} + \beta_{11} \text{Discretion* Innovations} + \beta_{12} \text{Innovations*Uncertainty} + \beta_{13} \\ & \text{Discretion* Innovations* Uncertainty} + \varepsilon \end{aligned}$$

We entered the variables in the following order. First, we entered the control variables and the key independent variables. Our overall model with these variables was significant ( $p < .001$ ). Next, in the Model 2 of table 2, we added interaction terms associated with managerial discretion, innovations and industry exports. The model was significant ( $p < .01$ , Table 2, Model 2). Last, we added the three way interaction term of managerial discretion, innovations and technological uncertainty and found that this model was significant as well ( $p < .05$ , Table 2, Model 3).

## Results

Table 2 reports the means, standard deviations, and correlation coefficients between the dependent, independent, and control variables. We use hierarchical moderated regression using ordinary least squares to estimate our models. To avoid multicollinearity between the predictors and the interaction terms and to enhance the interpretation of the main effects, we center all variables involved in the interaction terms (Aiken & West, 1991). Table 3 presents the results of this analysis.

Table 2: Intercorrelation Matrix for Dependent, Independent, and Control Variables

aN = 203, †p &lt; .1, \*p &lt; .05, \*\*p &lt; .01, \*\*\*p &lt; .001

	Variables	Mean	S.D.	1 a	2	3	4	5	6	7	8	9
1.	Exports Intensity	.181	.165	-								
2.	Average Firm Assets	9.627	19.251	.013	-							
3.	Industry Size	776.674	2557.953	-.093*	-.110**	-						
4.	Standards	.6650	.4731	.155**	.042†	-.118**	-					
5.	Appropriability Regime	32.9144	7.878	.082†	-.003	-.027	-.005	-				
6.	Heterogeneity Index	0.3433	1.6746	.031**	.032	.088*	.073†	.269***	-			
7.	Slack	2.3261	.4839	.167***	-.147***	-.107**	.146***	.152**	.039	-		
8.	Industry Innovations	13.719	21.0237	.326***	-.030	.079*	.252***	.157**	.243***	.154***	-	
9.	Managerial Discretion Index	3.009	2.8290	.360***	-.046	.101*	.192**	.139**	.226***	.303***	.419***	
10.	Technological Uncertainty	.0076	.0175	.089*	.039	.034	.079*	-.025	.004	.000	.212***	.118*



Table 3: Hierarchical Moderated Regression Models for Industry Exports 1996-1998a

<i>Variables</i>	<i>Model 1</i>	<i>Model 2</i>	<i>Model 3</i>
<i>Constant</i>	.046	.049	.028
<i>Control variables</i>			
<i>Average Firm Assets</i>	.000	.000	.000
<i>Industry Size</i>	-.000*	-.000†	.000
<i>Standard</i>	.003	.005	.003
<i>Appropriability Regime</i>	.001	.001	.001
<i>Diversity of Inputs and Outputs</i>	.017**	.018**	.020**
<i>Slack</i>	.018*	.016*	.018
<i>Direct Effects</i>			
<i>Managerial Discretion</i>	.013***	.013**	.017**
<i>Industry Innovations</i>	.003***	.004***	.005***
<i>Technological Uncertainty</i>	.044*	.070	.025
<i>Indirect Effects</i>			
<i>Managerial Discretion X Tech. Uncertainty</i>		.330**	.102*
<i>Managerial Discretion X Innovations</i>		.050*	.007*
<i>Innovations X Tech. Uncertainty</i>		.038*	.002*
<i>Three-way Interaction Effects</i>			
<i>Managerial Discretion X Innovations X Technological Uncertainty</i>			.026*
<i>R-square</i>	.215***	.252**	.270*
<i>R-square change</i>		.038**	.017*

aN = 203, †p &lt; .1, \*p &lt; .05, \*\*p &lt; .01, \*\*\*p &lt; .001

In Model 1 of Table 3, we entered the control variables and main effects of our independent variables. Our overall model with these variables is significant ( $p < .001$ ). In general, for our sample of industries, both innovation and managerial discretion have a positive relationship with industry exports.

Hypothesis 1 proposes that the presence of higher levels of managerial discretion in an industry will lead to greater industry exports. The coefficient associated with managerial discretion in our model is significant (Model 1, Table 3,  $p < .001$ ). Hence, hypothesis 1 is supported.

Hypothesis 2 argues that managerial discretion will more strongly motivate geographic sales diversification when the levels of innovations are high as compared to when they are not high. The interaction term associated with managerial discretion, innovations and industry exports is positive and significant ( $p < .05$ , Table 3, Model 2). Hypothesis 2 is supported.

Hypothesis 3 argues that managerial discretion will more strongly motivate geographic sales diversification when the levels of technological change are high as compared to when they are not high. The interaction term associated with managerial discretion, technological change and industry exports is positive and significant ( $p < .01$ , Table 3, Model 2). Hypothesis 3 is supported.

Figure 2: Discretion, Uncertainty and Exports

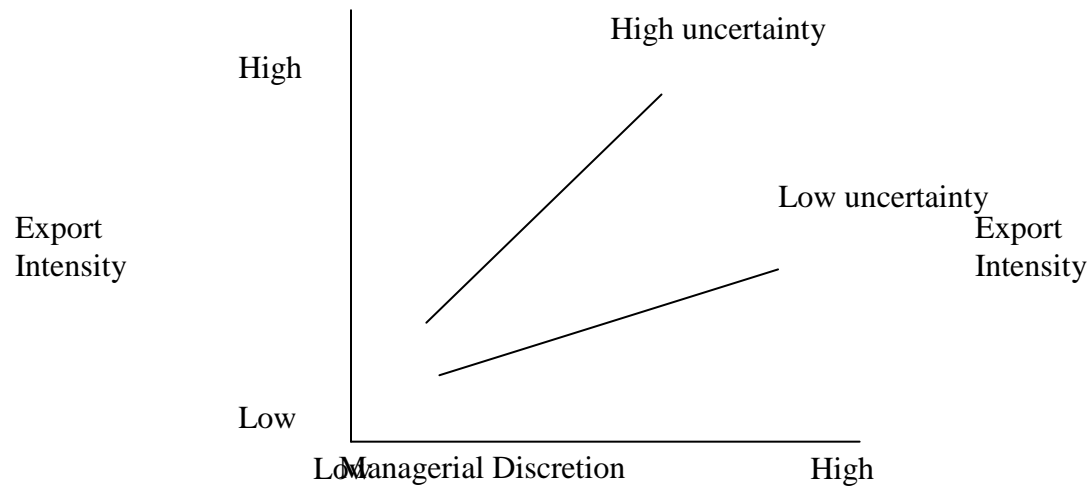
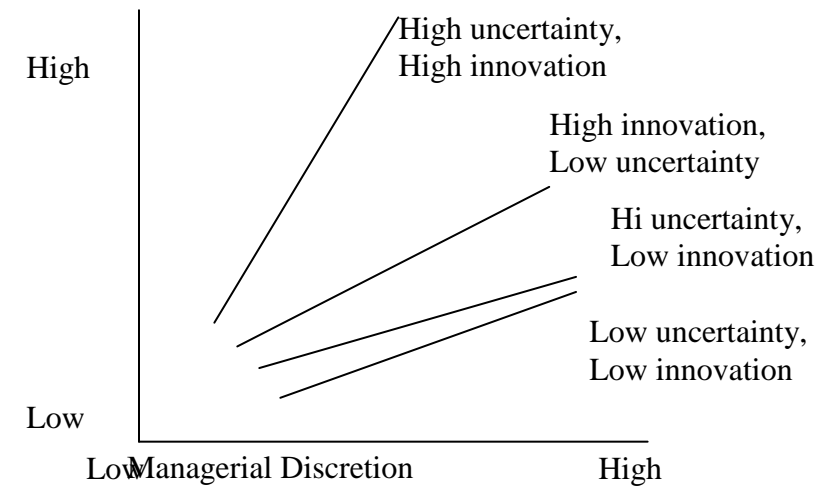


Figure 3: Discretion, Uncertainty, Innovation and Exports



Hypotheses 4a and 4b contend that the relationship between managerial discretion and industry exports depends in part on the joint effect of the levels of innovations and technological uncertainty. Model 3 (Table 3) adds the associated three-way interaction term hypothesized. The coefficient associated with the three-way interaction term of managerial discretion, innovations and technological uncertainty is positive and significant ( $p < .05$ ); indicating that in the industries with high levels of managerial discretion, the presence of innovations and technological change motivates geographic sales diversification. To gain further insight into the nature of the three-way interaction, we plotted this significant three-way interaction in Figure 3 following the procedure suggested by Aiken and West (1991). As predicted in hypothesis 4a, the relationship between managerial discretion and industry exports is most strongly positive when the levels of innovation and technological uncertainty are high.

In contrast, the relationship between managerial discretion and geographic sales diversification is the weakest when levels of innovations and technological change are low. This is consistent with hypothesis 4b, which predicts that the relationship between managerial discretion and geographic sales diversification will be weakest for those industries where levels of innovations and technological change are low.

### **Robustness tests and further analyses**

To check for the robustness of our results with more current data, we collected additional data till 2005 for the dependent variable and till 2001 for the independent variables. Though we found the levels of fluctuation in the independent as well as dependent variables unusual for 1999 through 2003 because of the market recession and recovery during these years (e.g., <http://www.census.gov/foreign-trade/statistics/historical/>), we conducted the analysis in the following ways.

First, we averaged the data for 1990 through 1999 for the independent variables, and 2002 to 2004 for the dependent variable. We again used hierarchical moderated regression for estimation. There were no material changes in the results relative to the reported results though minor differences were found in the regression coefficients and levels of significance (e.g., slack was now significant at .05 level whereas earlier it was significant at .001 level).

Second, we performed the analysis using the data beginning 1998 through 2001 for the independent variables, and 2003 to 2005 for the dependent variables. Though we found support for our key hypotheses, a few results were different. First, the control variable, appropriability regime, was now significant at .05 level whereas earlier it was not significant. Second, the control variable, slack, was now significant at .05 level whereas earlier it was significant at .001 level. Third, industry innovations variable

was now significant at .01 level whereas earlier it was significant at .001 level. Fourth, we observed minor changes in regression coefficients though signs remained consistent.

Overall, we did not find any material difference in the outcome relative to the reported results.

## Discussion

Industry exports are vital for growth, expansion and competitive advantage in the global marketplace. In this study, we systematically identified and examined the joint effects of managerial discretion, industry context and environment in motivating internationalization via industry exports. We introduce the notion that managerial discretion in combination with industry contextual and environmental variables motivates geographic sales diversification. The context of U.S. manufacturing industries during the mid-1990s, when the U.S. was the largest producer and consumer of most of the world's innovative products, makes this framework more generalizable to emerging markets that are on the path of becoming large producers as well as large consumers of such products (e.g., BRICS countries—Brazil, Russia, India, China and South Africa).

Our results demonstrate that a significant relationship exists between managerial discretion and industry exports, implying that managers exercise considerable influence on exporting when they have greater latitude, authority and control. Moreover, we found that the relationship between managerial discretion and industry exports is enhanced when levels of innovation are high. Managers are better able to use their latitude to leverage innovations for creating a portfolio of product recombinations that facilitates venturing into international markets. Our results also show that the relationship between managerial discretion and exports is enhanced when levels of technological uncertainty are high. Under these conditions, managers use their latitude to create a portfolio of geographically diverse growth options for hedging against uncertainty in the domestic environment.

We considered a more complex model by exploring how the combination of industry environment (i.e., technological uncertainty) and context (i.e., innovations) alters the influence of managerial discretion on industry exports. Our results show that the conditions are particularly ripe for industry exports when levels of technological uncertainty and innovations are high. Under this scenario, managers with the latitude to make internationalization decisions are armed with innovative product offering for penetrating worldwide markets and technological uncertainty at home provides them an opportunity to take such products to the international markets. As such, managerial discretion has the strongest positive relationship with industry exports under these conditions, whereas an absence of these factors makes the conditions particularly detrimental for industry exports.

Overall, with this research, we respond to the calls by a number of scholars to examine the role of managerial discretion in the internationalization process under contingencies (e.g., Crossland & Hambrick, 2010; Leonidou, 1998; Lohrke & Bruton, 1997; Salomon & Shaver, 2005)—according to these scholars, a reliable relationship between managerial variables and exports is yet to be found particularly in the presence of environmental and contextual factors.

#### Implications

### **Theoretical implications**

In the context of international business and global strategy, our findings have a number of theoretical implications. We believe that this is one of the first studies to use managerial discretion view to integrate the insights of scholars having polar views on strategic choice versus environmental determinism. We provide a foundation for future research with our empirical finding that internationalization process is influenced by a combination of managerial discretion, uncertainty, and an ability to offer innovative products to worldwide markets.

We also contribute to the literature at the intersection of upper echelon, international trade and strategy literatures with our results that managers require considerable freedom and authority over firm resources and structure for making key decisions. This is one of the few studies to extend managerial discretion view in the realm of geographic sales diversification (exceptions include Crossland and Hambrick, 2010, 2007).

Similar to Tong, Reuer and Peng (2008), this study contributes to both the real options and internationalization literatures by extending real options view to examine issues related to international business. Further, its findings highlight the role of environmental and contextual factors in affecting the relationship between managerial discretion and geographic sales diversification.

Our empirical findings also underscore the importance of innovations in the geographic sales diversification. In addition, this study highlights the role of environmental and contextual contingencies in the domestic market and their influence the relationship between managerial discretion and strategic decisions. These findings are consistent with the conceptual insights of scholars such as Burgelman and Grove (2004) who propose that, "...company's strategy resides in its strategic actions... (p. 13)...top management's beliefs...are the most important drivers of a company's strategy....leaders' strategic actions respond to external and internal selection pressures...rapid technological change may alter the industry structure. (pp. 14-15)...strategic action interacts with the environment (p.30)... technological platform ...give(s) rise to the emergence and growth of ecosystems (p. 42)."

Our findings also have implications for related streams such as international entrepreneurship that examine phenomenon such as role of MNCs top managers in promoting international corporate venturing. Scholars in these streams can fruitfully use our findings on the role of managerial discretion, innovations and environment in potentially motivating international corporate venturing between MNCs from the developed countries (e.g., G-8 nations) and start-ups in emerging markets (e.g., BRICS countries—Brazil, Russia, India, China and South Africa).

### **Managerial relevance**

In addition to the above theoretical implications, our findings have a number of important implications for managers. First, managers with high levels of discretion may want to leverage their latitude for action and assert their authority for pursuing internationalization if they are armed with innovative offerings and face environmental pressures at home. Such managers should confidently develop internationalization strategies for the markets that hold potential for growth because their firms are well positioned for pursuing geographic sales diversification.

Second, superior value will be generated for both the primary and secondary stakeholders when the managers with high levels of discretion are armed with innovative offerings and face pressures to shed inertia. In the words of Finkelstein and colleagues (2009, pp. 27-29), such managers must take strategic actions to match the environment—in our context, the actions of such managers will be matching the pressures and opportunities for internationalization.

Third, from a public policy perspective, such managers can proactively contribute to both their nation's GDP and GNP by pursuing internationalization. On one hand, geographic sales diversification benefits domestic firms by providing them opportunities for developing new markets worldwide. On the other hand, venturing in the international markets provides new revenue streams as well as worldwide legitimacy to the domestic brands and firms while hedging for uncertainty in the domestic markets. As such, from a policy perspective, managerial initiatives for geographic sales diversification have implications for the growth of domestic economy, businesses and the human capital.

### **Limitations, future research and extensions**

Our research framework regarding industry contextual and environmental factors is by no means exhaustive. We acknowledge that our analysis has certain limitations because it was conducted at a relatively macro (i.e., industry) level assuming homogeneity among firms (Klein, Dansereau and Hall, 1994). Though the implications of studies with 'managerial discretion' at the industry level permeate across-levels (e.g., Rajagopalan and Datta (1996) and Rajagopalan and Finkelstein (1992) study this

phenomenon at mesa-level; whereas Carpenter and Golden (1997) study the same at micro-level), some potential biases may have been introduced due to the level of study. For example, it is plausible that the firms within each SIC code are not involved in similar activities to the extent assumed by the U.S. Census Bureau. Indeed, shortcomings of the SIC classification led to the development of finer North American Industry Classification System (NAICS), which provides a greater level of detail about a firm's activity than SIC codes. Further, this would affect the assumption that firms within industry are homogeneous, resulting in certain bias in the managerial discretion scores of the industries. A systemic longitudinal analysis at the firm level but in different industries with CEOs as respondents could bring new insights into the role of managers in motivating geographic sales diversification under firm-specific contingencies.

Future research could explore how firm-level differences in TMT members' attributes (e.g., education, hierarchical position, background etc.) influence the choice of certain modes of internationalization over others (e.g. international joint ventures, FDI, greenfields). Organizational and international business researchers may also examine the role of managerial discretion, innovation and environment in mergers and acquisitions (M&A) and alliance decisions, particularly those involving MNCs and young firms from different countries.

Researchers may also strive to establish unequivocal causality between the constructs proposed in the study. Though we performed Univariate Analysis of Variance<sup>83</sup> to further test for the relationships, we acknowledge that our research design does not allow us to claim causality unequivocally. However, we can make an inference about causality with some confidence as the results of Univariate analysis are consistent with that our findings. We hope future research can use longitudinal data and pursue a lag structure building on the theoretical foundation developed in this study. Researches can then use Granger causality test or panel data regression analysis or time series analysis to establish causality.

Other studies might examine how managerial discretion in combination with firms' technological and operational capabilities influences their strategic choice on the use of different modes (e.g., alliances vs. acquisitions vs. greenfields vs. joint ventures) for international market entry. For instance, firms' information technology (IT) and supply-chain related capabilities may promote the use of one mode of internationalization over other depending on the levels of discretion managers have in different industries.

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<sup>83</sup> We thank an anonymous reviewer for this suggestion.



Scholars interested in macro-economic and cross-cultural approaches might attempt to distinguish between export destinations, analyzing how country variables such as risk preferences and power distances, among others, influence managerial decisions.

Though this study is limited to the context of U.S. manufacturing industries, this research has implications for firms from emerging economies that aspire to become both large producers of goods and consumer markets (e.g. BRICS countries). These countries are poised to become the dominant suppliers of manufactured goods and services as well as have large domestic markets between 2025 and 2050 (Ohmae, 2005). Drawing on the theories of international trade and organizational strategy, we believe that firms from emerging economies would also face similar challenges and opportunities in the future. U.S. firms' rich experiences in dealing with these issues have normative implications for firms from emerging markets. In light of our results, managers worldwide may engage actively in the development of innovative capabilities and respond effectively to environmental pressures for reaping benefits from industry exports.

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## WHAT MOTIVATES PEOPLE TO PURCHASE CHOCOLATE BRANDS: ITALY VERSUS RUSSIA

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### Abstract

Today highly competitive business environment and more exigent customers call for using all available company's resources especially a company's brand for providing better consumer satisfaction. We argue that customers are more loyal to a product brand that corresponds to their needs better (H1). While buying a chocolate, consumers want to satisfy firstly their physical and then their psychological needs (H2).

The findings indicate that the respondents prefer to buy chocolate brands that present the characteristics they like most. However, a positive evaluation does not translate into strong brand loyalty. In general consumers purchase multiple chocolate brands. The second hypothesis was disproved. It appears that the needs that are primarily satisfied by buying chocolate are psychological rather than physical.

**Keywords:** chocolate brands, motivation, consumer loyalty

### Conceptual background/hypothesis development

According to Kotler and Keller (2005) customer needs are the basis of all modern marketing. The key to a company's survival, profitability, and growth in a highly competitive marketplace is its ability to identify and satisfy unfulfilled consumer needs better and sooner than the competition. Keller (2007) proposes that brands make a client's choices easier since they signal quality. The brand is important for maintaining a client's loyalty with all the advantages that loyalty brings with it (competitive safety, expected cash flow, entrance barriers to other brands). Thus,

*Hypothesis 1. Customers are more loyal to a product brand which corresponds to their needs better.*

There are many classifications of consumer needs (Solomon, 2004). Innate needs are physical. Acquired needs are needs that are learnt in response to a culture or environment. These may include needs for self-esteem, prestige, affection, power and learning.

*Hypothesis 2. While buying a chocolate, consumers want to satisfy firstly their physical and then their psychological needs.*

### Methodology

The data were collected during November-December 2009 in Trento (Italy) and in Yekaterinburg (Russia) by personal interviews outside different types of outlets (supermarkets, discounts, specialty stores, etc.). The respondents were asked about three

internationally known (Ferrero, Cadbury and Ritter Sport) and two national chocolate brands regards to the general evaluation, length of purchase, frequency of purchase, important characteristics, reasons for buying chocolate, attitudes towards national and foreign chocolate brands. The collected responses were analysed using the SPSS-software. Corresponding figures were provided.

Hypothesis 1 is tested by comparing the reported length and frequency of purchase with the evaluation of the brands by the respondents and their satisfaction with them.

Hypothesis 2 is tested by analysing the motivations for buying chocolate expressed by the respondents.

## **Sample**

The Italian sample is made up of 240 questionnaires. They were collected through a non-probability convenience sampling. The questionnaires were collected in equal number (60) outside shops of four different types, i.e., supermarkets, discounts, small shops (independent individual owner), small shops (linked to a cooperative).

The interviewees were exactly two thirds females (66,7%) and one third males (33,4%).

They were fairly split between the various age groups (excluding the younger one, less than 18 years old, 2,1%, and the elder one, more than 60 years old, 9,2%), with the largest concentration in the groups between 46 and 60 years old (30%) and between 18 and 25 years old (24,2%). In the group between 26 and 35 years old there were 14,2% of respondents; in the group between 36 and 45 years old there were 20,4% of respondents.

The majority of respondents was married with children (50,8%) and a large group was of those who are single without children (37,1%).

The most widespread occupations were clerk (in private enterprise) - 16,6%; civil servant - 11,7%; housewife - 11,7%, professional - 8,3%, skilled worker - 7,1%, entrepreneur - 5,4%. However the largest group answered other occupation (32,5%); most of them were students.

The Russian sample consists of 200 questionnaires. They were collected in the same way as the Italian sample.

Also in this sample the proportion between females and males was two thirds and one third (slightly more males than in the Italian sample)

The largest concentration was in the group between 18 and 25 years old (60%). Other respondents were split evenly between groups of 26-35 years old (14,5%), 36-45 years old (10,5%), 46-60 (11%).

Most of the respondents were single without children (56%), the next largest group was those of them who were married with children (31,5%).

In terms of occupation more than a half of the Russian respondents were students (50,5%), while 33,5% of them were managers, 8,5% were engineers, etc.

## Limitations

Only 540 questionnaires were collected in two countries. Respondents were citizens of chosen two cities. The sampling methodology adopted (non-probability convenience sample) makes it impossible to generalize any of the findings and caused some macroscopic skewing of the sample, in particular the high proportion of students and the predominance of women (if in both countries apparently the task of shopping for groceries still falls mostly on the ladies, the consumption of chocolate indubitably sees a stronger sharing by the gentlemen). An additional limitation is due to the fact that only three “international” and two “national” chocolate brands were chosen in every country limiting the scope of the findings.

In view of the limitations of the samples, the analysis presented in this paper will be mainly descriptive and each of the hypotheses will be tested for both the samples, in order to ascertain possible different attitudes between the people interviewed in Russia and in Italy.

## Results

In relation to the general evaluation of the various brands, the respondents tend to be rather satisfied with two of the international brands mentioned (Ferrero and Ritter Sport) and to a less extent with the others (see Table 1). The first national brand is evaluated well enough (although not as well as the two international brands) while the second national brand and the remaining international brand (Cadbury) are clearly less appreciated (although being still above the neutral point – save for Cadbury in Italy).

The sub-samples differ in the average score of the evaluation of each brand, but the difference, albeit significant at the 99% level, might easily be attributed to slightly different perception of the scale used, rather than to an actual difference in evaluation (except for Cadbury, where the difference is so great that it certainly shows that the Italian sample is less impressed by this brand than the Russian one). Remarkable is that the ranking of the brands is basically the same (Ferrero and Ritter Sport swap the first place but the difference between them is barely discernible).

Table 1. General evaluation of the brand (1 not satisfied at all to 5 fully satisfied)

Brand (% of answers for the brand)	Full sample		Italy		Russia	
	average	median	average	median	average	median
<i>Ferrero (100)</i>	4,10	4	4,01	4	4,20	5
<i>National brand 1 (99,8)</i>	3,84	4	3,88	4	3,79	4
<i>Cadbury (57,7)</i>	3,29	3	2,78	3	3,43	4
<i>National brand 2 (98,9)</i>	3,56	4	3,69	4	3,40	4
<i>Ritter Sport (97,5)</i>	4,09	4	4,02	4	4,18	5



Besides the general evaluation of the brand, the interviewees were asked to evaluate their satisfaction in relation to the price and the quality of the selected brands. In relation to price (see table 2) both sub-samples show less satisfaction (the median in most cases being 3, the mid-point value and the average going in two cases below it). Despite this common trend to a limited satisfaction for the price of the product, the sub-samples differ significantly (always at the 99% level) in their evaluation for each brand and in their attitude to different types of brand. In detail, the Italian sub-sample shows a better acceptance (average 3,4 to 3,6; median 4) of the prices of the two international brands that received the highest marks in the general evaluation, while the Russian sub-sample shows that as far as price is concerned, the national brands have a much better evaluation. This undoubtedly is because of the price differential between national and international chocolate brands on the Russian market and high price-sensitivity of Russian people towards foodstuffs.

Table 2. Satisfaction about price (1 not satisfied at all to 5 fully satisfied)

Brand (% of answers for the brand)	Full sample		Italy		Russia	
	average	median	average	median	average	median
<b>Ferrero</b> (100)	3,21	3	3,41	4	2,97	3
<b>National brand 1</b> (99,5)	3,70	4	3,33	3	4,14	5
<b>Cadbury</b> (59,1)	3,09	3	2,50	3	3,27	3
<b>National brand 2</b> (97,5)	3,65	4	3,27	3	4,09	5
<b>Ritter Sport</b> (97,0)	3,43	4	3,64	4	3,20	3

Rather different is the satisfaction about quality (see Table 3). Both sub-samples are satisfied (sometimes extremely satisfied) with the quality of the brands. For the Italian sub-sample the most satisfying brands are Ferrero and Ritter Sport, that have an average evaluation slightly above 4; however, for all the brands excluding Cadbury the median is 4. The Russian sample is even more satisfied, with three brands with an average evaluation above 4 and a median of 5 and the remaining two – although with a lower average evaluation – having a median of 4. The most satisfying brand for this sub-sample is Ferrero, closely followed by the first national brand and then by Ritter Sport.

Table 3. Satisfaction about quality (1 not satisfied at all to 5 fully satisfied)

Brand (% of answers for the brand)	Full sample		Italy		Russia	
	average	median	average	median	average	median
Ferrero (99,3)	4,16	5	4,05	4	4,28	5
National brand 1 (99,1)	4,06	4	3,89	4	4,26	5
Cadbury (58,9)	3,42	3	2,76	3	3,62	4
National brand 2 (98,2)	3,71	4	3,59	4	3,85	4
Ritter Sport (96,8)	4,07	4	4,02	4	4,13	5

How do these perceptions translate into buying behaviour? The two factors chosen to evaluate buyer behaviour and, indirectly, brand loyalty are the frequency of the purchase of a given brand and the persistence in time of the purchase of that brand (length of the time since the brand was first bought).

In terms of frequency of purchase, the difference between the two sub-samples is quite big (see Table 4). The Italian one shows that the two brands are bought regularly or often by more than one quarter of the respondents are the two international brands (but one of them is actually Italian) that have received the best overall evaluation and are highly appreciated for their quality, although their price is considered rather high. The two National brands are frequently bought by about one fifth of the respondents, while Cadbury is basically inexistent in the local market. Indeed more than nine tenth of the respondents have never bought this brand and a few more buy it very seldom. A number of respondents never or seldom buys one or more of these brands. The brand that the respondents in the lowest proportion never or seldom buy is Ferrero, closely followed by Ritter Sport and the first National brand (Perugina). The second National brand (Novi) shows a marked polarisation in the buying behaviour: it is bought regularly or often by slightly more respondents than the first National brand, but many more say that they seldom or never buy it.

Table 4. How often brands are bought

Brand (% of answers for the brand)	Full sample			Italy			Russia		
	1	2	3	1	2	3	1	2	3
Ferrero (99,8)	48,1	33,0	18,9	32,2	38,9	28,8	67,0	26,0	7,0
National brand 1 (99,1)	36,7	31,2	32,1	38,7	31,8	19,5	22,5	30,5	47,0
Cadbury (87,3)	84,2	11,7	4,0	96,2	3,3	0,5	73,0	19,5	7,5
National brand 2 (99,5)	47,7	25,6	26,7	56,3	22,7	21,0	37,5	29,0	33,5
Ritter Sport (99,1)	48,6	31,9	19,5	37,3	34,7	27,9	62,0	28,5	9,5

1 = never or rarely 2 = from time to time 3 = regularly or often

The Russian sub-sample shows a markedly different buying behaviour. There is a clear difference in the purchase of National and international brands. Close to two thirds of the

respondents (almost three quarters for Cadbury) never or seldom buy the international brands, while a much lower proportion never or seldom buys the National brands. Even more marked is the difference when looking at the brands that are regularly or often bought. The National brands are regularly bought by a rather high proportion of the sample (the first National brand by almost half of them) while less than one out of ten of them does so with the international brands. The explanation for this could be either a strong patriotic preference for the National brands or the high price of foreign brands. Considering that in terms of satisfaction for the quality of the product two international brands score very high, the most likely reason is the relatively high price of these brands. The huge difference in the satisfaction with the price of the product, discussed above, confirms this conclusion. These brands are then bought mostly for special occasions (particularly Ferrero), while the National brands are for “everyday” consumption.

Also in terms of constancy of purchase of a given brand the two sub-samples clearly differ (see Table 5). The Italian one shows a low proportion of respondents who have never bought the brand (excluding Cadbury that has never been bought by 94% of the sub-sample); only the second National brand has never been bought by a largish proportion (slightly more than one fifth). The strong persistence in buying a specific brand, however, does not mean unquestioned brand loyalty: 85% of the sub-sample has been buying Ferrero and 80% Perugina for one year or more (78% and 72% respectively for more than three years), which means that most of them are regular buyers of more than one brand. The Italian sub-sample shows a buying behaviour typical of “expert” consumers in a mature market, attracted by brands but not captive.

Table 5. Since when the brands have been bought

Brand (% of answers for the brand)	Full sample			Italy			Russia		
	1	2	3	1	2	3	1	2	3
<i>Ferrero</i> (99,5)	16,4	11,4	72,2	7,1	7,1	85,2	27,5	16,4	56,0
<i>National brand 1</i> (99,8)	11,8	11,6	76,5	10,9	8,3	80,7	13,0	15,5	71,5
<i>Cadbury</i> (85,5)	61,2	8,3	30,6	94,3	1,7	3,9	32,0	14,0	54,0
<i>National brand 2</i> (100)	20,0	15,7	64,4	22,1	14,2	63,7	17,5	17,5	65,0
<i>Ritter Sport</i> (98,9)	16,3	14,0	69,6	11,5	10,6	77,9	22,0	18,0	60,0

1 = not bought    2 = up to few months ago    3 = more than one year ago

The Russian sub-sample shows a higher proportion of respondents who have never bought a certain brand, particularly foreign ones (up to one third of respondents). Correspondingly lower is the proportion of those who have been buying the brand for more than one year. Very few of them, in particular, are consolidated buyers (more than three years): only for the first National brand this last group reaches beyond 10% of the total and for the foreign brands it never reaches 3%. However, considering that – also for foreign brands that are basically

bought from time to time for special occasions – those who have been buying them for more than one year are always more than half of the respondents, this sub-sample gives a picture of a rapidly changing market and an evolution of buying behaviour. Chocolate is now becoming a more commonly and frequently acquired foodstuff. Foreign brands, despite their higher price, are consolidating their presence in the market and the consumers are increasingly willing to keep purchasing them. From the answers given, it appears that the penetration of foreign brands in the Russian market (at least in Yekaterinburg) is happening right now: more than three quarters of the respondents are now buying them, more than half have been doing so regularly (albeit not often) for more than one year; three years ago almost the totality of the respondents had never bought a foreign chocolate. This fact is not surprising because the mentioned international chocolate brands in general are considered expensive by Russian consumers; moreover they were not very well-informed about these brands some years ago, hence they trusted more the national chocolate brands. All in all the shift in the last three years is significant and indicates, besides the influence of global crisis on people's income and so their consumer behaviour, the consolidation of the presence of foreign brands of chocolate in this market.

The difference between the two sub-samples appears very clearly when the buying behaviour is referred to the brand(s) the respondents have evaluated positively (being satisfied or fully satisfied with the brand). In the Russian sub-sample, more than half of those who consider favourably the first national brand buy it regularly or even often and the same applies for more than one third of those who have a favourable opinion of the second national brand (see Table 6). For international brands, however, the very favourable general opinion expressed by the respondents does not materialise in frequent purchases of the brand: they are bought regularly by less than 10% of those who are satisfied by them. The Italian sub-sample shows a different attitude: a lower proportion of those who have a favourable opinion of a given brand actually buy it often or regularly (the most bought is Ritter Sport, 38%, the least is the National brand 1, 21,5%).

Table 6. Frequency of purchase of respondents evaluating positively the brand

Brand	Buys regularly or often this brand		Never buys this brand		Regularly or often National brand		Regularly or often international brand	
	Italy	Russia	Italy	Russia	Italy	Russia	Italy	Russia
<i>Ferrero</i>	29,1	7,5	4,4	13,1	20,1	45,6	26,0	9,4
<i>National brand 1</i>	21,5	54,1	10,2	2,2	29,4	40,0	27,0	8,9
<i>Cadbury</i>	<i>n.a.</i>	9,1	<i>n.a.</i>	12,8	<i>n.a.</i>	45,9	<i>n.a.</i>	9,1
<i>National brand 2</i>	33,8	35,4	10,1	3,5	30,9	52,2	31,6	7,1
<i>Ritter Sport</i>	38,2	9,1	4,2	11,9	28,5	45,9	28,5	9,1

Rather unexpectedly, a certain proportion – albeit small – of those who evaluate positively a brand never buy it. One tenth of the Italians never buy the national brand which evaluate positively and a much smaller proportion has the same attitude towards the two most appreciated brands (Ferrero and Ritter Sport). Among the Russians, only few people do not buy the national brand that they consider favourably and a bit more than one tenth do not buy the international brand.

Confirming a finding previously reported, the respondents showed a limited loyalty to the brands. Between 20% and 30% of the Italians who expressed a favourable opinion for a given brand say that they buy regularly or often another National brand and in similar proportion say that they regularly buy another international brand. Similar promiscuity is expressed also by the Russian sub-sample. Russians, however, show a strong preference for Russian brands: between 40% and 50% of them regularly buys another National brand besides the brand(s) they evaluated positively, while less than 10% does the same with international brands. Clearly, for this sub-sample the price of the international brands is often a discriminating factor in their decision of which brand to buy.

This behaviour points to a flexible attitude of the consumers of the sample towards the brands: they have clear opinions on them and on their quality. However a general positive evaluation does not translate into strong brand loyalty. Brand loyalty appears to be stronger for the Russians who have good opinion of their National brands, but also a large proportion of them tend to buy with regularity other brands. A larger proportion of Russians of the older age groups tend to buy their preferred National brand, while younger age groups tend to buy more than one brand. In any case, regular purchase of multiple brands seems to be the rule not only for the Italian sub-sample but also for a large part of the Russian one.

In relation to Hypothesis 1, in the end, it is possible to say that the sample prefers to buy chocolate brands that present the characteristics they like most, but apparently more than one brand has those characteristics and the decision of which brand to buy depends on various factors and can change from occasion to occasion.

The respondents were asked to state the most important reason(s) for buying chocolate. The answers are summarised in Table 7. Both sub-samples give the two main reasons *I like it* and *deliciousness* (the two reasons are mentioned by 64% of the Italian sub-sample and 61% of the Russian one). The next two are also the same for both samples, although in different order: *pleasure* and *cheering up* (with 20% and 10,5% of the Italian sample and 10,5% and 11% of the Russian one respectively). In the fifth position *healthy* comes for the Russian sub-sample (mentioned by 7,5% of the respondents) and *nutritious/snack* for the Italian one (8,3%, most often mentioned by mountaineers, who find chocolate a handy – and pleasant – store of energy when trekking or climbing). Next reason in order of mentions is to give *a gift*, and other reasons are mentioned but altogether by less than 10% of the respondents in both sub-samples.

Table 7. Main reasons for buying chocolate

	ITALY			RUSSIA		
	<i>n</i>	%	<i>rank</i>	<i>n</i>	%	<i>rank</i>
1 Healthy	4	1,7	9	15	7,5	5
2 Deliciousness	76	31,7	2	49	24,5	2
3 Cheering up	26	10,8	4	22	11,0	3
4 Children	9	3,8	7	1	0,5	8
5 I like it	78	32,5	1	73	36,5	1
6 Pleasure	47	19,6	3	21	10,5	4
7 Nutritious/Snack	20	8,3	5	9	4,5	7
8 Gift	12	5	6	12	6,0	6
9 Other	8	3,3	8	1	0,5	8
Total respondents	236			197		
q.naires	240			200		

Also when looking at how important some characteristics of chocolate brands are considered it appears clear that functional characteristics as being nutritious are much less important than those related to personal satisfaction (see table 8). Among the characteristics mentioned, two are considered of the highest importance by both sub-samples and a third one is quite important, while the remaining ones are relatively unimportant. The two most important characteristics (with an average close to 4,9 for the Russians and 4,8 for the Italians, both with a median of 5) are *quality* (overall evaluation, including many aspects) and *deliciousness* (taste). It is evident that these are the characteristics that the respondents, Italian and Russian alike, are looking for in chocolate and are at the basis of the decision of buying it and of the choice of brand. The next important aspect, slightly more important for Russians than for Italians, both in both cases with a median of 4, is price.

From this it can be surmised that in buying chocolate the level of price might become a factor deciding the choice of brand according to the occasion of purchase, but seldom would be an obstacle to a purchase.

Table 8. Importance of characteristics of chocolate brands

	<i>Total sample</i>		<i>Italian sample</i>		<i>Russian sample</i>	
	<i>average</i>	<i>median</i>	<i>average</i>	<i>median</i>	<i>average</i>	<i>median</i>
<i>Price</i>	3,66	4	3,5	4	3,85	4
<i>Quality</i>	4,77	5	4,67	5	4,89	5
<i>Deliciousness</i>	4,79	5	4,72	5	4,88	5
<i>Nutrition</i>	2,66	3	2,92	3	2,35	2
<i>Prestige</i>	2,34	2	2,49	2	2,17	2
<i>Assortment</i>	3,19	3	3,2	3	3,17	3
<i>Packaging</i>	2,63	3	2,49	2	2,81	3

From the answers given by the respondents, it appears that the needs that are primarily satisfied by buying chocolate are psychological rather than physical. Hypothesis 2, then, is disproved.

## General discussion

Although no company wants to lose its competitive advantages, it is perhaps inevitable in the face of growing competition in the global markets. Companies may focus on strengthening their financial position, developing organisational structure, reengineering business processes, using different product strategies and technologies. Our research highlights the importance of understanding the exact customer needs that they want to satisfy when they buy chocolate and then transforming these needs into a product brand characteristics.

## Managerial implications

We believe that these conclusions lead to some significant implications for national and international companies producing chocolate. What is most important is that they should be well-informed about their customers' needs and recognise the importance of their satisfaction by a particular brand in order to increase the brand loyalty. Concerning chocolate it appears that functional characteristics as being nutritious satisfying physical needs are much less important than those related to personal satisfaction (psychological needs).

However, the companies should take into consideration the fact that even a general positive evaluation very often does not translate into strong brand loyalty. Regular purchase of multiple brands seems to be the rule for the respondents. And the decision of which brand to buy depends on various factors (for example, the price of the international brands for Russian consumers) and can change from occasion to occasion.

## Future research directions

In no way do we suggest that our paper is the final word on this topic but we hope that it can act as a way to open a dialogue on the interdependence between consumers' perception

of brand characteristics and their loyalty to the brand. We consider that there is a number of very interesting questions that remain to be answered relative to our research. For example, in our study we only looked at three “international” and two “national” chocolate brands in two cities in Russia and Italy. It might be the subject of the future research if our findings are generalisable to other cities and brands.

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## CHALLENGES AND OPPORTUNITIES FOR SMEs IN THE INTERNET ERA

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### Abstract

Internet has been available as a competitive advantage tool to SMEs for years now. Several e-business models have been developed as well as, system architectures such as C2C, B2C, B2B, G2C and G2B. This paper discusses challenges and opportunities encountered by SMEs in the Internet era and finally describes the development of an innovative B2B e-business platform combining country and regional business information, a business directory and a 3D virtual exhibition.

**Keywords:** SME, challenges, opportunities, e-Business, B2B, 3D Virtual Exhibition, platform,

### Introduction

The diffusion of internet and ICT has substantially changed the nature of international business over the past recent decades, transforming the ways of doing business in unprecedented ways. Supporting the emergence of virtual communities and commercial arrangements that disregard the traditional boundaries between firms and consumers, it created a dynamic setting that, transforming the rules of competition, had the potential of generating great new wealth (Amit and Zott, 2001). In fact, the economic integration and interdependence foreseen with the emergence of internet expected the “end of geography”<sup>vi</sup>, made many believe that time and space would have ceased to represent limits in business transactions, and suppliers, firms and customers would have finally been linked in a seamless web that would have covered the entire world (de la Torre, 2001). Others even envisaged that the internet had the potential of bringing the economy closer to the theoretical model of perfect competition (Unctad, 2001).

This paper is organized as follows: Section 2 provides some related background research while Section 3 discusses challenges and opportunities for small and medium enterprises (SMEs) in the Internet era. Section 4 explains the architecture and advantages of ExpoGloboOnline, an innovative global B2B Internet model. Finally, Section 5 draws the concluding remarks and provides recommendations for future work.

### Background Research

Internet has the potential to cut procurement costs, help employees work together more efficiently, improve customer service and reach more customers and enter new markets (Unctad, 2001). E-commerce could create new and cheaper opportunities, especially

advantageous for SMEs to participate in international trade. But in order to fully benefit from this opportunity, SMEs need to develop new capabilities that would enable them to use technology intensive resources in a way that boosts their comparative advantage and maximizes value. Simply put, opening to the global market through a website does not substitute a full export strategy (Unctad, 2001). Thus, entrepreneurs and managers need to consider internet not as simple promotional tools that merely increases the visibility of their company but grasp the underlying strategic importance behind online operations. Only so, will e-commerce become an important tool for development.

As SMEs begin their operations worldwide, they must consider that they are expanding the frequency, depth and breadth of their operations abroad (Rhee, 2005). Therefore, firms that launch the process of international expansion must attune to the new way of doing business in order to be capable of endure in the global context and come to terms with the fact that firm performance depends on its capability of modifying its organization capabilities and its strategic processes to appropriately exploit information technology as a business resource (Sambamurthy et al., 2003). Essentially, if retailers decide to adopt the internet as a sales channel, then a response of greater magnitude will be required of them, since they must develop online order-taking capabilities and build logistic capabilities to ensure the timely delivery of products (Lee and Grewal, 2004).

While each type of firm may have a different strategic concerns, it is important to understand the general impact of information technology on firm performance, especially considering that the internet revolution has affected the whole organization of economic life of most sectors of the economy (Unctad, 2001). It is unquestionable that information is a central element of this new digital economy. To conduct business over the internet, firms have to deal with a substantial amount of information, so much so that some researchers have even considered as the “currency” of the New Economy based on Internet.<sup>vii</sup> As it flows more quickly and in more directions, the amount of information exchanged has exponentially increased. Firms are thus required to possess an information-processing capacity or else they run the risk of being exposed to so much information that consequently can increase their perception of the uncertainties that stem from operating in an unfamiliar environment, and stall their overall process of international expansion (Rhee, 2005). To be able to reap the greatest benefits and gain and sustain competitive advantage, it is fundamental that firms learn to leverage information and recognize the value of new information, assimilate it and apply it to commercial ends (Rhee, 2005).

Regarding knowledge as an important strategic factor Rhee (2005) makes a couple of interesting considerations and sustains that: “the importance of knowledge, coupled with the difficulty of handling knowledge, makes the management of knowledge one of the most important strategic issues.”<sup>viii</sup> According to Rhee (2005) a firm’s ability to acquire the adequate knowledge to be able to survive international expansion relies on both objective

knowledge and experiential knowledge. At first, firms must be able to understand their possibility of conducting successful business transactions by acquiring objective knowledge of the host foreign country and so, they must be inform themselves of the tariff barriers, investment regulations, supplier practices, labor laws and so on. In concrete terms, the efforts of developing countries to adopt e-commerce and e-business will be futile if supplies spend weeks in a warehouse waiting for customs clearance. (Unctad, 2001) Subsequently, firms will acquire learning-by-doing knowledge, i.e. experiential knowledge, as it operates in its host country—a type of experience can help a firm accumulate tacit knowledge that can become a source of competitive advantage (Rhee, 2005).

With its unprecedented reach, connectivity and low-cost information and processing power, as the internet era unfolds it challenged the conventional theories of value creation (Amit and Zott, 2001). In sharp contrast to the axiom inherited from the industrial age, which views the relative scarcity of a factor as the determinant of competitive advantage, in the internet economy, abundance becomes the major determinant of value (Rhee, 2005). Consequently, information becomes increasingly perceived as something to share, rather than protect, in order to maximize its value. This new approach challenges the traditional way of doing business as enterprises are now expected to rethink the ways in which they interact with their stakeholders and learn to share information with other enterprises to ensure compatibility of technical standards and business models. According to Unctad's 2001 E-Commerce and Development Report, this alteration of approach represents a viable threat to the SMEs in developing countries, since this type of decentralized decision-making process, which requires workers to feel empowered and to perform a wider range of tasks, greatly challenges the firms' traditional notion of authority and hierarchy.

## **Challenges and Opportunities**

### **Challenges**

A major challenge that has developed together with the advent of internet is the technological disparity that has increased between developed and developing countries. This digital gap seems to be a consequence inherent to the socio-political trends of a country, that according to some<sup>ix</sup> especially corresponds to the differences in political systems, in the levels of education and in the industrial development, even though there is no real agreement in the literature as to its causes (Guillén and Suárez, 2005). In recent years, this technological inconsistency has inevitably affected the overall performance of international business in general, as firms considering international expansion from within a low infrastructure level country have been equally deterred as foreign firms that want to penetrate the markets of such a deficient host country (Rhee, 2005). In light of this reasoning, the 2001 Unctad Report suggests that it would seem more strategic for firms in developing countries to on reduce their business to consumers (B2C) e-commerce that point on activities of businesses serving end consumers with products and/or services and maximize and enhance their business-to-

business (B2B) approach by making goods or delivers services for the productive process of other enterprises, especially since the price of computing power, and PCs remain unaffordable for the vast majority of the population of the world.

In fact, B2B e-commerce is expected to play a pivotal role in the future of e-commerce, especially since the liberalization of the economic processes through the various mechanisms of e-business can strengthen the ability of the business enterprises to participate in the economic arena without depending too much on the various traditional, and sometimes restricting, bilateral or regional trading agreements.

### **Opportunities**

The internet also creates new opportunities for innovative inter-firm cooperative arrangements and the formation and consolidation of strategic alliances (Unctad, 2001). In the face of ongoing intense competition, firms will be obliged to adopt new strategies or business models in order to survive and inter-organizational linkages seem to provide the private sector with the necessary flexibility to achieve multiple objectives in the face of mounting international competition (Miner et al., 1990). Yet, as alliances are expected to consolidate as the best business strategies to acquire new technology, resource dependence theorists argue that the irregular resource distribution between partners can lead to adverse performance outcomes, since research has demonstrated that firms generally receive a smaller share of the “alliance pie” when they rely on partners for technological know-how (Unctad, 2001; Lee and Grewal, 2004). Furthermore, literature on strategic alliances also cautions on alliances that are formed primarily to meet legitimacy needs and not to attain efficiency, for these mechanism usually affects firm performance negatively (Lee and Grewal, 2004). The personal involvement of entrepreneurs and managers in networks allows them to bypass the political tensions that generally arise in formal project structures, and grant them access to new markets or to different sources of financial resources that are usually required to guarantee the survival of the company.

To be able to benefit from inter-organizational linkages, entrepreneurs and managers thus need to consider them not as simple promotional tools that merely increases the visibility of their company on the web, but rather as an instrument that permits them to implement a strategic communication plan in B2B commercial operations, that will consequently encourage, joint research and development (R&D), regional technology exchanges, co-marketing agreements and strengthen and proliferate market and manufacturing rights throughout the region. Ultimately, the consequences of giving entrepreneurs the opportunity to proceed autonomously can certainly foster a wider range of deeper political and social integration through professional relationships that go beyond any type of bilateral trade agreement.

In light of the predominant opportunities and threats Internet poses in context of e-business and global economy that are mentioned in the above analysis, IMC Business

Global, in cooperation with Euro-Med TDS, are proposing two distinct and innovative B2B platforms, in order to encourage SMEs to enter the global arena, without being intimidated by the various threats and challenges that they may foresee in the virtual world, and participate more prominently in international business. The overall goal of these platforms is to enhance local and regional trade in ways that will strengthen the region's economic development.

## **Expoglobalonline.com**

### **Platform Architecture**

The platform is an innovative B2B 3D Virtual exhibition system to enhance local and regional trade. It is structured under one single database with hundreds of tables and complex relationships. It includes more than 200 regional and country specific domain websites. The platform is integrated with a Customer Relationship Management (CRM) system used by the sales executives of the company, a Content Management System (CMS) used by the Web administrator and a Business Intelligence System (BIS) used by the Web Marketing team to measure traffic and analyze user behavior. Finally, the platform is integrated with ExpoPark, a 3D virtual exhibition environment (Figure 1). Future work includes the transformation of the platform to a multilingual one with the inclusion of 29 languages. Future research will also investigate the possibility of implementing a live business forum where executives and decision makers around the world can discuss latest business trends and opportunities from the comfort of their office.

Currently the platform provides three primary components (Figure 2):

- Country information – Each country domain (e.g. GreeceExpoOnline.com) or regional domain (e.g. EuroMedExpoOnline.com) provides useful information for business executives such as country (or regional) economy and business environment information, access to public sector, NGOs, chambers and trade associations and a Showcase where countries can promote their key industries with the use of videos.
- Business Directory & Marketplace – The database includes more than a million companies that are organized into three types of memberships: Platinum, Gold and Silver. In addition, the platform has a marketplace where companies have the opportunity to promote their latest and most innovative products.
- 3D Virtual Exhibition – Each Platinum member has a personalized 3D virtual pavilion. The system is so sophisticated that with a touch of a button the Web Administrator can create parallel exhibitions based on country or region or even based on category (e.g. Furniture Exhibition) that all related pavilions will be included. Each exhibition simulates the experience and feeling of a physical exhibition with added advantages explained in the next section.

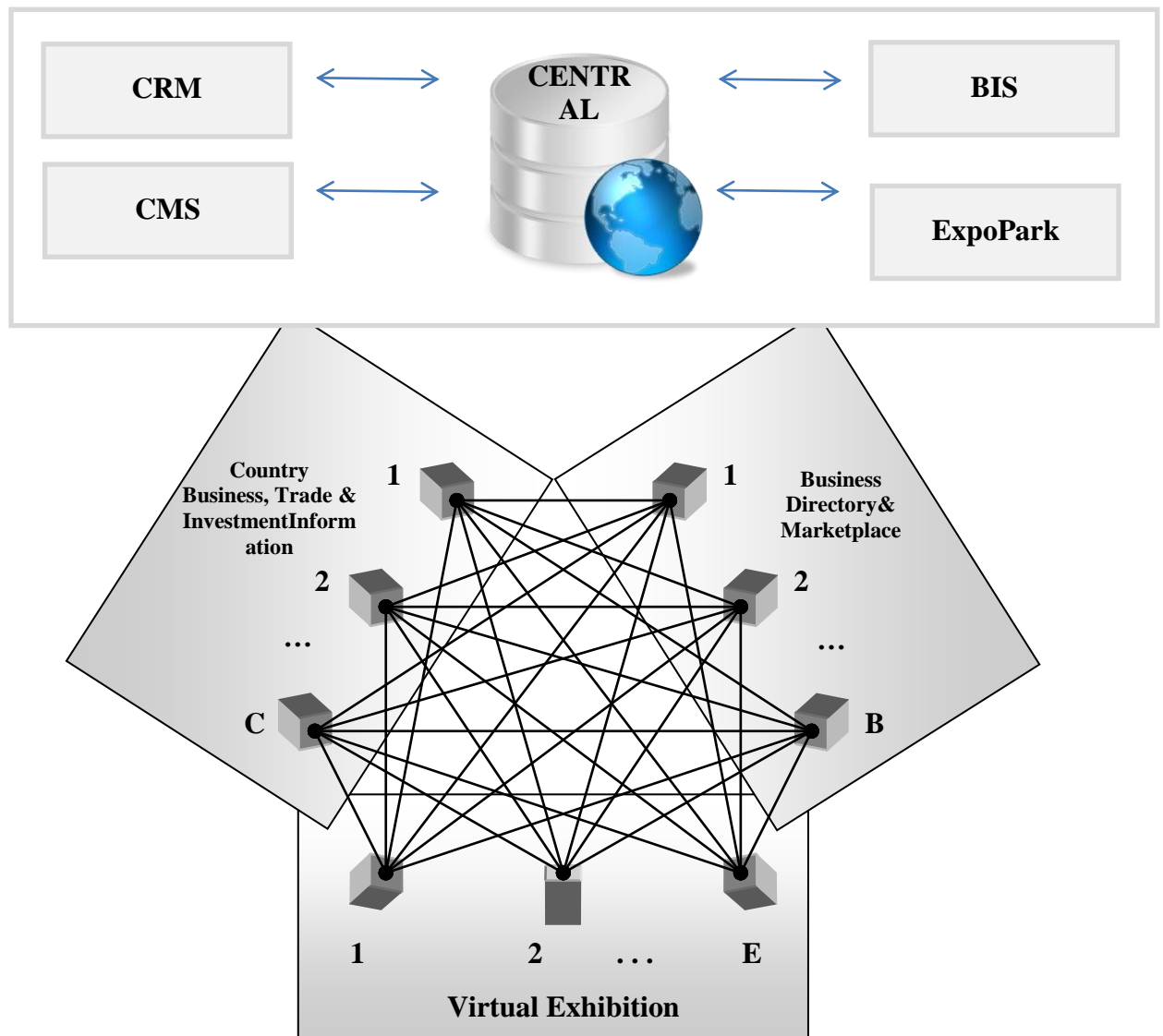


Figure 2: The 3 Primary Components of EGO

### Platform Advantages

The platform offers several advantages with the most significant ones are briefly described below:

- Promotion of a country's business, trade and investment opportunities internationally
- Ability for a company to be enlisted not only in a specific country but also regional and international
- Ability to engage in a virtual exhibition that simulates a physical exhibition with functions such as, product display, video presentation, online catalog, business card exchange, notes facility, and chat (text, voice, video)

- Ability to participate in parallel exhibitions. For example, a company may have a pavilion in a Furniture exhibition and at the same time participating in a EuroMed Exhibition
- Identify the number, type and location of visitors contacting each pavilion
- Ability for a company to include its profile information in other languages therefore offering a multi-language business environment
- Ability for companies to provide keywords related to their business. These are used for smart optimization to improve their ranking and appearance within the platform

While the ExpoGlobalOnline platform is recent, the success of the site is evident from the number of monthly visitors to the site. The site receives more than 1 million visitors per month with an increase of approximately 12% every month.

### **Emed b2b.biz**

A global platform of supply and demand of goods and services between businesses in the agro-food sector. Currently, it consists of the fifteen members of Euro-Med TDS (all the national Unions of Chambers of Commerce and business confederations of European and Mediterranean countries, such as Italy, Spain, Algeria, Palestinian Authority, Egypt, Greece, Israel, Jordan, Malta, Morocco, Portugal, Syria, Tunisia, Turkey ) and covers a total of nearly 8 million companies.

### **Platform Architecture**

The platform consists of two interdependent applications:

- Local access points (Pal): currently with 15 partners and 1 point for international access (Pai). The number of Pal can be extended indefinitely through the sale of rights to new countries;
- Operating System Node (NOS), which performs the following functions:
  - Output the specific identification Pal codes;
  - Allows interconnection;
  - Promotes dialogue and stores the transaction;
  - Stores all the proposals for the supply and demand;
  - Make simple and advanced searches;
  - It stores, manages, and search the business directory and knowledge base;
  - Make statistical analysis on the traffic system.

### **Platform Advantages**

The multiplicity of actions that companies can accomplish through the platform enables firms to offer their goods or services, or request goods or services, in the global market. Companies

who purchase User Id and Password, and enter the system to sell or buy goods or services will conduct business in a professional but personalized, flexible, and cost efficient manner. Any private person acting on the platform, has his own "site" to manage. Firms accept a code of ethics, and recognize that all business transactions completed or communications held on the platform is recorded in the main memory and can be produced in court as legal documentation by any aggrieved party.

The small and medium enterprises find additional advantages:

- The creation of business partnerships that allow small operators to join forces and respond to large scale requests.
- Assistance and advice by the various associated Chambers of Commerce and/or Confederations.

It can be argued that no other global market environment, material or immaterial, can offer companies greater safety, faster times, lower costs for trades initiated by the relationship between demand and supply of goods and services, and concluded with an agreement commercial details with legal validity.

## Conclusions

Not all threats that SMEs face or encounter can be resolved through a B2B platform, especially since most of these threats and/or challenges concern their 'internal' capacity to cope with ITC technology. Yet, we sustain that these two platforms provide benefits that entrepreneurs and managers, and to some extent even employees, can use to generate new value for the firm. Being platforms that enables the interconnection of more business firms, they do have the potential to link suppliers, firms and customers in a seamless web that covers a vast coverage of the entire world as it was anticipated at the advent of internet. The variety of services incorporated in these platforms, such as live chat features, in-platform e-mail service, exchange of virtual business cards and efficient B2B search engines, are intended to go beyond merely increasing company visibility but rather to offer two dynamic settings that stimulate an increase in business interaction. Last but not least, in view of the number of nodes that prevail in both networks it is clear that the abundance of flow of information can easily be translated in knowledge that strengthen business firms capacity to endure in the global market and provides them with the opportunity to create new, perhaps personalized, forms of value.

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## CAUSALITY OF RELATIONSHIPS BETWEEN THE DIMENSIONS OF CUSTOMER LOYALTY IN SERVICES MARKETS: EVIDENCE FROM BANKING

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### Abstract

This study examines the causality of relationships between the dimensions of customer Loyalty in service industries, sheds light on the effects of customer Satisfaction on individual Loyalty dimensions and explores the mediating impact of interrelations between Loyalty dimensions on these effects.

In the frames of a wider research project, also involving service quality metrics' assessment, this study examines between variables relationships under a structural equations modelling analytical perspective. To this end, a specially designed research instrument is used for evidence collection. Data is analyzed through SPSS and LISREL.

The causality of relationships between the dimensions of Customer Loyalty was found to run along the path: "word-of-mouth" → "customer retention intentions" → "business extension intentions". The direct effects of customer Satisfaction on customers' "affectionate" and "behavioural" commitment were found to vary. Between the statistically significant direct effects the strongest was that on "word-of-mouth" followed by that on "customer retention intentions". On the other hand, the direct effect on "business extension intentions" was found statistically insignificant. The indirect effects of customer Satisfaction on "customer retention intentions" and "business extension intentions", via "word-of-mouth" were found to be threefold and fourfold stronger respectively than the direct ones.

The study adds to the existing Customer Satisfaction – Customer Loyalty literature. While up to date published research mostly examines between constructs effects at the aggregate level, new light is now shed by examining the effects at the level of dimensions. Support is provided to the idea that not only the dimensions of Loyalty are interrelated but the causality of the relationship between them runs from "affectionate" to "continuance" Loyalty.

In managerial terms, customer Satisfaction campaigns, in services industries, would yield more if primarily targeted at enhancing customers' "affectionate" rather than "continuance" commitment.

Rests upon its design of examining relationships between constructs at the level of dimensions, rather than at the aggregate. To the best of the authors' knowledge no such study has been reported in the banking services literature.

**Keywords:** Customer Satisfaction, Customer Loyalty, Greece, Banking

## Introduction

Unanimity in considering Satisfaction as a key driver of Customer Loyalty seems to have been reached, among management practitioners and academics. With very few distinct exceptions (e.g. Bloemer et al., 1998; Shankar et al., 2003; Tsoukatos and Rand, 2006), however, research over the years has mostly investigated the Satisfaction – Loyalty relationship at the aggregate rather than at the level of specific dimensions (e.g. Cronin and Taylor, 1992; Anderson and Fornell 1994; Rust and Zahorik 1993; Lam et al., 2004; Chandrashekar et al., 2007). This investigative perspective, though, largely overlooks the well documented in the literature multidimensionality of Customer Loyalty (e.g. Zeithaml et al., 1996; Gremler and Brown, 1996; Oliver, 1999) as well as previous research findings proving that the construct's elements are causally interrelated with the direction of causality running from emotional to behavioural Loyalty (Oliver, 1999; DeWitt et al., 2008; Garnefeld et al., 2011). As a consequence, literature gaps related to variations of Satisfaction effects on specific Loyalty dimensions are left wide open. This paper reports research findings contributing towards overcoming these gaps.

As part of a wider study, also involving service quality metrics' assessment, the interrelations between the dimensions of Loyalty are examined under a structural equations modelling perspective. Under the same analytical perspective, the study goes on to explore the effects of Satisfaction on specific Loyalty dimensions as well as the mediating impact of interrelations between Loyalty dimensions on these effects.

Reported findings are expected to be important to both academia and practice. In scholarly terms, enhancing current understanding on managerial issues is always beneficial as piled-up theoretical knowledge eventually finds its way towards practical application. In this respect the debates over the Satisfaction-Loyalty interactions at the level of construct dimensions and the interrelations between these dimensions are re-opened. In managerial terms, to the extent that customer Loyalty is a key organizational asset leading to improved economic performance and profits (Gronroos; 2000; Reicheld et al., 2000), the better firms are equipped to understand the dynamics of the relationships between the dimensions of Loyalty as well as the Satisfaction-Loyalty links the more capable they become of leveraging their Satisfaction campaigns towards achieving best possible outcomes. Valuable evidence is provided that Customer Satisfaction campaigns, in banking and services industries in general, should be targeted at attitudinal rather than behavioural Loyalty.

The remainder of this paper is organized in six sections as follows: After this introductory section, there follows section 2 containing a literature review on the main constructs and issues related to this study. Section 3 is devoted to describing the study's methodology and discussing its results. Section 4 offers a comprehensive review of the study's implications while limitations and directions for further research are discussed in section 5. The study's general conclusions are, finally, presented in section 6.

## **Literature Review**

### **Discussion of Customer Loyalty**

Academics and practitioners agree that customer Loyalty can be beneficial to a firm through increasing sales, lowering customer costs, generating predictable income and profit patterns etc. (Jones and Taylor, 2007; Gronroos; 2000). In service industries, especially, building customer Loyalty is key to the survival and growth of firms (Reichheld, 1996). Despite agreement on Loyalty's positive consequences, unanimity seems to exist when it comes to the concept's conceptualization and measurement. In this regard, a great extent of variation is observed across studies (Jones and Taylor, 2007).

Early marketing studies perceived Customer Loyalty as a strictly behavioural phenomenon (Oliver, 1999; Bodet, 2008) that is evaluated in terms of repeat purchasing frequency (Newman and Werbel, 1973; Tellis, 1988), considering only a single brand/service, not seeking information on other brands/services etc. (Newman and Werbel, 1973). The core strength of this approach was that it offered objective means of evaluating Loyalty in terms of specific and quantifiable net present worth (Reichheld, 1996). Early enough, however, severe criticism was addressed to this one-dimensional perspective (e.g. Day, 1969; Monroe and Guitinan, 1975; Jain et al., 1987) on a number of accounts: offering an outcome-based only view of what really is a dynamic process (Bloemer et al., 1999), recording only what consumers do or have done and not what they think, disregarding the psychological component of Loyalty (Oliver, 1999) etc. As such, this strictly behavioural approach of addressing Loyalty was considered as incapable of distinguishing between true and spurious Loyalty (Storbacka et al., 1994; Liljander and Strandvik, 1995; Bodet, 2008).

To deal with this criticism and the particularities of the growing services sector, where the human contact element of transactions facilitates the development of interpersonal relationships (Iacobucci and Ostrom, 1996; Macintosh and Lockshin, 1998; Jones and Taylor, 2007), behavioural-oriented conceptualizations of Loyalty were soon complemented with attitudinal-affectionate components. In this respect, Zeithaml et al., (1996) measured attitudinal customers' Loyalty to a service provider in terms of customers' affective commitment and behavioural intentions. The former was measured along three items: a) saying positive things about the company to other people, b) recommending the company to people seeking advice, c) encouraging friends and relatives to do business with the specific company. Behavioural intentions were measured across the items: d) considering the specific

company as first choice for doing business with in the future and e) doing more business with the specific provider in the future. Gremler and Brown (1996) viewed service Loyalty across a behavioural, an attitudinal and a cognitive dimension while Oliver (1999) defined attitudinal Loyalty as the consumer's "... deeply held commitment to rebuy or repatronize a preferred product/service consistently in the future, thereby causing repetitive same-brand or same brand-set purchasing, despite situational influences and marketing efforts". Moreover, Oliver (1999) thought of attitudinal Loyalty as being integrated in four consecutive phases. In the initial "*cognitive*" phase, the consumer gets experience-based information indicating that a product/service is preferable to its alternatives. On the grounds of a cumulative positive experience, the consumer moves-on to the "*affective*" phase where a commitment to the product/service is developed. After recurring positive incidents, Loyalty goes on to the "*conative*" (behavioural intentions) phase reflecting the consumer's desire to keep purchasing the same product/service in the future. Depending on the obstacles, however, this desire may become unrealized. Finally, "*action loyalty*" is related to the consumer's true commitment to not only rebuying the product/service but to also "*overcome obstacles that might prevent the act*".

A review of current literature suggests that unanimity is finally reached regarding the dual behavioural - affectionate nature of Customer Loyalty (e.g. Tsoukatos and Rand, 2006; Oliver, 1999; Garnefeld et al., 2011 etc.). It also reveals, though, that a great deal of confusion exists over the true meaning of Behavioural Loyalty. A closer look into the growing body of studies pertaining to Attitudinal and Behavioural Loyalty exposes that most often behavioural intentions are mistakenly assumed as synonymous to actual behaviour (e.g. DeWitt et al., 2008; Garnefeld et al., 2011 among many others). As Oliver (1999) has very clearly put it, however, conative (reflecting intentions) Loyalty is at a lower step of the ladder than behavioural (reflecting real action) Loyalty, very simply because intentions do not always turn into actions.

In view of the above, much is still to be learned about the true relationships between Attitudinal and Behavioural Loyalty as opposed to the state of existing knowledge on Attitudinal Loyalty, which is more advanced. Although Ajzen and Fishbein (1977) have argued that attitude is a strong predictor of behaviour, in the majority of published studies the two manifestations of Loyalty are most often examined as independent and non related (Durvasula et al., 2004).

As regards Attitudinal Loyalty, the consensus is that it is operationalized across two sub-dimensions: "*continuance commitment*" and "*affective commitment*". The former reflects customers' intentions to preserve a relationship with a specific product/service and/or provider while the latter reveals a psychological disposition, very similar to "*love*", towards a product/service and/or its provider (Garnefeld et al., 2011). Customers' affective commitment is primarily articulated by word-of-mouth communication (Garnefeld et al., 2011). That is, talking favourably to others about specific products/services and/or their providers

(O'Mitchell, 2005). Because this is done at no cost to the firm, word-of-mouth can be highly efficient in attracting new business (McConnell and Huba 2007), competing with and/or enhancing traditional advertising. *"For many service brands, word of mouth—and, especially, personal recommendations—has long been more powerful than media advertising in driving both trial and repeat purchase behaviour"* (Ostrom et al. 2010, p. 23). This is especially true in financial services where high stake decisions are often taken. Prospective customers are more likely to trust word-of-mouth than other promotional forms because the communicator is considered as having no connection with the service provider. (O'Mitchell, 2005). Evidence exists, that word-of-mouth goes further than simply attracting new business to being the main antecedent of customers' behavioural intentions (Oliver, 1999; Tsoukatos and Rand, 2006; DeWitt et al., 2008) and even beyond that, to enhancing the communicator's own Loyalty. In the latter respect, Garnefeld et al. (2011) propose that word-of-mouth should be considered as a Loyalty enhancing instrument and that customers, from the very early stages of their relationship with a firm, should be encouraged to recommend the product/service and/or provider.

### **Discussion of Satisfaction**

In the literature, Satisfaction is generally conferred upon as the main driver of Customers' Loyalty and Behaviour towards a firm (Bloemer et al., 2002), which in turn affect profitability and corporate economic performance (Jones and Sasser, 1995; Mittal and Kamakura, 2001; Chumpitaz and Paparoidamis, 2004). Support is provided to the argument that repeated instances of transaction-specific Satisfaction lead to overall Satisfaction (Oliver, 1999; Bodet, 2008), which mediates between transaction-specific Satisfaction and Loyalty (Parasuraman et al., 1994; Jones and Suh, 2000).

Although the role of Satisfaction as the main driver of customer Loyalty is theoretically very well documented (Tsoukatos, 2007), relationships between the two constructs are found to vary between products/services, industries, and settings (Fornell, 1992; Cronin et al., 2000; Johnson et al., 2001; Olsen, 2007) with observed correlations often below 0.30 (Johnson et al., 2001). Moderate to low relationships have been found by several studies (e.g. Bloemer and de Ruyter, 1998; Mittal and Kamakura, 2001; Szymanski and Henard, 2001). Quite a lot of research on trying to shed more light on these issues is reported, mostly targeted at examining the effects of additional drivers and/or moderators between the two constructs (Olsen, 2007).

Not much is known, however, about the effects of Satisfaction on specific customer Loyalty dimensions and even less on whether these effects may be influenced by existing interrelations between Customer Loyalty dimensions. Empirical findings providing evidence that Customer Satisfaction positively affects both Behavioural and Attitudinal Loyalty do exist (e.g. Woodside et al., 1989; Nelson et al., 1992; Heskett et al., 1994; Zeithaml et al., 1996; Athanassopoulos, 2000; Van der Wiele et al., 2002; Durvasula et al., 2004; Lee and Hwan, 2005

etc.). With a few very distinct exceptions (e.g. Tsoukatos and Rand; 2006), however, strength differences among Satisfaction's effects on Behavioural and Attitudinal Loyalty or the mediating impact on these effects of relationships between Customer Loyalty dimensions are not researched. This study is designed to shed new light on these issues.

## Methodology

### Research Setting

Evidence for the study is drawn from Greek banking with special focus on face-to-face service interactions. Currently (2009 data), the industry encompasses 65 banks either established or having at least one branch in the Country, operating through 4,304 "*bricks and mortar*" service/sales outlets and employing 66,969 employees in total (HBA, 2011). During the past decade two parallel trends have been observed regarding banking services' delivery. On the one hand, the number of ATMs doubled from 3,605 to 7,624 (HBA, 2011) in combination with heavy investments in various e-banking forms. On the other, the number of face-to-face service/sales outlets increased by 28%, a rate almost double from its EU-27 (15%) counterpart (HBA, 2011). The latter is believed to reflect customers' preference towards face-to-face banking, stemming from technological illiteracy, low internet penetration and security concerns (Observatory for the Greek IS, 2007; Marinakis and Karanikolas, 2007).

### Research Instrument and Data Collection

Data was collected through a specially designed for the study research instrument. The survey consisted of five sections: respondents' demographics, respondents' quality expectations across four service quality metrics, respondents' performance perceptions across the same metrics, respondents' overall Satisfaction with their bank's services and respondents' Loyalty to their bank. Overall Satisfaction, in section four of the questionnaire, was measured as a single item construct (Meyer and Westerbarkey, 1996), while Loyalty, in section five, was measured across three distinct dimensions: word-of-mouth (WOM), customers' retention intentions and customers' extension of business intentions. The former was meant to reflect respondents' "*affective commitment*" (O'Mitchell, 2005; Garnefeld et al., 2011) towards their bank, while the second and third would reflect their "*continuance commitment*" (Garnefeld et al., 2011). All items in sections two to five were measured on 7-point Likert scales, anchored at 1= "not at all"/"absolutely not"/"not important at all" and 7= "extremely"/"absolutely"/"most important".

The survey was executed during the period from February 1<sup>st</sup> to June 30<sup>th</sup> of the year 2010 in a banking industry setting in Crete, Greece. A total of 1,000 questionnaires were administered, at a rate of four via the internet to one through personal interviews. Internet respondents were recruited among specific mailing lists of bank customers, whereas personal interviews were conducted among customers of specific bank branches. Eligible for the sample were adult individuals, users of face-to-face services of both retail and/or corporate banking, who had at least one face-to-face banking transaction during the prior month. All

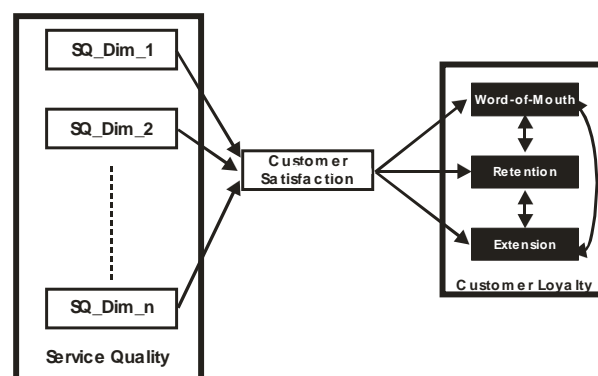
questionnaires were anonymous and no record of specific banks, which customers were doing business with, was taken. In view of this study's design to explore between variables relationships, the above described convenience sampling strategy is considered adequate. In study designs where generalisation is not the primary goal random sampling is not paramount (Calder et al., 1981). Overall, the survey yielded a sample of  $n=458$  usable questionnaires after 78% and 38% response rates for personal interviews and internet administration of questionnaires respectively. Careful checking of filled questionnaires revealed no systematic bias that could be attributed to the two diverse modes of questionnaire administration.

### Data Analysis and Results' Discussion

As already mentioned in the introductory section of this paper the design of the wider study involved: a) the assessment of alternative, banking specific and generic, service quality metrics, b) the interrelations of Loyalty dimensions, c) the examination of effects of overall Satisfaction on specific customer Loyalty dimensions and d) the examination of the mediating impact of interrelations between Loyalty dimensions on these effects. Herein, while we'll describe the entire modelling and analytical design of the wider study we'll then proceed with focusing our results' discussion on parts b to d of the study.

A Structural Equations Modelling (SEM) analytical pattern was chosen for data processing and most specifically the Path Analysis (PA) variation of SEM, appropriate when observed variables only are involved. The software package LISREL 8.72 was used in this respect. Based on the grounds of existing literature (e.g. Parasuraman et al., 1988; Cronin and Taylor, 1992; Luarn and Lin, 2003; Tsoukatos and Rand, 2006; Bandyopadhyay and Martell, 2007) all possible variations of the general model depicted in Figure 1 were examined.

Figure 1. – General Model





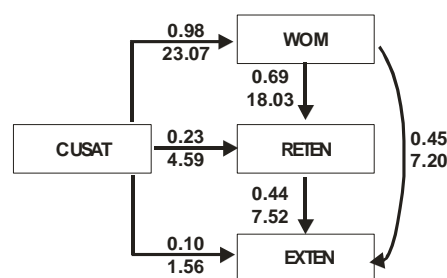
The exogenous variables of the model variations represented the dimensions of the SQ metric under evaluation each time. The right hand side of all variations under assessment, however, identically reflected possible relationships between customer Satisfaction and customer Loyalty dimensions as well as interrelations between the latter. Variables **CUSAT**, **WOM**, **RETEN** and **EXTEN**, measured in identical 7-point Likert scales, reflected respondents': **Overall Satisfaction** with their bank, willingness to engage in **Word-of-Mouth** communication in favour of their bank and its products/services, intention to **Keep on Doing Business** and intention to **Extend their Business Relation** with their bank respectively.

Model parameters were estimated by Maximum Likelihood (MLE) and model variations were evaluated on the account of Overall Fit and Structural Assessment (Diamantopoulos and Siguaw, 2000). To allow for non-normality the Sattora-Bentler statistic was used (Sattora and Bentler, 1994) for overall fit appraisal. Structural Assessment was based on the grounds of estimated parameters and  $R^2$  values (Diamantopoulos and Siguaw, 2000). For a full account of overall fit and structural assessment of all model variations please see Tsoukatos and Koulentaki (2011).

### Presentation and Discussion of Results

As stated already, this section will only discuss analytical results related to interrelations between Loyalty dimensions, the effects of Satisfaction, and the mediating impact on the latter of revealed interrelations between the former. In this respect, Figure 2 below depicts the produced model together with path estimates of direct effects from/to variables.

Figure 2. The Customer Satisfaction-Customer Loyalty model <sup>(a, b)</sup>



A Arrows represent direct effects

B Pairs of numbers indicate direct effects' estimates (numbers on top) and t-values (numbers below).

$R^2$  values of structural equations associated with the model (below) are high, thus, exhibiting strong predictive power of estimated equations.

$$WOM = 0.98 * CUSAT \quad R^2 = 0.54$$

$$t\text{-values} \quad 23.07$$

$$RETEN = 0.23 * CUSAT + 0.69 * WOM \quad R^2 = 0.69$$

$$t\text{-values} \quad 4.59 \quad 18.03$$

$$EXTEN = 0.10 * CUSAT + 0.45 * WOM + 0.44 * RETEN \quad R^2 = 0.63$$

$$t\text{-values} \quad 1.56 \quad 7.20 \quad 7.52$$

### Direct Effects of Satisfaction on Dimensions of Loyalty

As indicated in Figure 2 above between the direct effects of Customer Satisfaction (CUSAT) on the three dimensions of Loyalty under consideration, the strongest (0.98, t-value: 23.07) was that on Word-of-Mouth (WOM), reflecting customers' "*affective commitment*" to their bank (O'Mitchell, 2005; Garnefeld et al., 2011). Satisfaction's direct effects on dimensions associated with customers' "*continuance commitment*" (Garnefeld et al., 2011) intentions, i.e. Keep on Doing Business (RETEN) and Extend Business Relation (EXTEN), are of much lower magnitude. The CUSAT→RETEN effect of 0.23 is statistically significant (t-value: 4.59) whereas the CUSAT→EXTEN effect of 0.10 is not (t-value: 1.56). These results offer support to Tsoukatos and Rand (2006) who, in a Greek insurance setting, reported that the effect of customers' Overall Satisfaction on their willingness to engage in favourable for their insurer WOM communication was statistically significant whereas the effect on customers' intention to extend their business with their insurer was not.

### Causality of Relationships between Loyalty Dimensions

The model, in Figure 2, also depicts significant relationships between the dimensions of Loyalty, the causality of which runs from "*affective*" to "*continuance*" commitment related dimensions. Direct effect estimates of WOM on both RETEN and EXTEN are statistically significant; 0.69 (t-value: 18.03) and 0.45 (t-value: 7.20) respectively. The direct effect estimate of RETEN on EXTEN is also significant; 0.44 (t-value: 7.20). These results offer support to previous research findings proposing word-of-mouth as antecedent of behavioural intentions

related dimensions of Loyalty (Oliver, 1999; Tsoukatos and Rand, 2006; DeWitt et al., 2008; Garnefeld et al., 2011).

### **The Mediating Impact of Interrelations between Loyalty Dimensions on the Effects of Satisfaction**

The model, in Figure 2, further depicts the enhancing impact of word-of-mouth on Loyalty dimensions related to “*continuance commitment*”. The indirect CUSAT → WOM → RETEN effect estimate ( $0.98 \times 0.69 = 0.68$ ) is almost threefold higher than the direct CUSAT → RETEN estimate of 0.23. Furthermore, both the CUSAT → WOM → EXTEN ( $0.98 \times 0.45 = 0.43$ ) and CUSAT → WOM → RETEN → EXTEN ( $0.98 \times 0.69 \times 0.45 = 0.31$ ) indirect effect estimates are fourfold and threefold higher, respectively, as compared to the direct CUSAT → EXTEN effect estimate of 0.10. These results support similar findings reported from (among others) Oliver, (1999); Tsoukatos and Rand, (2006) and DeWitt et al., (2008). Moreover, Garnefeld et al.’s (2011) proposed notion that word-of-mouth is enhancing the communicator’s own behavioural Loyalty is fully supported.

### **Implications of the Study**

The above discussed results yield important implications. First, the long-established in the literature notion that overall customer Satisfaction is an immediate antecedent and strong driver of customer Loyalty (Cronin and Taylor, 1992), is once again confirmed. However, examining the relationship between the two constructs at the aggregate level is wrong, as it fails to expose the impact of Satisfaction on individual Loyalty dimensions. Findings of previous research reporting varied effects of Satisfaction between Loyalty dimensions (Tsoukatos and Rand, 2006) are confirmed. Hence, examination of Satisfaction-Loyalty relationships at the aggregate should be avoided as it may lead to systematic error.

Second, Loyalty dimensions are not independent constructs and should not be treated as such. Previous research findings on existing relationships, of specific causality, between Customer Loyalty dimensions (Luarn and Lin, 2003; Tsoukatos and Rand, 2006; Bandyopadhyay and Martell, 2007) have been confirmed. As expected, the causality was found to run from “*affectionate commitment*” to “*continuance commitment*” (Garnefeld et al., 2011). Most specifically, it followed the trail “willingness to engage in word-of-mouth communications in favour of the service firm and its products/services” → “intention to preserve current business relationship with the service provider” → “intention to extend current business relationship”. Garnefeld et al.’s (2011) notion that word-of-mouth enhances the communicator’s own Behavioural Loyalty is fully supported by the findings of this study.

Third, between significant direct effects of Satisfaction on Loyalty dimensions, under consideration, the strongest is the one on customers’ willingness to engage in word-of-mouth communication, followed by the one on their intentions to preserve current business relationship with their service provider. The direct effect on customers’ intentions to expand current business levels was found to be non-significant. Moreover, word-of-mouth is proven

to have a mediating impact on Satisfaction's effects on other Loyalty dimensions. Indirect effects of Satisfaction, through word-of-mouth, on customers' intentions to preserve and extend relationship were found to be threefold and fourfold stronger, respectively, than the direct ones. These findings not only support previous research reports (e.g. Tsoukatos and Rand, 2006) but also give additional meaning to Garnefeld et al.'s (2011) notion about word-of-mouth's role in enhancing communicators' own Loyalty.

The implications of these study's findings are of critical importance to managerial decision making. It is now proven that word-of-mouth communication, besides its well established in the literature effectiveness in attracting business from new customers (Trusov et al., 2009), is also capable of promoting communicators' retention and attracting new business stemming from it. Managers should be innovative in exploiting word-of-mouth communication in all these respects. Furthermore, they should be aware of possible differential effects of Satisfaction on specific Loyalty dimensions in view of better exploiting their Satisfaction campaigns' potential. Directly targeting such campaigns towards building customers' retention and/or cross-buying intentions might prove inefficient. Aiming such campaigns primarily at creating and/or reinforcing their customers' affectionate bonds with their firm will be much more beneficial. New business will be attracted customers through positive word-of-mouth communication of devoted customers (Trusov et al., 2009) and at the same time stronger motivation of existing customers to keep-on doing and extend their business with the firm will be achieved.

### **Study Limitations and Further Research Directions**

The main limitation of this study is that it drew evidence from a single service industry, i.e. Greek banking. Further research should be undertaken to confirm this study's reported findings in other service industries and settings. Convenience sampling is certainly an additional limitation, especially in view of that questionnaires were to a great extent administered via the Internet. However, this type of sampling is considered adequate when between constructs relationships are examined (Calder et al., 1981). As such is very common in the management literature (e.g. Brady et al., 2002; Chang et al., 2002; Wang et al., 2004; Semeijn et al., 2005). Despite these limitations, the methodology of this study provides future researchers a solid basis for their work.

### **Conclusions**

The findings reported in this paper build upon previous research on the Customer Satisfaction - Customer Loyalty link as well as on research about the internal relationships between customer Loyalty dimensions. Valuable insights to managers are provided indicating that their firms' customer Satisfaction campaigns should be primarily targeted at increasing the "*affectionate*" rather than the "*continuance*" commitment of their customers. Garnefeld et al.'s (2011) notion that word-of-mouth is enhancing communicators' own behavioural intentions is confirmed. Hence, targeting at positively affecting customers'

*"affectionate commitment"* will eventually result in enhanced behavioural Loyalty. Although the situational variables in the Greek banking industry may differ from those in other industries, the study's methodological framework can be adapted to apply to every research setting.

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<sup>vi</sup> De la Torre and Moxon (2001)

<sup>vii</sup> Liautaud and Hammond 2001 cited in Rhee (2005)

<sup>viii</sup> Rhee (2005) pg. 283

<sup>ix</sup> Guillén and Suárez, 2005 cite a couple of studies such as Mosco, 1996, McChesney, 1999, Everett, 1998



## **BUILDING ALLIANCE MANAGEMENT CAPABILITY: THE ROLE OF A FIRM'S REPERTORY OF EMBEDDED ALLIANCES AS VALUABLE EXPERIENCE**

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### **Abstract**

In this paper we examine which type of alliance experience matters most for developing an alliance management capability. Although experience is deemed to be an important antecedent of a firm's capability to manage collaborations, we argue that only some types of alliances are likely to foster the development of such a capability, thus representing the valuable alliance experience. Starting from the identification of the constitutive skills of an alliance management capability, we develop a theoretical framework which proposes that only alliances resembling the nature of the so-called embedded ties provide firms with these specific skills. We refer to the collection of such alliances as a firm's repertory of embedded alliances. Moreover, we argue that, in order to affect the capability building process, such a repertory needs to be not only extensive but also heterogeneous in terms of alliance goals, contents, governance forms and partners. Finally, we assume a stronger effect of the valuable alliance experience when leveraged through the use of deliberate learning mechanisms.

**Keywords:** alliance management capability, alliance experience, embedded alliances, deliberate learning mechanisms.

### **Attribution**

Although the paper is the result of collaboration among the authors, in the final draft Claudio Turi wrote section titled "Introduction" and section titled "Deliberate learning mechanisms and alliance management capability", Angela Delli Paoli wrote section titled "Valuable alliance experience and alliance management capability", Laura Castaldi wrote section titled "The Alliance Management Capability" and Clelia Mazzoni wrote section titled "Discussion"

## Introduction

During the years, there has been an explosion of interest in knowledge, which today is considered to be one of the most important resources for people, firms and countries. The economic role played by knowledge assets has changed since the industrial revolution, as it led to the adoption of artificial energetic sources, making human work mainly cognitive (Rullani, 2004: 249). In the field of strategic management, this has conducted to the knowledge-based view of the firm (KBV), asserting that firms are knowledge-based activity systems deriving competitive advantage from their cognitive structures (Nonaka and Takeuchi, 1995; Conner and Prahalad, 1996; Grant, 1996; Spender, 1996; Tsoukas, 1996; Boisot, 1998; Davenport and Prusak, 1998; Rullani, 2004). In today's complex economic scenario firms are unable to produce internally all the knowledge necessary not only for the achievement of a sustainable competitive advantage but also for their survival. At the same time, they cannot rely on mere market transactions to sustain the continuous process of knowledge creation. Therefore, firms often opt for the specialization of their activity and cognitive work division, engaging in strategic alliances.

However, despite their relevance, interorganizational collaborations often fail to reach their goals because of managerial difficulties (Simonin, 1997; Anand and Khanna, 2000; Ireland *et al.*, 2002). In this context, firms' ability to manage interorganizational alliances - defined *alliance management capability*<sup>[1]</sup> (Schreiner *et al.*, 2009) - appears to be one of the most important organizational knowledge assets.

In the last decade, several scholars have addressed the question of how firms can develop such a capability. Building on organizational learning and evolutionary economics, most of these studies assume that a relevant antecedent of a firm's ability in managing collaborations, and therefore of alliance success, is previous alliance experience (Anand and Khanna, 2000; Kale *et al.*, 2002; Zollo *et al.*, 2002; Sampson, 2005; Heimericks and Duysters, 2007).

However, empirical studies on the effect of previous experience on alliance performance have led to mixed results. Some scholars (Anand and Khanna, 2000) found a strong positive effect just for a specific type of collaboration (R&D joint ventures). Others studies, which distinguish between general collaborative experience and partner-specific collaborative experience, have provided different findings about their association with performance (Zollo *et al.*, 2002; Hoang and Rothaermel, 2005).

Despite in these studies scholars have highlighted the importance of experience in managing collaborations and have stressed the need to take account of differences in the types of alliance experience, we still lack a more comprehensive understanding of the linkage between the characteristics of previous experience and the alliance management skills which are fostered by such an experience.

The aim of the paper is to make a contribution towards the understanding of which part of experience can be considered valuable for the generation and development of a firm-level capability enabling firms to successfully manage interorganizational collaborations.

To get to the point, we first identify the constitutive elements of an alliance management capability following Schreiner *et al.* (2009) who conceptualize it as a multidimensional construct made of *coordination*, *communication* and *bonding* skills. Then, on the basis of such a conceptualization, we delimit the type of experience which is more likely to stimulate the development of such skills and refer to it as *valuable alliance experience*. In fact, we believe that previous alliance experience matters only to the extent that it provides the firm with those specific skills required to manage collaborations, i.e. with the elements that constitute an alliance management capability. In other words, the identification of the main components of such a capability is a necessary prerequisite to detecting the part of experience which contributes to its development.

We offer a framework which focuses on the alliance management capability building process. More specifically, in the proposed model, after breaking the alliance capability down into its constituent skills, we identify the part of experience which contributes to foster them thus affecting such a capability. Moreover, since experience is deemed to be a necessary but not sufficient condition in the capability building process (Simonin, 1997; Zollo and Winter, 2002; Heimericks and Duysters, 2007), we also recognize the role played by the adoption of deliberate learning mechanisms in such a process.

The paper is therefore organized as follows. Next section presents the theoretical background on the issue of alliance management capability. The following section describes the theoretical framework analyzing the dimensions supposed to affect the development of such a capability. Finally, we discuss some main implications and provide concluding remarks.

## **The Alliance Management Capability**

Entering an alliance is widely recognized as a necessary strategy for firms aiming at filling their knowledge gaps and keeping pace with rapid environmental changes (Doz and Hamel, 1998). However, the complexity of interorganizational relationships makes alliance success difficult to achieve, as confirmed by their high failure rate. Several challenges in the pre-alliance phase (selection of the partner, choice of the governance structure of the alliance, etc.), as well as in the ongoing management of the alliance (building of trust, management of interfirm knowledge sharing, etc.) make the outcome of a partnership extremely uncertain. Hence, given the role of partnerships in today's competitive environment and the asymmetric distribution of alliance managerial skills (Anand and Khanna, 2000: 296; Ireland *et al.*, 2002: 435), the capability to manage alliances has been identified as an important source of competitive advantage (Dyer and Singh, 1998; Ireland *et al.*, 2002). Following Schreiner *et al.* (2009), we term such a capability *alliance management capability*.

So far, one main stream of research on this subject has emerged focusing on the process behind the development of a firm's capability in managing alliances. More specifically, this body of literature mainly stressed the role played by experience in such a process by analysing its effect on performance.

For instance, Annand and Khanna (2000) found a positive association between collaborative experience and alliance performance by measuring the value created for each firm in the alliance in terms of stock market returns. Such a positive relationship is supposed to be due to the learning effects triggered by the accumulation of alliance experience. Other studies, which distinguish between general alliance experience (meant as the total number of previous agreements) and partner-specific alliance experience (meant as the number of previous ties with the same partner), gathered mixed findings (Zollo *et al.*, 2002; Hoang and Rothaermel, 2005). For instance, in studies on the same industry (biotechnology), Zollo *et al.* (2002) found a positive effect of partner-specific experience on alliance performance while Hoang and Rothaermel (2005) found that only biotech firms' general alliance experience was positively associated with joint project performance.

Other studies, although recognizing the importance of previous alliances, assume that collaborative experience alone is not enough (Simonin, 1997; Kale *et al.*, 2001; Heimeriks and Duysters, 2007; Kale and Singh, 2007). Simonin (1997: 1167) suggests that the lessons of experience have to be internalized by the firm and drawn into specific know-how in order to achieve benefits from future partnerships. Moreover, Sampson's findings (2005) about the decreasing marginal returns of alliance experience on a firm's innovative performance suggest the possibility of a depreciation of the value of experience over time and consequently the need to institutionalize and diffuse best practices within the organization (Sampson, 2005: 1027).

Building on organizational learning, evolutionary economics and dynamic capability studies, many scholars have proposed that firms need to invest in *deliberate learning mechanisms* (Zollo and Winter, 2002) in order to leverage previous alliance experience and therefore improve alliance performance (Kale and Singh, 1999; Kale *et al.*, 2002; Draulans *et al.*, 2003; Heimeriks and Duysters, 2007; Kale and Singh, 2007). These studies assume that the use of deliberate learning mechanisms helps the firm to derive lessons from previous collaborative experience and diffuse alliance management knowledge within the organization. In other words, by purposefully designing the organization for accumulation, storing, integration and diffusion of organizational knowledge acquired through experience, firms will make capability building more effective (Kale *et al.*, 2002: 749.).

Although these studies have offered considerable insight into the alliance management capability building process, they have given less attention to what actually constitutes a capability in managing alliances (Shreiner *et al.*, 2009; Schilke and Goerzen, 2010). Schreiner *et al.* (2009), in the attempt to extend a second stream of research on which elements constitute

an alliance capability, identify it as a multidimensional construct based on three skills - *coordination*, *communication* and *bonding* - required to manage the post-formation phase of an alliance. *Coordination* refers to the capability of managing and coordinating the interdependence between partners; *communication* entails the ability of fostering information sharing within the alliance; *bonding* refers to the firm's ability to enhance strong personal relationships among individuals involved in the collaboration.

We believe that the two research streams on alliance management capability – how it develops and which elements constitute it – are strictly related. Indeed, an attempt to deepen our understanding of a capability building process needs to be based on the analysis of the constitutive elements of the focal capability. In fact, in this study we aim to combine the two research streams on alliance management capability. Particularly, starting from Schreiner *et al.*'s (2009) conceptualization of such a capability as composed of coordination, communication and bonding skills, we attempt to shed more light on the linkage between alliance experience and alliance management capability. Indeed, Schreiner *et al.*'s (2009) conceptualization calls for a careful analysis of what kind of experience can actually foster the development of the aforementioned skills within the firm. Actually, we believe that merely referring to *alliance experience* as the basis for capability building without taking into account the type of experience accumulated by the focal firm, could be misleading. Following this logic, we isolate the part of alliance experience which is likely to foster the development of coordination, communication and bonding skills from that part which can hardly contribute to increase a firm's alliance management capability. In the following section we present in detail the proposed theoretical model, generating a set of propositions.

## **Theoretical Framework**

As shown in figure 1, we propose a multidimensional framework for the investigation of the relationship between the part of experience identified as valuable alliance experience and alliance management capability. Moreover, we suggest that the adoption of deliberate learning mechanisms is likely to affect such a relationship.

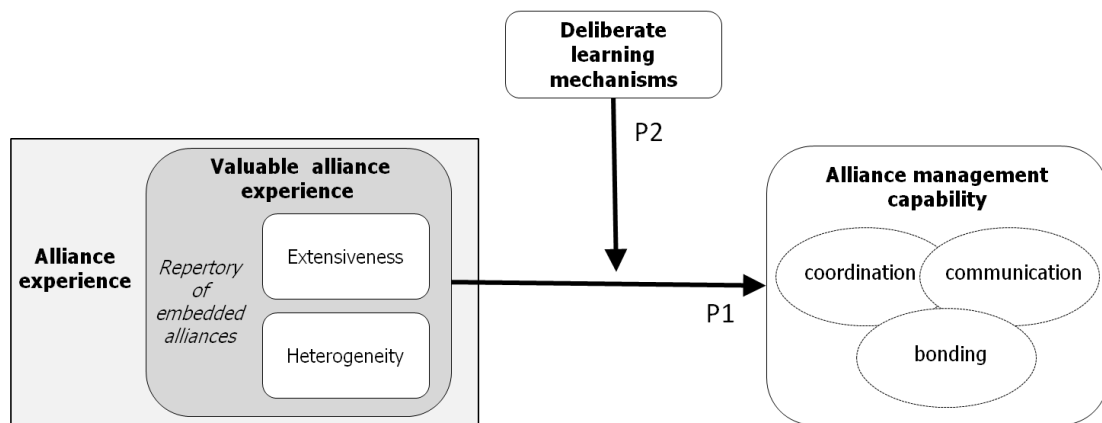


FIGURE 1

*A theoretical model of alliance management capability building*

In what follows we provide explanations for each of the assumed relationships.

#### **Valuable alliance experience and alliance management capability**

Many research suggest that previous experience in managing alliances might be a critical antecedent of alliance or firm success (Powell *et al.*, 1996; Lorenzoni and Lipparini, 1999; Anand and Khanna, 2000; Kale *et al.*, 2000; Hoang and Rothaermel, 2005; Sampson, 2005; Heimeriks and Duysters, 2007). Such a positive association between experience and performance is supposed to be due to capability development (Simonin, 1997; Zollo and Winter, 2002; Heimeriks and Duysters, 2007).

Overall, studies which stress the role of experience are built on the assumption that a firm's accumulation of experience in a focal activity makes it possible to repeat the action in a similar way. Such an assumption derives from the experience curve literature, which suggests that repeated engagements in an activity produce benefits through learning by doing (drawing inferences, encoding, storing and saving experience) (Levitt and March, 1988). As individuals remember skills by practising them, in the same way organizations remember activities by doing them. That is to say that the skills of an organization reside in their routines and in the operational knowledge which derives from the routinization of an activity (Nelson and Winter, 1982: 99).

In such a process of experiential learning, organizations develop a capability adopting those routines and strategies that are likely to lead to the desired outcome, and refining the routines by learning within them.

With reference to the specific process of alliance management, previous alliance experience might help firms to store and develop a repertory of practices which facilitates the interpretation, anticipation and response to unforeseeable contingencies and to the unpredictable nature of the interaction between alliance partners (Anand and Khanna, 2000:

298). Such an experience seems to assume a more critical role under some circumstances. For instance, Sampson (2005) states that alliance experience produces collaborative benefits when alliance activities are characterized by high levels of ambiguity and uncertainty and managerial decisions cannot be based on observable criteria.

Apart from facilitating decision-making, alliance experience might also help firms to further develop their internal capabilities in terms of strategic and network assets (Powell *et al.*, 1996: 119). The model of learning proposed by Powell *et al.* (1996) assumes that a more extensive experience at managing R&D alliances leads to a more diverse firm's portfolio of alliances and, in this way, increases the firm's ability to become more centrally connected and so to gain information and reputation benefits.

Generally, these studies suggest that the extensiveness of a firm's repertory of alliances (alliance experience) is positively related to a firm's alliance management capability.

However, we put this statement one step further by arguing that alliance volume does not necessarily imply learning from alliances: the effect of experience may differ according to the type of previous ties a firm has been involved in. In fact, the logic that firms learn how to manage alliances as their overall experience increases, neglects that only some types of experience are actually likely to foster managerial learning.

Indeed, following the perspective that experience produces benefits thank to the development of routines derived from repeated engagements in the same activity, we believe that the alliance experience which matters is only the one allowing firms to practice and routinize the specific skills required to manage collaborations.

Therefore, the starting point in understanding which type of alliance experience might be really valuable is a clear identification of the constitutive skills of alliance management capability. As mentioned above, we use Schreiner *et al.*'s conceptualization (2009) of a collaborative capability as composed of *coordination*, *communication* and *bonding* skills<sup>[2]</sup>. Coordination refers to the ability to understand and match the interdependence among partners; communication entails the ability to share relevant and accurate knowledge with partners, as well as the ability to choose adequate communication modes according to the context; bonding refers to the firm's ability to strengthen interpersonal relationships among individuals involved in the collaboration (Schreiner *et al.*, 2009: 1401-1402).

The focus on what actually constitutes an alliance management capability helps us to delimit the experience which matters most. In fact, assuming that alliance management capability is made of coordination, communication and social bonding skills, as stated, we need to ask which kind of experience could matter for developing these skills, excluding that part which does not contribute to this process. Therefore, we need to focus on the nature of the relationship in order to understand which type of previous ties might be influential in facilitating alliance management learning. In other words, which ties have the features that

can provide firms with communication, coordination and bonding expertise? We advance the hypothesis that alliance management learning is more likely generated as previous relationships resemble the nature of the so-called *embedded ties*, characterized by a unique combination of personal, social and economic factors and defined by three main components: *trust*, *fine-grained information transfer* and *joint problem-solving arrangements* (Uzzi, 1997).

*Trust* – meant as the mutual confidence that no parties involved in the relation will exploit another's vulnerability – is a unique governance mechanism based on voluntary, non-obligating exchanges of assets and resources by norms of generalized reciprocity.

Trust seems to operate on the basis of a heuristic process characterized by subtle control of interdependence and self-regulation, instead of a calculative risk-based decision focused on monitoring devices (Uzzi, 1997: 43).

Such a process speeds up decision making and economizes cognitive resources such as time and attention, not damaging information quality. In this way, it provides alliances with an *open architecture* to transfer and exchange *fine-grained information* (Uzzi, 1996: 678), which is proprietary, sticky, strategic and tacit knowledge, hard to codify and acquired through learning by doing. Knowledge sharing develops through the establishing of shared norms, codes, languages and representations which provides the normative background for communication. By generating "a common conceptual apparatus", this alignment offers the opportunity of creating a common base which avoids that misunderstanding deriving from speaking different languages (Nahapiet and Ghoshal, 1998: 253).

As a result, by taking for granted the integrity of partners, embedded ties help partners to develop *joint problem-solving arrangements*, in this way making partners able to coordinate their interdependence, to work through problems, learn by them and accelerate problem correction.

Synthesizing, the features of embedded ties (trust, fine-grained information transfer and joint problem solving arrangements) allow for greater transparency between partners thus facilitating the formation of strong social bonds, foster the activation of a communication-intensive process of relationship management and support the joint resolution of problems and the mutual coordination (Kale *et al.*, 2000: 223). For this reason, embedded ties are likely to provide firms with coordination, communication and bonding experience and, therefore, seem to correspond to the part of experience which really counts for developing the capability of managing alliances as previously defined.

Stated the importance of previous embedded ties in the alliance capability building process, we suppose that it is not the number of all previous alliances to matter but the extensiveness of the collection of embedded alliances a firm has accumulated over time. We refer to such a collection as the firm's *repertory of embedded alliances* (Figure 1).



So far, the analysis has allowed us to delimit the repertory of relevant experience. As a further step, we need to ask which features of such a repertory as a whole may enhance managerial learning, avoiding the paralyzing effect which transforms experience into a *core rigidity* (Leonard-Barton, 1992). In fact, a firm's repertory of embedded alliances can be characterized by heterogeneous or homogeneous ties in terms of alliance goals, contents, governance forms and partners.

We recognize the existence of two main experiential risks in alliances which resemble embedded ties:

- the tendency to choose similar partnerships in terms of alliance goals, contents and governance forms;
- the over-repetition of the alliance with the same partner.

This may lock firms in a specific experience which sets up idiosyncratic routines inapplicable to different types of alliances. Paradoxically, the same embedded ties which can stimulate managerial learning might turn into a liability restricting firm's experience outside a specific relationship.

On the contrary, a heterogeneous repertory of embedded alliances - in terms of goals, contents, governance forms and partners - makes firms able to experience different alliance management practices. A diverse and broader range of collaborative experience provides greater opportunity to refine interaction routines and procedures for cooperating making them more versatile and generally applicable. Thus, the diversity of ties might result in a more general managerial capability.

Therefore, in our framework, the extensiveness of the repertory of embedded alliances is a necessary but not sufficient condition for learning from experience: the more a repertory is formed by heterogeneous partnerships, the less the risk that experience transforms into a rigidity.

We refer to the experience provided by an extensive and heterogeneous repertory of embedded alliances as *valuable alliance experience*.

Summarizing, we suppose that it is not the extensiveness of all types of alliance experience to matter but the extensiveness and heterogeneity of a firm's repertory of embedded alliances.

By this argument, we elaborate the following proposition (Figure 1):

*Proposition 1: the extensiveness and heterogeneity of a firm's repertory of embedded alliances (valuable alliance experience) will be positively related to alliance management capability.*

#### **Deliberate learning mechanisms and alliance management capability**

Our analysis thus far has assumed that firms with an extensive and heterogeneous repertory of embedded alliances are more likely to develop an alliance management

capability. However, in line with previous studies, we believe it is necessary to look also at those intra-firm dynamics which foster such a capability building process.

In fact, there are limitations that constrain learning by doing and, therefore, the process leading from valuable alliance experience to alliance management capability cannot be taken for granted. As Levinthal and March (1993: 96-97) remarked, experience is often a *poor teacher* and learning entails many of the same cognitive limits that constrain rationality. Organizational limitations, such as problems of memory, conflict and turnover, accentuate the cognitive limitations of individuals, thus making learning from experience extremely difficult. More specifically, firms have to foster knowledge sharing within the organization, otherwise critical knowledge would reside only in those who have learned the lessons (Heimeriks and Duysters, 2007: 42).

As regards alliance management, learning from prior experience is likely to be even more challenging as compared to other tasks for which experience effects have been documented, since alliances are usually less frequent, more heterogeneous and more causally ambiguous than other processes (Zollo *et al.*, 2002: 703).

As a result, scholars that investigated alliance management capability building assume that, although important, alliance experience is a necessary but not sufficient condition for improving alliance performance (Simonin, 1997; Kale and Singh, 1999; Kale *et al.*, 2002; Heimeriks and Duysters, 2007).

In line with these scholars, we believe that what really matters is the way prior experience translates into a capability. Zollo and Winter (2002) argue that the ability of a firm to derive lessons from previous alliance experiences and develop a process to manage partnerships in a systematic and relatively predictable fashion is an example of a dynamic capability whose development requires deliberate learning processes of explicit *knowledge articulation* and *knowledge codification* going beyond semi-automatic stimulus response and tacit accumulation of experience. Similarly, Kale and Singh (2007) highlight the importance of enhancing an *alliance learning process* so that firms can learn, accumulate and leverage alliance management knowledge gathered in previous partnerships. They argue that experience is a *crude approximation* of the mechanisms that lie at the foundation of an alliance capability, which, instead, would develop from proactive efforts to accumulate and leverage alliance know-how associated with prior experience. In particular, apart from the above-mentioned processes of knowledge articulation and knowledge codification, they address the role of *knowledge sharing* and *knowledge internalization* mechanisms as a way to diffuse best practices within the firm.

Heimeriks and Duysters (2007) found that a firm's alliance capability resulting from learning mechanisms for capturing, disseminating and applying alliance management knowledge, mediates between a firm's alliance experience and alliance performance. Similarly, Draulans *et al.* (2003: 160) argue that companies need to develop processes directed at learning from alliances and spreading alliance management knowledge within the

company in order to achieve alliance success. They found that organizations that institutionalize and structure learning from experience are able to achieve superior alliance performance.

More in general, several scholars stressed the importance of investing in deliberate learning mechanisms in order to leverage and disperse alliance knowledge within the organization, such as: codified tools (databases containing firm's alliance history, manuals, checklists and guidelines), formal and informal debriefings of alliance managers, alliance training systems, problem-tracking and problem-solving procedures, rotation across different partnerships of experienced alliance managers, alliance committees and task forces, dedicated alliance functions (Simonin, 1997; Kale *et al.*, 2001, 2002; Zollo and Winter, 2002; Draulans *et al.*, 2003; Heimeriks and Duysters, 2007; Kale and Singh, 2007).

Building on these studies, we assume that valuable alliance experience will have a stronger effect on the development of alliance management capability when alliance management knowledge accumulated in previous partnerships is leveraged through the use of some deliberate learning mechanisms.

On the basis of these arguments, we offer the following proposition (Figure 1):

*Proposition 2: the more a firm invests in deliberate learning mechanisms, the stronger the positive relationship between valuable alliance experience and alliance management capability.*

## Discussion

In this study, building on Schreiner *et al.*'s (2009) conceptualization of an alliance management capability as made of coordination, communication and bonding skills, we have introduced the concept of *valuable alliance experience*, that is the type of experience which is more likely to contribute to the development of such a capability. Contrary to other studies which highlighted the role of the firm overall collaborative experience, we propose that only alliances which resemble the features of embedded ties might represent an antecedent of an alliance management capability. In fact, these ties, being characterized by features such as trust, fine-grained information transfer and joint problem-solving arrangements, provide firms with an experience of the specific skills required to manage interorganizational relationships. We refer to this part of experience as the firm's *repertory of embedded alliances*. Moreover, we suggest that the more such a repertory is heterogeneous in terms of alliance goals, contents, governance forms and partners, thus providing firm with an experience of different alliance management practices, the more likely previous experience will transform into a general applicable alliance management capability. In addition, we focus on the need to design internal organization in order to foster the development of an alliance management capability. We emphasize the centrality of adopting organizational mechanisms, managerial practices and routines - *deliberate learning mechanisms* - suitable to interorganizational alliance management and consequently to knowledge transfer processes.

### **Theoretical implications**

From a theoretical point of view, our framework makes a contribution to existing literature in several ways. First, it extends alliance management capability studies by bridging two research streams usually treated in isolation: what alliance management capability is and how it develops. Previous studies have focused either on the process leading to an alliance management capability, highlighting the role of alliance experience and deliberate learning mechanisms (Kale *et al.*, 2001; 2002; Draulans *et al.*, 2003; Heimeriks and Duysters, 2007; Kale and Singh, 2007), or on the elements which constitute such a capability (Shreiner *et al.*, 2009). In this paper we have showed how an enhanced understanding of the issue of alliance management capability can be reached by bridging these two streams of research. More specifically, by focusing on the constitutive elements of an alliance management capability, we question the assumption that all previous alliances lead to an improvement in the firm's capability to manage relationships and advance the hypothesis that only some of them can actually contribute to this process. Although some other scholars have distinguished among different types of alliance experience and empirically tested their effect on performance (Zollo *et al.*, 2002; Hoang and Rothaermel, 2005), they did not link the characteristics of such experience to the specific skills required to manage collaborations. Second, our model contributes to theory by stressing the need of focusing on different levels of analysis when dealing with the issue of alliance management capability. Specifically, our framework explores the role played in the capability building process by interorganizational elements - both at the alliance level (embeddedness of ties) and at the entire collection of previous ties level (heterogeneity of the repertory of embedded alliances) - as well as intraorganizational elements (deliberate learning mechanisms). Thus, alliances are likely to enhance managerial learning when firms, at an interorganizational level of analysis, have been involved into several and diverse embedded relationships and, at a firm-level, adopt suitable internal organizational mechanisms, managerial practices and routines to leverage such an experience. In addition, our framework might be useful for the analysis of other organizational capabilities (such as the capability to manage mergers and acquisitions). Generally, our argument suggests that breaking capabilities down into their constituent skills might be central in order to identify, among previous experience, what might represent a valuable one.

### **Managerial implications**

From a managerial perspective, the framework suggests some point of intervention for alliance management. First, by highlighting the role of embedded ties in the alliance capability building process, it stresses the importance of managing relationships through personal involvements and close bonds. Second, it recognizes the role of a differentiated repertory of alliances as a means of preventing inertia. Although we admit that the heterogeneity of the collection of embedded alliances a firm accumulates over time is often contingent on concrete opportunities and environmental factors, we think that to some extent

it can be strategically designed. Third, it stresses the role of the adoption of organizational mechanisms to turn experience into a capability. In this case, the role of management becomes more crucial. In fact, some of the deliberate learning mechanisms (for instance a dedicated alliance function) may lead to an excess of bureaucracy and others (e.g., codified tools such as guidelines and manuals) may limit the dynamic evolution and revision of firm's routines and procedures. Therefore, the mere adoption of these mechanisms is not enough since the leverage of previous alliance experience through such mechanisms is a process that needs to be dynamically managed in order to avoid organizational inertia and the generation of core rigidities.

Indeed, though we have argued that valuable alliance experience is likely to be an antecedent of an alliance management capability, we need to consider that such a process might actually develop in a cyclical way. If, according to our framework, an extensive and heterogeneous repertory of embedded alliances may provide the firm with specific communication, coordination and bonding skills, these skills are actually likely to lead the firm to experience further embedded and heterogeneous relationships, which will lead to an additional improvement in the firm's alliance management capability and so on. In other words, we need to consider the likelihood of a virtuous cycle enhanced by such a capability building process.

## Endnotes

[1] Other scholars refer to such a capability as *collaborative know-how* (Simonin, 1997) or *alliance capability* (Anand, and Khanna, 2000).

[2] Following this perspective, we believe that alliance management capability is the ability of favorably and successfully managing and coordinating an individual alliance during the post-formation phase. In so doing, we exclude from alliance management capability the skills related to pre-formation and formation phases of alliances (such as, for example, the selection of partner and the choice of governance structure), as they only indirectly affect the relationship.

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**THE EVALUATION OF THE STRATEGIC BUSINESS UNITS OF DERIVATIVES  
WITHIN GERMAN SAVINGS BANKS AGAINST THE BACKGROUND OF THE  
CURRENT ECONOMIC CRISIS: SYSTEMATIC LITERATURE REVIEW & INITIAL  
APPROACH**

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**Abstract**

This paper provides a systematic literature review on the critical success factor (CSF) approach within the banking industry. This is done in order to create a theoretical basis for further research regarding the question if there are CSFs which have to be considered implementing a meaningful and sustainable business strategy for the business segment 'derivative sales' within German saving banks against the background of the current financial and economic crisis. In detail it presents a wide list of success factors, success factor categories and their developments in order to build up an appropriate platform for further bank-specific research regarding this approach. It could be observed that a generally accepted holistic concept is still outstanding and no research regarding critical success factors has taken place within the banking industry since the year 2005.

In addition to this, research objectives are formulated and an initial outlook is given how the identified scientific gap will be addressed within further research using grounded theory as overall methodology within a constructivism worldview.

**Keywords:** Systematic Literature Review, (Critical) Success Factors, Predictive Factors, Competitive Factors, Financial Crisis, Bank, Banking, Derivatives.

**Introduction**

The impacts of the global economic and financial crisis are still very much in evidence, especially in relation to the market of OTC-derivatives. This has suffered from many regulatory and legal changes. Within the business segment of selling derivatives to hedge client's interest rate exposure, German savings banks have just started to position themselves during the last years, making use of different strategies to enter, stay in and leave the competitive environment.

While smaller institutions do not actively engage within this business segment, medium and larger savings banks make use of different forms of co-operation, either horizontally with other savings banks (e.g. within special purpose vehicles) or vertically with their mother institutions. Furthermore the set up of own business units within their institutions as well as the involvement of external consultants (hired as outsourced sales units) can be observed.



Against the background of the global economic and financial crisis, the available resources within savings banks as well as the up-coming changes within the landesbanks'<sup>84</sup> sector, the question that arises is: What are the critical success factors which have to be considered in implementing a meaningful and sustainable business strategy for the business segment 'derivative sales' within German savings banks.

### **Global Economic and Financial Crisis**

For critically discussing the approach's results the economic and financial crisis of 2007 has to be reviewed shortly. Due to the different perspectives and variety of research the issue shall only be addressed briefly on a descriptive level illustrating the central causes, the development economy has taken and the outcomes.

Since August 2007 catastrophic developments hit the national economies, financial institutions and financial markets all over the world (Hellwig, 2009). Even though it is hard to determine the exact origins the results became visible to the "general public on the global level" in 2007 (Radun, 2009, p. 348). As central element of this crisis the US housing bubble, especially regarding subprime mortgages, is seen (Baker, 2008; Singh & Bruning, 2010). The origins of this bubble can be referred to the stock bubble in the mid-90s. The increased stock-wealth had led to more consumption and people tended to invest their money in housing. As the supply of houses is relatively fixed in the short-run the prices began to rise and people were able to sell their houses on higher prices than they have paid in order to buy better homes (Baker, 2008; Singh & Bruning, 2010).

The consumption motivation was accomplished through extraordinarily low interest rates due to the slowly recovering economy, which still suffered from the 2001-recession and the arising threat of deflation (Baker, 2008). Accelerating low levels of lending standards combined with wrong stimulates regarding the housing-market (e.g. "teaser-rates" and "negatively amortizing loans") had additionally led to a strong increase of subprime-mortgages since the years 2001 (Sanders, 2008; Radun, 2009). At the beginning of 2007 nearly 13% of all mortgages had the purpose of private house financing. Regarding this volume of more than half a trillion US-Dollar nearly 700 billion were securitized and had become tradable. Doing this, the loan-giving institutes could pass on their default risks to the capital market and could relieve their balance sheets (Kofner, 2009). The validity of the securitized papers was assessed by rating agencies, which made used of statistic (historical) databases determining the default probability and the recoverability of the collaterals (Kofner, 2009; Radun 2009).

After a time of decreasing and low interest rates the Federal Reserve Bank changed its interest-rate policy and introduced a period of increasing federal funds rates (Eisenbeis,

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*84 Landesbanks are central institutions for the savings banks with the intention to be competence centres and to offer links to the financial markets for savings banks.*

2010). Due to financing on revolving loans with adjustable interest rates especially debtors with low credit-worthiness could not meet their financial obligations any more (Singh & Bruning, 2010). As a consequence the number of non-performing loans increased and many homeowners had to face foreclosure (Kofner, 2009; Baker, 2008). The increasing number of debt enforcement led to an increasing offer of houses and at the beginning of 2008 the house prices had already fallen over 30 percent in annual rates (Baker, 2008). In 2009 about 1.5 million US-households defaulted and faced foreclosure (Les, 2009).

As the house prices decreased and the number of non-performing loans increased, the financial industry had to depreciate their positions and became more and more restrictive regarding their lending standards as well as to roll over the granted loans. In addition to this the securitization markets had become more and more illiquid (Eisenbeis, 2010). As within the securitization market national as well as international investors were involved, the former national problems of subprime mortgages spilt over to other economies, stock markets and became a global financial crisis (Kofner, 2009; Sing & Bruning, 2010). Many financial institutions had to make value adjustments on their investments resulting in decreasing equity-positions with impacts on their ratings, their refinancing possibilities and their lending opportunities (Kofner, 2009; Eisenbeis, 2010). A general loss of trust against other asset classes and the financial sector itself took place and led to strong problems regarding the refinancing of banks through interbank borrowing (Radun, 2009). As a consequence several banks went bankrupt or needed supported by government or other public institutions. These rescuing programs were accomplished by several economic programs by governments trying to stabilize and stimulate the economy (Kofner, 2009). Regarding the German banking industry it became obvious that several banks were also invested in the US mortgage market through special purpose vehicles. This led to dramatic problems regarding refinancing and solvency and private as well as fully/partly state owned banks needed to be rescued by the state (Hau & Thum, 2009).

### **Success and its Measurement**

Even though the term 'success' is used quite often an appropriate definition is far away from being trivial as it occurs to be an abstract parameter, which cannot be measured directly (Strauss, 2005). In addition to this the terms success and success measurement cannot be discussed separately as at least the performance measurement is determined by the definition of success. Therefore combined explanations of three approaches take place in the following, mentioning the underlying definition of success as well as its measurement, followed by the advantages and disadvantages. A special focus is laid on the practicability of the considerations.

Traditionally the term success is defined to be the difference of an input-parameter to an output-parameter. A positive balance is defined to be success, while a negative difference is characterized to be a loss/failure (Fritz, 1995). As organizations and companies do not only

strive for economic goals, further considerations took place, having the objective to determine the efficiency and therefore performance of a company (Grabatin, 1981).

The **goal approach** assumes that companies are systems serving different purposes. The enterprises' objectives are clear and identifiable. Therefore success is defined to be the achievement level of the set objectives (Buehner, 1977). As this approach is rather practical and easy to use, there are several disadvantages going along with this. A main argument is that only internal stakeholders are taken into account. The environment as well as competitors are completely disregarded and therefore the approach lacks the possibility to compare enterprises with each other (Grabatin, 1981). Finally the approach assumes that each company has a main goal, which is quite problematic regarding the bundle of goals defined by companies (Staehle, 1999).

An extension is made with the **system approach**, which considers – in addition to the internal processes and structure of the organization – the relationship of the entity with its environment. Within this concept, success is defined to be an “abstract, multidimensional construct” (Staehle, 1999, p. 445), which focuses on the survivability of the company. On the one hand the abstract level of definition leads to problems regarding the implementation, but on the other hand it offers the possibility to include external dimensions.

The **stakeholder approach** makes use of a completely different idea. It assumes that each stakeholder (shareholder, employee, customer, etc.) assess the organization/object in a different way, depending on his own motivation and intention (Staehle, 1999). Following this idea success is defined to be the level of agreement within these groups. By widening the perspective the stakeholder-approach considers far more dimensions than the other approaches, but can also be characterized to be more abstract. Therefore a practical implementation seems to be even more difficult.

To sum up it can be said that the more perspectives are included the higher the level of abstraction and the lower the applicability. Hence, many success factor studies make use of the goal approach using its definitions and methods of performance measurement (e.g. Kalka, 1996; Haenecke, 2001).

## Theoretical Background of Critical Success Factors

The CSF approach has the aim to identify the general, sustainable factors, which differentiate successful from less successful companies (Hoffmann, 1986; Fritz, 1995; Hildebrandt, 2002; Hesse, 2004). Following the arguments of Riekeberg (2003) critical success factors<sup>85</sup> can be characterized to be

- definable,

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<sup>85</sup> Within literature the terms 'success factors' and 'critical success factors' are used synonymously (Kube, 1991).

- sustainable in the long-term<sup>86</sup>,
- directly/not influenceable by the company itself,
- company- or industry-specific,
- limited in their amount,
- original influencing variables leading to empirical or analytical assumptions about causal links,
- which help to explain the current or future positive or negative success of a business (unit).

Riekeberg (2003) distinguishes between 'critical success factors' and 'success factor categories'. While their characterization seems to be quite similar the levels of abstraction make the important difference as success factors can be aggregated to success factor categories.

The general goal of the success factor approach can be split into three considerations (Jenner, 1999). These are firstly the identification of the determinants, secondly their characteristics and thirdly the intensity regarding their influences (Fritz, 1995). These pieces of information about the cause-and-effect-relationship shall lead to the ability to make predictions for the future. Therefore the knowledge of the critical success factors helps a company to make transparent and rational decisions regarding their business strategy (Grimm, 1983).

General assumption of this approach is the consideration that only a few factors determine the success or failure of an enterprise, parts of a company or a business unit (Hoffmann, 1986; Leidecker & Bruno, 1984). Disregarding multidimensionality and multi-causality the theory's advocates believe that such critical factors always exist (Riekeberg, 2003). This leads to the argument, that the identification of all influencing factors is not necessary as only some of them have relevance (Daschmann, 1994; Lange, 1982). The identification of these *critical* factors is the aim of the critical success factor approach (Liehr-Gobbers, 2006), offering the company's management a framework for their strategic decisions (Böing, 2001).

First steps to a critical success factor approach were made with the research of Daniel (1961) and Rockart (1979). Researching information systems, Daniel (1961, p. 116) originally states that these systems "[...] should focus on ,success factors'. In most industries there are usually three to six factors that determine success; these key jobs must be done exceedingly well for a company to be successful". Daniel's thesis were followed and developed further by Rockard (1979, p. 85), who comes to the conclusion that "critical success factors thus are, for any

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<sup>86</sup> Regarding further information of this strategic aspect of the critical success factor please refer to Grimm (1983), Fritz (1995) as well as Annacker (2001).

business, the limited number of areas in which results, if they are satisfactory, will ensure successful competitive performance for the organization. They are the few key areas where 'things must go right' for the business to flourish".

Based on this a more professional and more academic examination took place (Woywode, 2004) with the result that the search for success factors also spilt over from single enterprises to whole industries as well as the theoretical organization itself. Beginning in 1980 strategic management research became also interested in the critical success factor approach and several large research projects were introduced, e.g. the Profit Impact of Marketing Strategies-Project (Woywode, 2004). Even though they became quite popular, their results often were low and Ghemawat (1991, p. 11) sums up: "The whole idea of identifying a success factor and then chasing it seems to achieve something common with the ill-considered medieval hunt for the philosopher's stone, a substance that would transmute everything it touched into gold."

Research on critical success factors can be roughly distinguished in research which on the one hand concentrates on the success or on the other hand focuses on the failure of economic activity. Studies which focus on failure of a company ('negative success') can be accredited to the insolvency or crisis research (Fritz, 1990) and will not be regarded further. In addition to this, research can be often differentiated by studies highlighting only one single factor or in contrast to this on a bundle of variables (Strauss, 2005).

Depending on the method, the identification of critical success factors can result from theoretical or conceptual findings, logical considerations, knowledge (from experts) or empirical analysis (Lange, 1982). Until now, two general directions of scientific approaches regarding success factors have been established: a qualitative and a quantitative approach (Tomczak, 1992). The qualitative approach analyzes a variety of qualitative arguments in order to find similarities and overlaps by using (soft) criteria. These are then defined to be critical factors (Haenecke, 2002). In contrast to the qualitative approach which focuses on qualitative arguments and does not rely on corporate data, the quantitative approach focuses on mathematical and statistical methods to analyze. Its researchers base their analysis on figures, trying to identify coherences by using mathematical methods for analysis (Werries, 2008).

Additionally, studies can be differentiated according to their scientific objective and the type of study (Haenecke, 2002). While explorative studies have the aim to identify patterns for setting up hypotheses, confirmatory studies have the goal to deduct practical suggestions by an assessment of logical causalities or to empirically prove theoretical theses (Werries, 2008). These confirmatory studies try to identify critical success factors by using a logical-deductive method (Werries, 2008). In contrast, explorative studies are usually based on empirical-inductive findings. In the history of critical success-factor research both approaches have had relevance and were used (Gruenig, Hecker & Zeus, 1996). While till the 90s most of

the studies can be seen as explorative analysis, recent studies have moved towards a confirmatory approach (e.g. Evanschitzky, 2003; Riekeberg, 2003; Hesse, 2004).

In summary it becomes obvious that besides the variety of former and present studies also the methodological approaches strongly differ. Deficits regarding comparability and less possibilities to draw hypotheses in order to set up a framework have been the result and a holistic concept of the critical success factors approach, which has been generally accepted and fully empirically examined, is still outstanding and missing (Rehkugler, 1989; Fritz, 1990; Goettgens, 1996). Therefore the critical success factor approach can still be seen at its beginnings and has problems regarding its acceptance (Fritz, 1990; Kube, 1991; Schroeder, 1994; Goettgens, 1996; Kieser & Nicolai, 2002).

### **Systematic Literature Review on Bank specific CSF**

Works on literature reviews, like Tranfield, Denyer and Smart (2003, p. 214), suggest to make use of (iterative) scoping studies for management research in order to “assess the relevance and size of the literature and to delimit the subject area or topic”. This has already been done for presenting the historical, theoretical and methodological developments in the previous sections. As iterative process such scoping studies were rerun focusing on bank-specific research regarding ‘critical success factors’. The online databases EBSCO were searched through on 15.10.2010 using the following search terms: *(Success Factors) and Banks*, *(Critical Success Factors) and Banks*, *(Success Factors) and Derivatives*, *(Critical Success Factors) and Derivatives*.<sup>87</sup> A hand search of literature using the local library was also carried out.

As a preliminary result indicated by various sources, it becomes obvious, that previous research on success factors has been mainly conducted in the fields of the traditional manufacturing industry as well as on retail market. In contrast to their quantity and variety, the research on success factors in the banking industry seems to be quite limited. Especially focusing on ‘derivatives and CSF’, it becomes apparent that, so far, neither quantitative nor qualitative research has been embarked upon. Therefore, the assumption is drawn that the review has to start on a more generic (bank) level, and the following sections illustrate previous research and empirical findings on CSFs in banking.

Scoping previous studies reveals that Riekeberg (2003) and Strauss (2005) have already carried out literature reviews regarding CSFs in banking some years ago. Riekeberg identified ten studies to match his criteria. From these, he isolated 73 CSFs, which he aggregated into 12 success categories (cf. Appendix 1). Furthermore, Strauss (ibid) covers 20 studies presenting the reader an overview of the factors involved (cf. Appendix 2). In addition to this meta-analysis, an own systematic literature review was carried out using EBSCO, German National Library, Google Scholar incl. Emerald, ZETOC and Ethos (cf. Appendix 3 for

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<sup>87</sup> In addition to this also the German expressions/translations were used, offering even more possibilities to gain pieces of information.

inclusion/exclusion criteria). To sum up, only the already known work by Strauss (which was not covered by previous reviews) matched the inclusion criteria. The lack of new studies confirms the assumption that there is not much empirical work as to CSFs on banks in general and on derivatives in particular in comparison to other industries. This deplorable state might be partially explained by the financial crisis of the recent years preventing further research on banks and their success determinants to be carried out. Analyzing the identified studies it can be concluded that the theory of CSFs regarding the banking industry, especially in recent history, has mainly taken place in the German-speaking areas. On the one hand, this might have been caused by a stronger focus on this approach by German-speaking researchers or, on the other hand, by a certain bias of German speaking academics. The general trend, that newer studies focus on more generic and, therefore, more transferable work instead of on company-specific research is interrupted by Strauss emphasizing corporate banking within the saving banking group. The inconsistent results of the respective literature reviews regarding the characterization as well as categorization of factors mirror the different objectives of the authors as well as the general problems of the scientific approach on CSFs itself. Hence, so far, a generally accepted list of 'the critical success factors' for the banking industry implicit from literature review is currently not existent. Nevertheless, the aggregations of previous literature reviews in combination with an analysis of Strauss' work offer an appropriate overview of possible CSF (categories).

## Conclusion and Outlook

It could be observed that a generally accepted holistic concept of a critical success factor approach is still missing – especially within the banking industry. Therefore, the general applicability of the approach against the background of the business segment of derivative sales within regional banks seems questionable or might have to be accomplished by resorting additionally to other theoretical approaches. Nevertheless, the approach might be a useful starting point of a theoretical basis and might help to operationalize it. Summarizing, the literature review has shown that, so far, the aforementioned research issue has not been addressed within previous research.

The aim of up-coming research, therefore, is to identify these critical factors by 'building a bridge' between academic methods and practical knowledge thereby closing the gap between science and practice. Therefore, the research objectives are briefly

- to explore the nature of current business strategies for derivative sales within savings banks,
- to examine the critical success factors differentiating successful from less successful business units,
- to understand the external and internal influences on the implementation of new business strategies for derivative sales and

- to recommend strategies to enable saving banks to deal with this sector.

Relating to the savings bank industry up-coming research will be limited to the field of hedging/optimizing interest rate risk on the customer's liability side. Other derivative classes like foreign exchange- and credit-derivatives as well as derivatives for the asset side shall be excluded by definition. The final outcome shall be the development of a conceptual framework contributing to a better understanding of this business segment by academics and practitioners as well as providing a basis to optimize existing or the setting up of new sustainable business level strategy. For this research, sustainable business strategy shall be defined to answer the questions 'what has to happen to achieve a defined position in relation to other competitors within a market segment and what has to be fulfilled to stay successful in the long term' (Collis & Montgomery, 1998; Grant, 2002). The business strategy shall set up conditions for the effective arrangements of offers, resources and abilities for the business unit and defines conductive 'competitive strategies' (Hofer & Schendel, 1978; Collis & Montgomery, 1997; Gruenig & Kuehn, 2000). Hence, the business strategy sets the guidelines for a certain market segment within an organization.

Therefore, the up-coming research is highly relevant for the banking and consulting industry, offering in-depth - expertise within a market-environment which is swiftly and radically changing but still having high profit potential. The purpose of the up-coming research is exploratory, accepting that only few practitioners will be able and willing to participate and share their experiences and meanings about the research questions and objectives. The aim to construct a framework needs a deep understanding of the business activity accomplished by considerations about regulations and future developments and, therefore, requires complex discussions. Finally, one of the researchers can be seen as a passionate practitioner regarding the topic, working within this area for years. For these reasons it seems to be appropriate to take the position of constructivists to answer the research question.

Choosing grounded theory as an overall methodology, research will be based on the techniques of face-to-face in-depth expert interviews (as well as participant observation). Figure 1 illustrates a rough, initial concept of the research design. The upcoming results will then help to close the identified scientific gap regarding the question, how to make the business segment 'derivative sales' within German saving banks successful against the background of the current economic crisis.



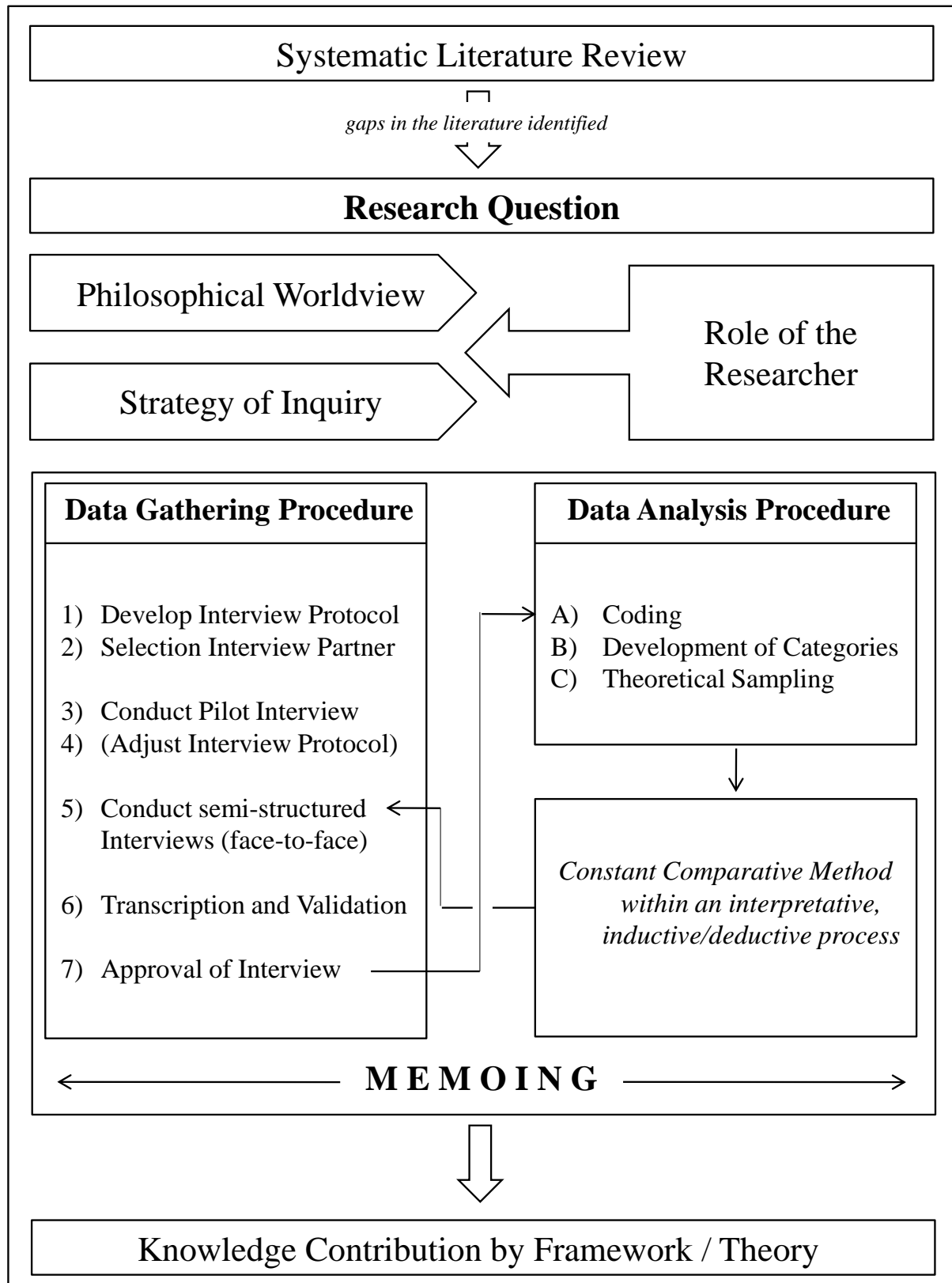


Figure 1: Overview of Data Gathering and Analysis Procedure

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**Appendix 1: Success Categories according to Riekeberg's Literature Review**

	Success Category	Quantity of Mentioning	Quantity of Studies	Author/Source
<b>External</b>	Potential Demand	12	5	Clawson (1974), Doyle et al. (1979), Fenwick (1979), Martin (1967), Olsen & Lord (1979)
	Competitive Position	6	5	Clawson (1974), Doyle et al. (1979), Fenwick (1979), Martin (1967), Olsen & Lord (1979)
	Attractiveness of Location	5	3	Clawson (1974), Doyle et al. (1979), Olsen & Lord (1979)
<b>Internal</b>	Customer Focus	9	6	Davis (1989), Doyle et al. (1979), Hansen & Weinberg (1979), Krueger et al. (1992), Priewasser (1992), Zimmermann (1988)
	Organization	5	4	Davis (1989), Krueger et al. (1992), Priewasser (1992), Zimmermann (1988)
	Management (institutional sense, business policy and administration)	12	4	Davis (1989), Krueger et al. (1992), Priewasser (1992), Zimmermann (1988)
	Qualification and Motivation of Employees	5	4	Davis (1989), Krueger et al. (1992), Priewasser (1992), Zimmermann (1988)
	'Governance'	3	3	Krueger et al. (1992), Priewasser (1992), Zimmermann (1988)
	Focusing on targets, Focusing on closings	3	2	Davis (1989), Krueger et al. (1992), Priewasser (1992), Zimmermann (1988)
	Business Culture / Corporate Identity	3	2	Krueger et al. (1992), Priewasser (1992), Zimmermann (1988)
	'Image'	1	1	Hansen & Weinberg (1979)
	Miscellaneous	9	3	Clawson (1974), Hansen & Weinberg (1979), Zimmermann (1988)

Source: Aggregated from Riekeberg (2003), p. 180/188

**Appendix 2: Success Factors according to Strauss' Literature Review**

No.	Author(s)	Date of Publication	Country	Target Group	Research Method	Internal Success Factors	External Success Factors
1	Martin	1967	USA	Private Clients	quantitative, confirmative	Bank: relation 'spendings for marketing' to 'dividends on deposits', accommodativeness of the location	Sociodemographic Factors: population within business area, yearly population growth, share of inhabitants aged over 65, share of minority households, share of houses for rent, share of households with migration background, job <u>Economic Factors:</u> average income / house value, retail space within business area <u>Competitive Situation:</u> relation population/bank institute, number of institutes within (business) area, market penetration
2	Clawson	1974	USA	Private Clients	quantitative, explorative	<u>Branch Characteristics:</u> attractiveness of interior and exterior, age of the office, distance to a shopping center, parking adequacy, promotion activities	<u>Sociodemographic Factors:</u> share of persons aged 45 to 64 or older, income per capita within business area, share of renters next to the branch <u>Economic Factors:</u> median value of owner-occupied homes, retail sales per year within one-half mile radius, savings per capita <u>Competitive Situation:</u> population per saving and loan facility (S&L), amount of competing S&L-facilities, total assets of competing S&L facilities, average net saving gains of competitors
3	Heggestad	1977	USA	Private Clients	quantitative, confirmative	-	<u>Economic Factors:</u> average total deposits, ratio of time and savings deposits to total deposits, growth of retail sales, income per capita <u>Market Structure:</u> market concentration <u>Risk</u> (moderating factor)
4	Doyle et al.	1979	Great Britain	Private & Business Clients	quantitative, explorative	<u>Branch Characteristics:</u> age of the office, existence of night safe	<u>Market Potential of Business Area:</u> age distribution, distribution of occupational groups, characteristics of local environment of branch: number of retail sellers, number of other branches of the same bank within environment <u>Competitive Situation:</u> relation of 'amount of non-financial institutes' and 'amount of competitive branches'
5	Fenwick	1979	Great Britain	Private Clients	quantitative, explorative	age of the office	age distribution within business area, categorization of the population to social-economic groups, houses under constructions, competitive situation (amount of competitors)
6	Olsen & Lord	1979	USA	Private Clients	quantitative, confirmative	-	<u>Variables of Demand:</u> average income per household, placement of retail area, purchasing power of households, amount of employees, inhabitants of rented apartments (in percent) <u>Variables of Supply:</u> external and internal competition (amount of competitors from other/own institutes within business area)

No.	Author(s)	Date of Publication	Country	Target Group	Research Method	Internal Success Factors	External Success Factors
7	Hansen & Weinberg	1979	USA	Private Clients	quantitative, confirmative	<u>Bank Name</u> <u>Customer Focus:</u> distance from shopping-area's central point, existence of walk-up window <u>Image and Reputation:</u> newness of office	-
8	Lenz	1980	USA	-	quantitative, confirmative	<u>Organization Structure:</u> president's span of control, division manager's average span of control, number of media used for advertisement	<u>Environment:</u> offices ratio, soci-economic development, mortgage loan rate <u>Strategy:</u> liquid assets, mix of financial services
9	Lynge & Shin	1981	USA	-	quantitative, explorative	amount of financial services	concentration of competitive environment, distance from bank office to (inner) city, greatness of institute (relative comparison of total assets), amount of inhabitants within area
10	Zimmermann	1988	Switzerland	-	quantitative/ qualitative, explorative	<u>Business Policy:</u> diversification, specialization, clarity and consistency, no political influence on management, profit orientation, focus on foreign countries <u>Leadership and Workforce:</u> front-end orientation, quality of management, pioneering spirit, briefing of workforce, business culture, qualification, experience from industry <u>Sale of Services:</u> efficient allocation of resources, activity within growing markets, profiling within the market <u>Business Operation (Organization):</u> tight and sales-orientated structural organization, continuous willingness for improvement regarding the organization's structure, IT <u>Miscellaneous:</u> size of enterprise, historical success	-
11	Cool et al.	1989	USA	-	quantitative/ qualitative, confirmative	<u>Operational Efficiency:</u> deposits per employee, loans per employee <u>Input Factor Payments:</u> salaries per employee, overhead per employee <u>Organizational Fit:</u> decision decentralization, degree to which departments have influence on strategic decisions <u>Product-market Investments:</u> marketing intensity, emphasis on sales force, product differentiation (all in relation to competitors)	<u>Market Share:</u> market share of total deposits / loans within the country of operation <u>Rivalry:</u> concentration of total deposits / loans
12	Davis	1989	International	Private Clients & Corporate Clients	qualitative, explorative	open business culture, shared core values, goal and profit orientation, customer focus, willingness to invest in new products, consistent/continuous management, willingness to hire best employees, investment in staff qualification and human resource development, management-information-system (matrix-approach), sustainable and balanced lending process	

No.	Author(s)	Date of Publication	Country	Target Group	Research Method	Internal Success Factors	External Success Factors
13	Priewasser	1992	Germany	-	qualitative, explorative	<u>Active Management:</u> creating instead of administrating management <u>Concentration on Core Business:</u> abandonment of proprietary trading, focus on credit business <u>Sales Orientation:</u> performance-related payments, sales unit have nothing to do with back office processes and control, engagement of management board within the sales process, sales orientated structural and process organization <u>Centralization of high-quality Business:</u> differentiation between generalists and specialists, abandonment of administration departments as far as possible, communicating business culture to improve performance of quality <u>Human Resources:</u> not explicitly mentioned, but often spoken about qualified and motivated employees	-
14	Krueger et al.	1992	Germany	-	quantitative, confirmative	<u>Strategy:</u> profit orientation, focus on costs, adaptability/flexibility, focus on innovation, product/market-concepts <u>Responsible Body:</u> qualification/person of management <u>Culture/Philosophy:</u> existence/consistence/acceptance of overall concepts <u>Structure:</u> organization of management, building of sub-systems, coordination <u>System:</u> management information system, planning/controlling-software, risk management systems, accounting and information systems <u>Potential of Realization:</u> potential of financing, human capital, marketing/sales/market research  ('success categories' as well as 'success factors')	-
15	European Banking	1993	Europe	Business Clients & Corporates Clients	qualitative, explorative	(1) size of requirement for value adjustments (2) extent of interest margin (4) cost of operation-level (5) share of provision gains (6) share of loan volume (7) cross-selling results (9) use of information/communication-technologies (10) abandonment of gainless services	(3) expansion rate of European Union (8) volatility of interest rates
16	Priewasser	1994	Germany	-	qualitative, explorative	market orientation, controlling, quality of service/customer support, quality of management, quality of employees, price, capital structure, information technology, organization, universal financial services, capability to be innovative, business culture, level of self-service support, specialization	-



No.	Author(s)	Date of Publication	Country	Target Group	Research Method	Internal Success Factors	External Success Factors
17	Avkiram	1995	Australia	Private & Business Clients	quantitative/ qualitative, explorative	tangible convenience, staff number (full-time equivalent), customer service quality, managerial competence of the branch manager, use of decision support system	<u>Socio-Economic Factors:</u> number of persons aged 15 years or more, population growth rate, average age of persons aged 15 years or more, average annual family income, proportion of private dwellings rented <u>Factors of Market and Environment:</u> number of small business establishments, presence of competitors
18	Mercer Management Consulting	2002	International	Private Clients & Corporate Clients	quantitative/ qualitative, explorative	corporate management, human resources management, risk management, marketing, earnings orientated management, cost management, products, sales organization ('success factors' in the meaning of 'value drivers' within the survey)	-
19	Krauss	2003	Germany	Corporate Clients	quantitative, explorative	<u>Competence of Business Relations:</u> competence of customer advisory service, competence of problem solving, strong links to the region/knowledge of regional market, organization of customer advisory service, customer satisfaction, professional trainings <u>Competence of Customer Care:</u> relationship management, trust/openness, personal meetings, customer loyalty, personal engagement/social skills/motivation of employees, acceptance of the corporate banking officers by the clients <u>Sales Competence:</u> risk focus, sales organization, modern financial services, conditions, modern distribution network <u>Competence of Change Management:</u> speed, flexibility, quality, image, advertisement/public relations, information, added value	
20	Riekeberg	2003	Germany	Private & Business Clients (Saving Banks)	quantitative, confirmative	<u>Customer Focus:</u> business culture for customer focus, knowledge of customers' needs and expectations, concrete implementation, customer focus within the company <u>Organization:</u> organizational structure and process organization, improvement and flexibility of organization/structure <u>Management:</u> institutional and functional management, business management <u>Qualification and Motivation of Employees:</u> qualification and motivation of employees <u>Overall:</u> governance, dimension of system, dimension of processes ('success categories')	potential demand, competitive position, attractiveness of location ('success categories')

Source: Aggregated from Strauss (2005), p. 64 et seqq.

**Appendix 3: Inclusion/Exclusion Criteria**

Parameters	Inclusion Criteria	Exclusion Criteria
<b>Location</b>	Industrialized Countrys (OECD members)	Non-Industrialized Countrys
<b>Time Frame</b>	Studies published from 01.01.2005 onwards	Studies published before 2005, already discussed by Riekeberg (2003)/Strauß (2005)
<b>Language</b>	Studies written in English/German	Studies not written in Englisch/German
<b>Study Type</b>	Primary Research, studies which report on findings which use qualitative and quantitative methods	Book Reviews, opinion pieces, policy documents
<b>Outcome</b>	Studies which are open to any result and do not focus on one single success factor	Studies which focus on the relevance of one success factor
<b>Miscellaneous</b>	Studies focussing on critical success factors in business units with relevance for derivate sales (e.g. corporate banking)	Studies focusing on critical success factors in non-relevant business units (e.g. Private Banking, M&A) or services (e.g. Transactions Services, e-Banking)

## THE BOUNDARIES OF FREEDOM OF THE PRESS IN SOUTH AFRICAN LAW

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### Abstract

Our entire social system is pervaded with a myriad of issues relating to freedom of expression. A free responsible press is one of society's greatest assets. Courts must now ensure that common law is not locked within the limitations of the past and they must re-consider common-law rules within the new context so as to render them congruent with the fundamental values and principles.

Strict liability of the press is now rejected as unconstitutional since it mars the free flow of information – a democratic principle. The press should, however not be placed in a privileged or superior position to that of the individual on the basis that the press constitutes an essential bastion of free expression in a democracy. The onus rests on the media defendant to prove a defense excluding unlawfulness on a preponderance of probabilities rather than a mere evidential burden. The media defendant in a defamation action is often in the best position to know whether reasonable steps were taken to verify the information published and so to establish that its publication was reasonable.

In a system of democracy dedicated to openness and accountability, as ours is the especially important role of the media, both publicly and privately owned, must be recognised. Freedom of expression is therefore a part of the very definition of self-government: the process of free discussion is required no matter whether the process leads to the truth or not.

**Keywords:** Freedom of expression, unlawfulness, reasonable, democracy and values.

### Introduction

Freedom of expression is a method of achieving a more adaptable and hence a more stable society, of maintaining the precarious balance between cleavage and necessary consensus (Baker, 1978).

John Manyarara describes press freedom as: "...Press freedom in the region is like the English weather: bright and sunny when you emerge from the comfort of your home – but if you are initiated, you will carry an umbrella because you are likely to need it on your way back. Therefore, my survey of press freedom in the region will be like a weather forecast: the forecast is always correct, it is the bloody weather which keeps changing" (Duncan and Seleokane, 1998). The barometer by which the extent of press freedom existing in a country can be measured with reasonable accuracy is that country's political climate.

Section 16 of the *Constitution* 1996 states:

- Everyone has the right to freedom of expression, which includes-
  - freedom of the press and other media;
  - freedom to receive and impart information and ideas;
  - freedom of artistic creativity; and
  - academic freedom and freedom of scientific research.
- The right in subsection (1) does not extend to-
  - propaganda for war;
  - incitement of imminent violence; or
  - advocacy of hatred that is based on race, ethnicity, gender or religion, and that constitutes incitement to cause harm (Constitution, 1996).

Freedom of expression is fundamental for democracy to succeed. It does, however, precipitate profound jurisprudential issues and complex problems that require dispassionate examination and a judicious weighing up of competing interests in a democratic body politic (Van der Westhuizen, 1994).

Chapter 2 of the *Constitution* 1996 contains no express hierarchy of rights and is affirmed by the Constitutional Court in *Khumalo and Others v Holomisa* 2002 (5) SA (CC0 (2002 (8) BCLR 771) nevertheless freedom of expression is a cornerstone of an authentic democracy since it is "*the indispensable condition of nearly every other form of freedom*", without which other freedoms would not long endure and therefore *de facto* it must be ranked as a very important right (Carpenter, 1995) In this regard a distinguished American judge. Mr Justice Cardozo, commented that "*freedom of thought and speech is the matrix, the indispensable condition, of nearly every other form of freedom*" (*Palko v Connecticut* 1937 302US 319).

## **The Nature of Freedom of Expression**

Section 16(1) protects free expression and not only free speech (De Waal, Curie and Erasmus, 2002). Expression is a wider concept than speech and includes activities such as displaying posters, painting and sculpting, dancing and the publication of photographs. In principle, every act by which a person attempts to express some emotion, belief or grievance should qualify as constitutionally protected expression (De Waal, Curie and Erasmus, 2002).

Our entire social system is pervaded with a myriad of issues relating to freedom of expression. In the past a vast number of restraints inhibiting freedom of expression were adopted and used because of the oppressive nature of our body politic. The fact that South Africa is now functioning under a *Constitution*, which protects freedom of expression, implies that there will have to be changes, also in the area of freedom of the press, where the common law is not in step with the constitutional values of freedom, equality and human dignity.

## The Limitation of this Right

Fundamental rights and freedoms are not absolute (Carpenter, 1995). Their boundaries are set by the rights of others and by the legitimate needs of society. In the South African Constitution, a general limitation clause- section 36- sets out specific criteria for the restriction of the fundamental rights in the Bill of Rights. The existence of a general limitation clause does not mean that rights can be limited for any reason. The reason for limiting a right need to be exceptionally strong. The limitation must serve a purpose that most people would regard as particularly important (Meyerson, 1997). But, however important the purpose of the limitation, restrictions on rights will not be justifiable unless there is good reason for thinking that the restriction would achieve the purpose it is designed to achieve, and that there is no other way in which the purpose can be achieved without restricting rights. *"A free responsible press is one of society's greatest assets. The press is the artery through which a democracy's lifeblood flows, exposing corruption, dishonesty and maladministration. Thus the press has to be the watchdog, inciting the inert and curbing the over-eager. Effective freedom of press would be frustrated if freedom of expression is limited in such a way as to intimidate the media into not publishing"* (Klopper, 1979).

## Strict Liability of the Press

In the past our courts construed defamation in our common law in a very wide manner, thereby restricting press freedom. Strict liability of the press is now rejected as unconstitutional since it mars the free flow of information - a democratic principle (Burchell, 1998). Thus *bona fide* published untruths in the political sphere are defensible if it is of public interest. The press serves public interest by making available information relevant to the community as well as criticism on all aspects of public, political and social activities (Burchell, 1993).

Through freedom of expression, the press helps to establish true democracy. The contentious issues are the extent to which freedom of expression should be permitted and the manner in which the courts ought to balance it against equally fundamental rights and considerations applying in a democratic society such as *inter alia* the right to reputation or dignity, privacy, political activity, fair trial, economic activity and property (Burchell, 1993).

It is not without significance that section 16 of the South African Constitution, after stating that 'everyone has the right to freedom of expression', includes 'freedom of the press and other media' under the general rubric of freedom of expression, and places these facets of the right on an equal footing with the 'freedom to impart information and ideas, freedom of artistic creativity, academic freedom and freedom of scientific research.' *"The press should not be placed in a privilege or superior position to that of the individual on the basis that the press constitutes an essential bastion of free expression in a democracy. They bear an obligation to provide citizens both with information and with a platform for the exchange of ideas which is crucial to the development of a democratic culture... If the media are scrupulous and reliable in the performance of*

*their constitutional obligations, they will invigorate and strengthen our fledgling democracy (National Media Ltd v Bogoshi 1998 (4) SA 1195 (SCA)).*

## Defamation

The common law of delict requires a plaintiff in a defamation action for damages to show that a defamatory statement has been published with intent and knowledge of wrongfulness (*animus inuiriandi*). In the pre-democratic era, the courts alleviated the plaintiff's burden by presuming the presence of both intent and unlawfulness when defamatory material directed at the plaintiff was published to communicate information and comment, while obviously crucial in a modern democracy, should be no greater than that of an ordinary citizen to communicate. This need for substantially equal treatment of all who communicate with others has been recognised (*Pakendorf en andere v De Flamingh* 1982 3 SA 146 (A) 156B).

The Supreme Court of Appeal in *National Media Ltd v Bogoshi* 1998 (4) SA 1195 (SCA) has set broad, realistic standards of reasonableness, or reasonable care, for the media in regard to the publication of matter, which could be defamatory or impair other personality rights of the individual.

Hefer JA's judgment in *Bogoshi* constitutes the watershed decision in the revival of the common-law emphasis on freedom of expression, in particular of the print and electronic media. The court, in rejecting the concept of strict liability for the media, re-emphasised the vital role of media freedom in a democracy, affirmed that there was no closed list of defences excluding unlawfulness, and stressed that although a high degree of care is required of editorial staff, even the publication of some falsity may be in the public interest in special circumstances.

Publication in the press of false defamatory statements of fact will be regarded as lawful if, in all the circumstances of the case, it is found to be reasonable;... protection is only afforded to the publication of material in which the public has an interest (ie which it is in the public interest to make known as distinct from material which is interesting to the public (*Financial Mail (Pty) Ltd and Others v Sage Holdings Ltd and Another* 1993 (2) SA 451 (A))).

The decision in *Bogoshi* (*National Media Ltd and Others v Bogoshi* 1998 (4) SA 1196 (SCA) (1999 (1) BCLR 1)) relates both to the fault element of the delict of defamation and to the element of unlawfulness. Insofar as fault is concerned, the usual rule is that one will be liable for defamation only if one has *animus inuiriandi*. The focus in *Bogoshi* was thus the question of fault (negligence as opposed to strict liability).

A fault criterion of negligence is necessary not only to address freedom of expression but also to emphasize the imperative that the media should not be treated in a way, which is substantially inferior to other defendants in defamation cases. In other words, fault is required for the liability of both the individual and the media defendant; intention is required for the former and negligence is sufficient for the latter. The distinction is more readily

justifiable as a reasonable one than the now jettisoned distinction between intention-based liability for the individual and strict (no-fault) liability for the mass media. The press will thus not be held liable for the publication of defamatory material where it can show that it has been reasonable in publishing the material. Accordingly, the form of fault in defamation actions against the press is negligence rather than intention to harm.

However, fault need not be in issue at all if in the particular circumstances anterior inquiry shows that the publication is lawful because it is justifiable. *Bogoshi* indicates that the reasonableness of the publication might also *justify* it. In appropriate cases, a defendant should not be held liable where publication is justifiable in the circumstances – when the publisher reasonably believes that the information published is true. The publication in such circumstances is not unlawful. Political speech might, depending on the context, be lawful even when false provided that its publication is reasonable. It determines whether, on grounds of policy, a defamatory statement should be actionable because it is justifiable made in the circumstances.

In *Holomisa v Argus Newspapers Ltd* 1996 (2) SA 588 (W) at 618E-F a judgement presciently foreshadowing *Bogoshi* as regards the availability of a defence based on absence of negligence, Cameron J held that a defamatory statement “*which relates to free and fair political activity*” is constitutionally protected, even false, unless the plaintiff shows that, in all the circumstances of its publication, it was made reasonably made. The Court in *Holomisa* did not, however, consider it correct to import into our law the so-called *Sullivan* principle (*New York Co v Sullivan* (1964) 376 US 254 (1964) 11 L ed 2nd 686) that defendant press members will not be liable for defamatory statements made of public figures unless the plaintiff can show that the statement was made with actual malice. Such a principle would give far too little protection to the right of dignity. The approach that is preferred in both *Holomisa* and *Bogoshi* of reasonable publication.

Jonathen Burchell commenting on *Bogoshi* writes, “*The test of reasonableness or public (legal) policy is a supple criterion which can ensure that the law of delict is able to meet the needs of a changing society... The accommodation of freedom of expression under the unlawfulness inquiry is now firmly acknowledged by the Supreme Court of Appeal*” (Burchell, 1998).

The central reasoning of the Supreme Court of Appeal in *Bogoshi* for confirming that the media defendant bore a full burden of proof on a preponderance of probabilities rather than a mere evidential burden. The media defendant in a defamation action is often in the best position to know whether reasonable steps were taken to verify the information published and so to establish that the publication was reasonable. It would be unrealistic to expect the plaintiff to prove facts that he or she has very little of discovering

It was with great relief that I read the judgment of Hefer JA in *Bogoshi* and I enthusiastically support the conclusions thereof. These conclusions in *Bogoshi* are momentous and signify a profound, beneficial change in direction of the common law. Freedom of expression

(including media freedom) at last received due recognition. A vital function of the press is to make available to the community information and criticism about every aspect of public, political, social and economic activity and thus to contribute to the formation of public opinion (Van der Walt, 1998)

However, without wishing to appear churlish, I want to focus on some blurred edges in the judgment. The central problem is whether a media defendant can rely on absence of knowledge of unlawfulness and negligence, i.e. whether reasonable mistake or ignorance could be a defence. Negligence of the defendant may well be a determinant of the unlawfulness of the publication.

The central issue is not whether a media defendant can rely on a defence of absence of knowledge of unlawfulness due to negligence, but whether such a defendant can rely on a defence of absence of knowledge of unlawfulness not due to negligence. Reasonableness of the publication also includes an inquiry into whether the person detrimentally affected by the publication was given an opportunity to reply, at least after publication. The fact that a media defendant, who has channels of reply available, has not granted the opportunity to a person detrimentally affected by one of its application to reply to the allegations about him or she, after publication, will be a factor to be considered in determining the overall unreasonableness of the publication.

But the reasonableness inquiry is not completely open-ended: it involves the balancing of other rights against freedom of expression, and what is most important, in the context of freedom, equality and dignity. A right to reply (rebuttal) could according to me attractive- it may provide a quick and effective remedy and, in most cases, would not interfere with any editorial discretion because very little editing appears to take place.

The question arises whether special principles should be invoked to protect the press, or for that matter individuals, when they make defamatory statements about a member of Government. The *Reynolds* decision in the Court of Appeal (referred to by Hefer JA in *Bogoshi*) was confirmed by the House of Lords (*Reynolds v Times Newspapers Ltd and Others* [1999] 4 All ER 609 (HL) [2001]2 Ac 127).

The House of Lords declined to recognize a special defence of political speech. It differed in this regard from the Australian High Court decision in *Lange v Australian Broadcasting Corporation* (1997 189 CLR 520 (1997) 145 ALR 1) (a case approved by Hefer JA in *Bogoshi*), finding that the common law should not develop 'political information' as a generic category of information the publication of which attracts a qualified privilege irrespective of the circumstances. In *Lange v Atkinson* (NZ 1997 2 NZLR 22-Eds) Lord Nicholls pointed out: "One feature of all the judgments, New Zealand, Australian and English, stands out with conspicuous clarity: The recognition that striking a balance between freedom of expression and protection of reputation calls for a value judgment which depends upon local political and social conditions. These conditions include matters such as the responsibility and vulnerability of the press".



## Right to Dignity and Right to Freedom of Expression

Twenty four years after the decision in *Pakendorf v De Flamingh* 1982 3 SA 146 (A) where strict liability of the press was apply, the *Mthembu-Mahanyele v Mail & Guardian Ltd and Another* 2004 (6) SA 329 agree that strict liability has a negative impact on press freedom. There must be a balance between the right to dignity, including reputation, and the right to freedom of expression. Both rights were now given special protection in the bill of Rights, and the question was whether a class of people (members of Government) had to lose the right to the protection of their dignity and reputation in the interest of public information and debate.

In *Mthembu-Mahanyele* the Cabinet Minister had asserted that words published by a certain weekly newspaper in its annual 'report card' on the performance of Government Ministers were defamatory of her. She pleaded that the respondents had acted recklessly, not caring whether the contents were true; and that they took no reasonable steps to establish whether the statement made was true. The Court had for reasons of convenience referred to Cabinet Ministers, but that could not be taken to mean that other members of Government, or parliamentarians or officials of State had to be treated differently (*Mthembu-Mahanyele v Mail & Guardian Ltd and Another* 2004 (6) SA 332).

Freedom of expression in political discourse was necessary to hold members of Government accountable to public. And that some latitude must be allowed in order to allow robust and frank comment in the interest of keeping of society informed about what Government did. Errors of fact should be tolerated, provided that statements were published justifiably and reasonably. That does not mean that there should be a licence to publish untrue statements about politicians. They too have the right to protect their dignity and their reputations.

As Burchell puts it: "*There are limits to freedom of political comment, especially in regard to aspects of the private lives of politicians that do not impinge on political competence. Politicians or public figures do not simply have to endure every infringement of their personality rights as a price for entering the political or public arena, although they do have to be more resilient to slings and arrows than non-political, private mortals*" (Burchell, 1998).

But where publication is justifiable in the circumstances the defendant will not be held liable. Justifiability is to be determined by having regard to all relevant circumstances, including the interest of the public in being informed; the manner of publication; the tone of the material published; the extent of public concern in the information; the reliability of the source; the steps taken to verify the truth of the information (this factor would play an important role too in considering the distinct question whether there was negligence on the part of the press, assuming that the publication was found to be defamatory); and whether the person defamed has been given the opportunity to comment on the statement before publication (*Mthembu-Mahanyele v Mail & Guardian Ltd and Another* 2004 (6) SA 332). In cases

where information is crucial to the public, and is urgent, it may be justifiable to publish without giving an opportunity to comment.

## Conclusion

The *Constitution* 1996 requires the government to respect the principle of democracy when dealing with citizens. Therefore, in a democratic system of government, the relationship between state and the citizen is not simply a power relationship. Rather than state power, the consent of the governed is the defining characteristic of the relationship.

In *Holomisa* Cameron J said: *"Our Constitutional structure seeks to nurture open and accountable democracy. Party to that end, it encourages and protects free speech and expression, including that practised by the media. If the Constitution affords is to have substance, there must in my view be some protection for erroneous statement of defamatory fact, at least in the area of 'free and fair political activity'" (Holomisa v Argus Newspaper Ltd 1996 2 SA 588 (W)).*

In a system of democracy dedicated to openness and accountability, as ours is the especially important role of the media, both publicly and privately owned, must, in my opinion, be recognised.

Our entire social system is pervaded with a myriad of issues relating to freedom of expression. Courts are obliged to consider the Bill of Rights and the values embodied therein, when assessing whether conduct is wrongful. The Bill of Rights is therefore a medium or prism through which the light of every aspect of the law of delict will eventually be refracted. Limitations on freedom of expression should only be justifiable when it can show that the non-limitation would probably cause specific harm.

Freedom to speak and write about public questions is as important to the life of our government as is the heart of the human body. Freedom of expression is therefore a part of the very definition of self-government; the process of free discussion is required no matter whether the process leads to the truth or not. In fact, this privilege is the heart of our government! If that heart be weakened, the result is debilitation; if it be stilled, the result is death. *It is reporting that puts the needs of society first and everything else; including the need for the media to make profit, last... Responsible reporting is reporting that reflects reality as it is not as journalists and those propping them up would like it to be* (Nel, 1998).

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## CENTRAL AMERICA MAQUILADORAS AND THEIR IMPACT ON ECONOMIC GROWTH AND EMPLOYMENT

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### Abstract

The objective of this paper is to analyze the different perspectives of the roles played by the maquiladora in Central America as a lever of economic growth and social development in the region. Maquiladoras are industries that import materials and equipment, perform assembly or manufacturing processes, then re-export the finished goods to other countries. After a brief historical review of the maquiladoras emergence in the Central America region, the context is analyzed to underline the legal regime of temporal import and legal regime of managerial oriented free zone or fiscal precinct. Afterwards, the impacts that the maquiladoras have had in the regional economic growth and employment generation under the variable of the Asian competence is analyzed. After the discussion, prospective scenarios are analyzed and several strategies are recommended, including the promoting and creation of maquiladoras that go beyond the competitive advantage of cheap human labor. The Central America countries must design and implement strategies of diversification of the maquiladora development process in industrial sectors that require greater added value and technological innovation.

**Keywords:** Central America, economic growth, employment, in bound industries.

### Introduction

The maquila (In bound industry) term etymologically comes from the Arabic term makila as a measurement for capacity used in milling to design the proportional share of grain, flour or oil (AVANCSO, 1994:2). Nowadays, the maquiladora industry is located within the geographical boundaries of a country with facilities in place for international transactions. These territories receive foreign-owned intermediate inputs, carry out some transformation processing, taking advantage of cross-border discontinuities, and later returned the final products to their country of origin. The maquila is a production system based on a form of contract under which, the intermediate inputs and raw materials imported are transformed through processes that add value. Afterwards, the added-value products are outbound and sent back as finished products to the country of origin for marketing. The maquiladora industry activities are possible in those areas that allow process segmentation. Developed countries tend to concentrate on those activities that require technology, innovation and

design for sustained growth. On the other hand, the assembly routine, intensive in terms of manpower, tends to take place in developing countries with lower labor costs as their competitive advantage.

### **Theoretical framework**

Theoretical studies have determined that some of the benefits of Foreign Direct Investments (FDI) are ownership, location and internalization costs (Caves, 1996). Many of these benefits are provided by the Central American countries. Investors choose to invest in certain areas, mainly focusing on the availability of resources and markets. If foreign investment is seeking resources, it arrives to the locations which have abundant natural resources (Lipsey, 2006). Several analyses of the endogenous determinants of maquiladoras consider both the size of the enterprise and the intensity of research and technological development. The analysis of exogenous determinants of foreign direct investment in the maquiladora plants, takes into account the host country localization advantages, market size and labor costs (Campos, 2008).

Campos (2003) investigated classical factors such as market size, infrastructure, macro-economic environment and institutional factors. Campos inquired about whether the government's structural reforms of the host country play an important role in the attraction of foreign investors. A country's commitment to implement structural and financial reforms, as well as efforts to achieve trade liberalization and privatization, may encourage steady long run foreign direct investment (Forbes, 2006).

Regarding the institutional quality variables, the economic growth literature emphasizes the role of economic institutions in promoting investment and achieving better human development indicators. The institutions provide the local conditions for business operations, but they differ in support of physical and infrastructural factors, such as transport and telecommunications infrastructure. Institutional quality is an important factor to be considered for decision making by foreign investors, to enter directly or as outsourcing (Antras, 2003).

Bengoa and Sanchez-Robles (2003) find that economic freedom level, economic stability, and human capital level are important determinants in foreign direct investment. The determinants of location are the origins of the host country's comparative advantages. The maquiladora companies choose investment in locations which not only minimizes the cost of production but also the relative prices of factors such as natural resources, labor costs, human capital and proximity to market.

Countries that have more development in financial markets are capable of operating more efficiently the direct foreign investment. Foreign direct investment can be attracted by an economy that has more and better liberalized financial market, but at the same time, financial liberalization is encouraged by foreign direct investment. Financial reform is the most important of the structural reforms aimed to accelerate financial development. It is necessary

to facilitate financial programs for new productive activities oriented towards exports and to promote business development services.

Foreign investors assess and appreciate the host country's financial institutions and their capabilities to allocate efficiently the economics resources, monitoring the maquiladoras, diversifying and sharing risks, and mobilize the profits. Fewer restrictions to foreign capital imply more foreign capital inflows of FDI. Prasad et al. (2003) argue that absorptive capacity measured by the host country's financial development is a condition for foreign capital inflows to contribute to higher economic growth. The impact of FDI on economic growth is three to six times more efficient than the total investment (De Gregorio, 1992).

The FDI is attracted to countries with stable macroeconomic environment, and better levels of economic development and infrastructure. The risks of investment in terms of political and economic environment also affect the expected return on investment. The economic and political stability of host country attracts more foreign direct investment (Bevan and String, 2000). FDI requires the formulation and implementation of economic policies that promote strategic alliances and joint actions between the foreign direct investors, the domestic private capital and the Nation-State. One strategy implemented to bring down high rates of unemployment and poverty is the attraction of foreign investment by offering tax incentives, along with abundant cheap labor. Another major challenge is the creation of appropriate conditions for attracting investment. The businessmen's sensitivity to political movements limits solid and stable investments.

Maquiladoras as an instrument to achieve economic growth is a diversification dilemma in terms that although they create jobs and contribute to economic growth, however they bring some other side effects harmful to the local economies. To encourage economic growth in Central American countries, the diversification dilemma of maquiladora industry must be resolved and recommendations for improvements integrated into the programs tied to promotional schemes aimed at attracting foreign direct investments. There is a need to renew the instruments of export promotion, to strengthen the competitive advantages created in the region. To this end, it is suggested to design a common strategy of promotional programs to attract foreign direct investment for all Central American countries in order to avoid unfair competition while attracting new maquiladoras.

Coordination of governments' efforts of Central American countries will help to sustain an industrial integration project to boost regional development. In the same way, reforms to the legal framework to extend the scheme to sectors such as agribusiness, services and supply chain, etc., are necessary. Regarding labor laws and regulations, there must be law and order enforcement and compliance, besides agreements and behavior codes adopted by companies.

There is a need for transparency in all sectors: Auditing organizations in maquiladora industry by requiring independent assessments, monitoring of working conditions, as well as verification of enforcement and compliance with labor rights and behavior codes,

conformance with administrative and managerial standards industrial security and accounting, corporate social responsibility, environmental standards, regulations of free trade agreements, governance. There must be greater supervision of human and labor rights by specialists in the field, and greater promotion of social certifications among maquiladoras, particularly SA8000, which assesses the conditions and respect for labor rights and certification of "no sweat" (without holding).

The Central American governments and industry must develop unify criteria, to design strategies and mechanisms to facilitate the negotiation processes, as opposed to relying on the unilateral revision by the United States government of labor rights, management of the environment, expropriation, as well as how to structure and implement programs to coordinate the different economic agents involved in strategic alliances.

A regional economic development strategy must take into consideration growth in employment and production. This can be accomplished by focusing attention on the improvement of the efficient in the maquiladora industrial activities to increase value added in the region. This in turn, requires intermediate inputs to the maquiladora sector in the local regions throughout the Central America countries, subject to supply and demand forces operating in the national and international markets for the factors of production and the final demand for consumer goods and services. Local supply of intermediate inputs to the maquiladoras promotes indirect exports through an open market economy which together with improvements in domestic competitiveness can be transformed into direct exports (Agosin, Gitli and Vargas, 1996). The International Labor Organization (ILO) argues that the maquiladora industry in Central American is moving its full manufacturing processes in a complete package to add economic value. Central American maquiladora industry has to develop and implement horizontal and vertical strategies to compete with the Asian maquiladoras' production; otherwise the Central American maquiladoras will be left lagging behind. A horizontal strategy to broaden the impact on economic growth, and to generating jobs in the maquiladora industry in Central America, is growing and expanding activities of raw material's suppliers, services and inputs, as well as the expanding distribution networks in local markets.

Economic agents involved in the development processes of the maquiladora industry in Central American countries, government authorities and private sectors, are responsible for designing and implementing strategies for developing industrial activities, around comparative and competitive advantages. Among other advantages offered by the Central American region to foreign direct investment, is the territorial proximity to the world's largest market, infrastructure, and a new labor culture. Offering these advantages reveals the new territorial and spatial restructuring of the maquila, with the creation of new regions which are the foundation of the new production strategy for exporting.

The Central American countries have to formulate and implement strategies to diversify the maquiladora industry aimed to create industries involving higher added value and technological innovation processes, such as automotive or aviation industries. For the future success of the maquila, it is important to strengthen technological innovation to create competitive advantages in the industry. Foreign direct investment has been discerned as an important catalyst for technological development, which is a necessary condition to increase the region's competitiveness in international markets.

This diversification of the maquiladora industry requires technological breakthrough to provide employment for more skilled and specialized workforce, and also to lead to the formation of suppliers groups with more complex technological base. Diversification of the maquiladora industry requires the formulation and implementation of a national development strategy aimed towards and centered on the workforce. The strategy of human capital formation should consider training and developing the workforce for better performance in industrial sectors different from that of the traditional maquiladoras, and in accordance to the life cycles of these industries.

### **Brief History**

Historically, the maquiladora industry's tariff scheme in Mexico was initiated with an export orientation, restricting the sale of the products from the maquiladoras inside the country, except paying import taxes. The design of maquila's regimen was conducted in such a way that increments in competitiveness had no impact on the national process of industrialization and development as in the case of apparel and garment industry (Mortimore y Zamora, 1996). Mexico, followed by Central America countries and some Caribbean countries, has experienced an unusual growth of companies which, under the maquiladora industrial development strategy, link national economies of these countries to the world's most powerful economy, the United States. At the middle of the last century, Central American economies began implementing their industrialization plans. As part of their development strategy, they protected their nascent industries, using an import substitution process. The exception was Panama which was more oriented towards the service sector and finance. The maquiladora industry development in these Central American countries operate separate from the established traditional local economic system, most of the times creating enclaves more than hubs. The policy of tax and credit incentives encouraged and favored foreign investment into the creation of assembly industries oriented towards production for domestic consumption. It was the generally believed that foreign direct investment (FDI) is an important channel through which financial globalization would benefit the economy (Prasad, Rogoff, Wei and Kose, 2003). Although, it should be noted that FDI does not necessarily support financial globalization.

Financial globalization involves the differentiation of a set of measurements, ranging from financial development indicators to changes in government policy. Some countries consider



that attracting FDI is an important element of economic development, so the factors that attract such investment form the core issue of their development policy. Increasing foreign direct investment has expanded production activities related to the export of agricultural goods besides different manufacturing sectors to different industrialized countries

The maquila represents a form of trans-nationalization of production factors, which are widespread in industry sectors such as textiles and apparel, electronics and automotive. Since the seventies, all Central American countries have had legal systems/frameworks for sustaining and promoting the maquiladora industry. Since that time the maquiladora industry has been the main industrial source of a precarious female-employment paying low wages, without deference and respect to labor rights, under appalling working conditions. This condition can hardly be expected to improve in a sector in which the competitive advantage is formed by the reduction of labor costs (Martinez Zabalo Tola and Arena, 2005).

The maquiladora industries take many different forms in terms of their operation, transformation and expansion. These depend, not only on their capital networks, but also on the different types of employment arrangements, on the subcontracting and special interaction with other institutions, regional and local actors. All these elements are part of the structure of the local production chain and its relationship with the world economy. The resulting reconfigurations of the territories in relation to the emergence of the new production chains put the emphasis on production decentralization. These trends or patterns are a result of territorial expansion based on a new regional development model, where the local political elites, and other regional institutions, play an essential economic role (Betancur, 2001; Méndez, 1998).

This paper aims to identify maquiladora's elements in order to contribute to the analysis of links, logic and dynamic relations and to determine the impact on employment creation and economic growth in Central American countries. The paper also analyses the economic context in which the maquiladora operates drawn from propositions of material production in peripheral regional areas, supranational and global levels together with the socio-political relations in the Central America region. Also, this paper searches answers to what has been the impact of maquiladoras on the territorial reconfiguration to shape a territorial development approach, focusing on the industrial paradigm, the strategy of accumulation followed by the regimes and modes of regulation such as free zones.

### **Context of maquiladora industry in Central America region**

The Central America region extends over an area of 509,000 km<sup>2</sup>, equivalent to one quarter of the area of the Mexican territory. Its production represents 3% of the Latin America region and 13% of Mexico. Guatemala has achieved the highest gross domestic product (GDP) in the region, about 32,000 million dollars. Costa Rica and Honduras are the countries that have exhibited the greater stability indicators and annual growth. However, Honduras has experienced political unrest during the last two years (2009-2010). Since 2000 and until 2008,

Honduras and Costa Rica have been attracting the highest foreign direct investment (FDI). Costa Rica is the country with the best quality of life and competitiveness in the region. Currently, just about half (45 to 60%) of the Central America maquiladoras are owned by local capitalist investors. Also FDI tend to be concentrated mainly in services and maquila sectors. The accumulated investments due to the maquila during the period 2003-2005 for U.S. were \$ 1,754 million.

The maquiladora industry in Central America region focuses on the textile sector, clothing, metalworking, electronics and footwear. The out of region exports of the maquiladora industries are concentrated in manufactured goods and food, which represent just 28% of total exports. The number of Maquiladoras, percentage added value has increased. In some Centro American countries the number of direct jobs created has grown on the average 25% annually. All of the above had led to better supply chains and diversified production capacity (Acevedo, 2008).

### **Impact on regional economic growth**

The International Labor Organizations Report of 1997 (OIT, 1997) estimated that contribution of the maquila sector to the value added and exported to be about 20% for the Central America region. However, it must be remembered that statistics of maquiladora industry confuses value added with national content value because most of the inputs are imported. The ILO Report (OIT, 1997) estimated that over 90% of the sales of the Central America maquiladora industry are accounted for by United States. From this fact, it can be drawn a proposition that Central American countries are highly dependent on United States economy.

The maquila industry has increased its value to achieve almost 50 % in relation to total exports of the Central American Countries. Currently, over half of all exports in the region come from the maquiladora industry. Some researchers (OIT, 1997) have documented the weak connection between maquiladora industry and the other's national economic sectors. Most of the maquiladoras are economic enclaves of transnational corporations which are taking only advantage of cheap labor and some specific raw materials. Most of their inputs are supplied from abroad, from their parent companies and there is little room for local companies, in such a way that maquiladoras are not acting as economic hubs for the local business. The weight of Maquila in industrial production is not relevant when we take into consideration the contributions of small and medium-sized enterprises.

The output of the Clothing and apparel industry represents an important part of the maquiladora industry in Central American countries. Mexico which is the main competitor in the region has benefited from the North American Free Trade Agreement (NAFTA) (Campos, 2008). Less than 20% of apparel products manufactured in Central American countries are bound to the United States under the maquila's regimen and about 80% enter under the custom's regime of production – sharing. The residual production is integrated by the Asian

clothing maquila. Some of the implications are that the maquiladoras prefer to manufacture goods under a regime that give more incentives, such as not paying or paying the lower level of taxes to the host country, receiving subsidies, etc., which in turn their contribution for local economic development is low.

Companies' investments in advanced technology are low, compared with traditional investment flow which is still occurring in free zones. There is no evidence that maquiladora industry's technological complexity has a direct impact both in economic development and generation of well remunerated employment. Productive activities and development taking advantage of maquiladora industrialization are highly dependent both on demands' elasticity of final product and industrial differentiation's activities, but not on technological innovation and sophistication (OIT, 1997).

Although this economic phenomenon is common for Mexico and Central American countries, however, it has been fostered by local governments under specific development plans. The Puebla Panama (PPP) Plan proposal is totally opposed to endogenous development's dynamic advocated by both regional indigenous townships and social organizations. This is the main reason for rejecting the totality of the Plan initiatives, although it is recognized Meso-American region's economic vocation and local industries, besides their interest in development of instruments and local institutions promoting local and regional progress. Simultaneously, it is defined, and in practice imposed, the outward dominant development's vision toward exports. Impulse given to maquiladoras in the Southern-Southeast Mexican region, promotion of mega tourist projects or infrastructure serving to foreign trade become essential pillars of this kind of "development." Not all the existing maquiladora's infrastructure in Central America region is planned to generate an export processes platform.

To summarize, maquiladora industry's development in Central America countries is based more on reduction of production costs generated by cheap labor. On other way, technological innovation has not been a uniform process that benefits all economic sectors. The trend towards relocation of the maquiladora industry in Mexico and Central America region encourage participation of foreign direct investment. This investment together with domestic capital create value adding productive inter-related structures or development chains. Thus, both local and regional industry clusters interact to integrate the economic development processes.

### **Impact on the employment**

According to research from the Union Federations of Central American Countries, the population of the entire region is close to 34 million. From this total, 21 million are in age economically active, and only 12 million have jobs, from that, 8 million are men and 4 million are women (Orellana, 2007). Employment generating by maquila industry is the main source of jobs for women, who account for up to 87% of the total.

Lack of clearness in the maquila concept affects employment estimates. In a situation where the economy grows without generating employment, strengthening and expansion of maquiladora industry activity is supposed to move towards creating a more flexible labor market. Instead, the implementation strategies and general practices make for even more precarious the living conditions of population. The trend of the process oriented to making flexible the industrial labor relationship, introduces changes into the work's organization systems, through many mechanisms such as to transfer fixed costs to variable costs and to externalize costs and responsibilities assumed by outsourcing in situations which allow subcontracting. To externalize costs and responsibilities means for the maquiladoras to transfer them to other institutions such as governments, civil society, etc., as for example the case of social security, welfare, pollution to the environment, corporate responsibilities, etc.

Some of the problems hindering development are the non-observances of labor rights and high turnover of workforce. The turnover of workforce is due partly to cultural differences in labor relationships. But in general these two reasons explain why employment generated by maquiladora industry is highly volatile and of poor quality. The lack of both a policy and a national development strategy for labor force development, protection and supply leave the maquila at the mercy of foreign capital investors, who take advantage of the cheap local labor; and exploit guarantees established by government, such as tax exemptions. Maquila companies violate workers' rights, taking advantage of national laws that have relaxed labor rules. These kinds of laws make it difficult for governments to enforce the worker's rights.

In 1996 there were in Central American countries about one quarter of million people employed by the maquiladora industry, which represented approximately 25-30 percent of the workforce employed in industry (ILO, 1997). Altenburg (1995) estimated that maquiladora industry had created about 15% indirect jobs.

Production output and employment in the maquiladora industry are linked to economic cycles. When the economy goes into recession, the maquiladora industry comes to a standstill; workers are fired leading to employment instability and allowing greater turnover in response to down turns in the economy and labor contradictions. Wolf Herrera, Bernal Mármol and Martínez (2003) reported in their research several incidents in which were an expression of a new collective force's consciousness that had put in danger governance, although workers are not allowed to join unions or to file grievances to local labor authorities.

It has been argued that greater job stability affects labor costs because it results in better labor conditions and improvement in the competitiveness and productivity of the workers. While firing workers saves costs of unproductive labor, however, in the long-run productivity decreases due to the turnover in employment (the recruitment of new and inexperienced workers). Low labor cost is one of the factors attracting for foreign investment to the maquiladoras. Industry labor costs are about 65 percent of operational costs. For example, the average wage for a worker in free zones in Nicaragua is three times lower than

the average salary in Costa Rica. This competitive advantage is translated into lower remuneration and consequently into a lower living standards and limited potential for both economic and social development.

Women, on average 20 years old and predominantly single mothers, make up as much 80 percent of labor force of the maquiladora industry in Central American. The average salary of a female worker in a maquiladora plant is about 68% of a male worker. The salary earned by a single mother is not sufficient to cover the living expenses of the household. Moreover, the burden of domestic work and responsibilities at home, make it difficult for women to do other economic activities that would allow them to increase their income. According to a report published in 1992, in Guatemala wages are one half of the required income to get out from extreme poverty, (La Estrella de Panamá, 1992). For 2007, Orellana (2007) reported average salaries of \$133 dollars, with extreme cases of \$ 50 dollars per month per worker. It should be noted that in the Guatemalan case the wages paid in activities considered typically female employment is below the generally lower than subsistence wages earned by the average worker.

In general, wages in the Central America's maquila are lower than those paid in Mexican maquiladoras. If it is calculated the wage gap in Central American countries, those which have the highest labor costs, are at disadvantage compared to those whose have lower labor costs for the same work units. By the same reason, this situation represents a comparative advantage for countries that have the lower labor costs. Costa Rica and Salvador have the highest labor costs, and also they have the highest levels of productivity and quality (Fernández, 2002). It may not be paradoxical, because lower money cost per factor unit does not necessarily mean lower real cost.

Labor relationships between maquiladoras and workers have been a grievous story. Unfortunately, actions of human rights agencies on labor issues that are clearly related have prevented any understanding of the real situation. In the garment industry most of the maquiladoras are owned by Asian capital, mainly Korean capital investors. As a result they experience many labor problems due to cultural differences between the foreign management and their local partners and workers. Several studies on labor rights violations in Central American's maquiladoras have been sponsored by international advocacy agencies for the rights of women workers. Studies conducted by Oxfam International (2002), Ramírez and Martínez (2001), Tinoco (2002), Ramos and Vargas (2002) have established a relationship between origin of capital and companies attitudes with respect to certain labor rights. But regardless of the origin of capital, there is a clear tendency towards anti union policies formulated and implemented by the maquiladoras being manifested in decisions to allow their workers to join trade unions. In a total of 1,212 enterprises just 45 had union in the year 2003 (ASEPROLA, 2003).

Women workers in Central American's maquiladoras denounced the poor working conditions, discrimination through pregnancy's test practices; job insecurity and unsafe working conditions; violations of the workers' dignity and personal integrity; absence of health care; lack of pensions' plans and the breach of collective contracts, according to research from trade union federations in Central American's countries (Orellana, 2007).

In general, women bore the burden of retrenchment in the sector. When maquiladoras close plants, the trend is that women workers are who most suffer the consequences of these layoffs. Research with focus on women workers in maquiladoras plants shows that these women far from feeling exploited, prefer working in maquilas rather than being domestic workers. They see for themselves the opportunity to experience a situation of emancipation and liberation from submission to patriarchal authority, because it them with purchasing power that allows them some independence from parents or mate. Despite low wages paid by maquiladora industries, workers and families achieve better living standard. For example, maquiladora's women workers of peasant origins, earn some revenue to be shared with their families for improving welfare and living standards. Moreover employment generates structural changes in the future economic and social development of Central American society, stressing the important role that women play.

## Discussion

The analysis about the logic of capital accumulation and wealth creation derived from the production of maquiladoras is full of internal contradictions. The implementation of structural adjustment policies in a new economy environment focusing on a competitive market orientation implies the need for profound changes, both in labor relations, and in spaces and union behavior. The processes of economic globalization require that the liberalization of markets aim at increasing productivity while in a race to the bottom based on the lowering of production' and distribution costs.

Changes in a country's competitiveness occurred subject to a new international division of labor, in an environment where economic globalization processes, which have led towards a race to the bottom on the development of productive activities may not necessarily is sustainable in places where the costs of labor are lower. Critics believe that under the current economic policies, regional economies have reduced agricultural production and industrial bases, and have increased external dependence.

The current legal regimes in Central American countries related to maquiladora industry programs, generate both confusions and administrative rigidities. In all Central American countries, there are no criteria for homologation of promotional schemes for the maquiladora industry. And what is more absurd is that there is not a clear understanding about the role that this type of industry is playing in economic growth and national development. The lack of transparency in incentive programs and the tax benefits of export promotion schemes call into question the real scope of the benefits of trade liberalization.

Despite the outcome generated by the sophisticated maquiladora industry and its impact on economic development, modernization, and welfare of working population, there are doubts about its multiplier effects and the real impacts on economic growth and the generation of significant remunerative jobs. International maquiladora's knowledge on technology and innovation about and around the region is not homogeneous, since they have some specific differentiations. Development processes facilitated by maquila industry in Central America, has been uneven. The lack of uniform indicators makes it difficult to analyze the impact of the maquiladora industry on both regional economic growth and employment generation.

Wolf Herrera, Bernal Mármol and Martínez (2003) concluded that the persistence of poor working conditions and violations of labor rights in the maquila sector is due to the lack of political will, on the part of governments, to enforcing respect for existing laws. One of the biggest challenges is the enforcement and fulfillment of labor rights.

### **Prospective scenarios**

The future of maquiladora exports is uncertain due to the fact that the World Trade Organization (WTO) has eliminated production subsidies granted by local governments to incentive exports, in accordance with obligations of the World Trade Organization (WTO) regulatory framework. The Puebla Panama Plan designed to foster economic growth and social development in Central American countries, favored mainly infrastructure projects and employment generation in maquiladoras located on the territory from the Southern and Southeast Mexico to Republic of Panama. This development strategy was based on a policy that was to exploit cheap labor as a competitive advantage. Increasing of the maquiladora plants in situ will contribute within certain limits to the creation of employment and thus to related welfare.

The connectivity logic of the maquiladora industries also serves to consolidate a regional approach to development in Central America. The maquiladora approach to development has the effect of serving to contain migration from Meso American countries to United States and defining the region as an assembly area. To achieve this, the Central America region promotes attractive tax incentives for businesses, cheap labor force, and the imminent possibility of reducing transportation costs through the construction of dry channels and seaports that favor the transferring of goods from domestic to export to foreign markets.

The emphasis towards increasing the focus on attaining a greater comparative advantage requires learning about the development of the maquiladora industry. It facilitates the convergence of more sophisticated maquiladora activities. This convergence requires scientific and technological training of workers that result in new transformation processes and regional technological innovation.

Adherence to codes of conduct by trade organizations belonging to the maquiladoras, in order to obtain certification for respectful human and labor rights, in most cases will continue to be a simple showcase, in the middle of a market of certification companies and independent monitoring from nongovernmental organizations (NGOs). Environmental and social responsibilities are also among these types of certifications.

## **Recommendations**

To increase exports of maquila's industrial sector and value added is a tough challenge for local economies open to global markets. The challenge to increase the level of exports and improve competitiveness through an export strategy focused on maquila operations requires the establishment of a free trade area, and the abandonment of the economic model based on industrialization by import substitution. However, the opening of free trade areas and further more the opening of the local economies through both, the consolidation and expansion of access to the U.S. market, and negotiations with the European Union, the model of production based on maquiladoras is on the rise. Thus, free trade agreements are already required to expand and diversify markets of the maquiladora industry products, and to balance the strong dependence on the U.S. market.

To improve the economic development and social welfare, the maquiladora's industry should pursue a strategy to induce the investment of higher value-added businesses, such as aerospace, instead of large-scale assembly plants. An economic policy that offers to the foreign direct investors some incentives and tax exemptions, facilitates easiness of administrative procedures, a cheap workforce and raw materials, etc., all these factors could lead to greater affluence of maquiladora plants in Central America.

An important challenge for economic growth in the Central American region is to develop competitive advantages different from those related to labor costs, such as technological innovation companies that require more specialized labor that has more sophisticated technological capabilities to generate greater added value. Moreover, the high-tech maquiladora industry interacts with research and development centers. This will expand the supplier base through the formation of clusters, networks and industrial associations. The development of these local and regional clusters and networks with greater involvement of local and domestic capital can help to accelerate the process of economic integration with the support of foreign direct investment.

The strategy implemented by the regional maquiladora industry to quickly achieve levels of innovation, quality and competitiveness required by the regional industrial modernization process has to be supported by strategic alliances with foreign companies. The activity of assembling high-tech products is a facilitator of potentialities for both employing human resources with higher levels of professional training and for investments in human capital. The orientation towards the promotion of foreign direct investment for the creation of the maquiladora industry of high technology, such as electronics, biotechnology, etc., to displace



the low-tech maquiladora industry, will allow Central American countries to achieve higher levels of competitiveness and quality to increase participation in market shares under processes of economic globalization.

The challenge is to formulate and implement an industrial policy combining different industrial schemes involving local, regional and global supply chains to produce non-traditional exports and maquila. Government policies should be focused on achieving labor stability, quality jobs, and democratic governance for the estimated 500 000 workers seeking better living conditions and to live with dignity. The implementation of training programs and job training will help strengthen the competitiveness and productivity, as well as improve the living conditions of the workforce.

The trend is towards an increase in the maquiladora industries in Central America countries, which would bring increases in rates of employment and exports, but the challenge is to ensure that these increases also enhance economic development and social welfare for the region.

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## MERGERS AND ACQUISITIONS PERFORMANCE PARADOX: THE MEDIATING ROLE OF INTEGRATION APPROACH

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### Abstract

Based on theory and case studies, the merger literature suggests that implementation of integration approaches is important for effective post-merger integration. This hypothesis is tested with a relatively large sample by focusing on the fit of the integration approach to the synergy potential of the merged companies and the cultural differences between them. Findings suggest that the fit of the integration approach is positively related to integration effectiveness and mediates its relationship with synergy potential and cultural differences.

**Keywords:** Mergers and acquisitions, culture differences, synergy, fit of integration approach, performance.

### Introduction

For the last three decades, the management literature has been trying to explain the enduring paradox of the high failure rate of mergers and acquisitions (M&A) vs. the growing activity and volume of M&As. Recent meta-analyses that examined the most studied variables (King et al., 2004; Stahl and Voight, 2008) did not provide clear answers for this paradox or for the high failure rate of M&As. Researchers indicated that the results concerning the predictors of M&A success are inconsistent and confusing. A possible answer to this paradox is that existing research on M&As provides limited and insufficient understanding of this important phenomenon, especially concerning the post-merger integration process. In other words, at the pre-merger stage top executives may perceive the M&A as a good step for corporate growth, but poorly implemented during post-merger process.

Few scholars have focused on specific problems such as integration approaches. Their studies focused on theoretical issues based on literature review (e.g., Nahavandi and Malekzadeh, 1988; Weber and Tarba, 2011; Weber, Tarba, and Rozen Bachar, 2011) or on case studies (Haspeslagh and Jemison, 1991; Schweizer, 2005) rather than on empirical systematic studies based on relatively large samples. Although these studies identified various

integration approaches with different typologies, they maintain that the fit between the recommended integration approach and the approach actually implemented is crucial for both integration effectiveness and overall M&A performance. These claims have never been empirically tested, however, with any one of the recommended integration approaches. Furthermore, most of these typologies were suggested about 20 years ago and did not incorporate findings from the last two decades about possible important factors in the post-merger integration process, such as cultural differences.

This article seeks to fill some of these gaps. The goal of the present study is to explore systematically, based on a relatively large sample, the vital but neglected role of the integration approach in the implementation of M&As. To this end, a theoretical framework has been developed to (a) suggest revised framework for integration approaches that incorporates empirical findings from the last two decades, and (b) use the fit between the recommended and the actually implemented integration approach to better explain integration effectiveness. The findings of this study can guide future research toward more consistent findings on M&A success and help shape practices for achieving success.

### **The synergy assumption**

The finance and strategy literature has focused primarily on pre-merger factors to determine the success of M&As. The implicit assumption in these studies is that the activities and actions of the acquiring firm during the pre-merger stage are the sole determinants of value. Accordingly, studies either observe how managers of the acquiring firm search for alternatives or probe the content of their strategies, paying less attention to implementation. For example, strategic theories, especially the concept of strategic fit, suggest that relatedness between the buying and target firms determines the synergy potential, and as such is the key determinant of value creation. But the empirical evidence derived from studies of M&As that exhibit relatedness is mixed at best. More important, synergy potential was rarely measured in these studies. In other words, the presence of synergy potential was assumed based on indications of relatedness vs. unrelatedness, it was not measured directly.

The finance literature suggests further that on average M&As do not add value to the acquiring firm, and that more likely they are severely detrimental to long-term shareholder value. The results of a recent meta-analytical study on the effects of finance and strategy variables on M&A performance by King et al. (2004, 197) led the authors to conclude that "researchers simply may not be looking at the 'right' set of variables as predictors of post-acquisition performance."

Thus, an overarching theme of the present paper is that research utilizing traditional finance and strategy variables that focus on the pre-merger stage can predict only the potential of integration effectiveness, based on the assumption that synergy is present and that management knows how to harness it. In reality, the failure to find a consistent relationship between indicators of synergy based on relatedness and M&A success may stem

from an over-emphasis on the pre-merger stage at the expense of the negotiation process (Weber, Tarba, and Belkin, 2011a) and post-merger stage including the integration approach used during the processes of integration. With a few exceptions, the strategic and finance literature, has not considered the possibility that in the management of a merger, the problematic interaction between the buying and target firms (due to cultural differences), or low coordination and cooperation between managers (as a result of the culture clash following the merger) may play a key role in M&A success. Indeed, the management of the post-merger stage and the integration process are crucial in determining the extent to which the synergy potential is realized. To date, only a limited number of management studies have focused on identifying the factors that can contribute to post-merger integration success. It is likely, therefore, that strategic fit interacts with other systematic variables in the integration process to produce robust performance results.

### **Inconsistent Effects of Culture Clash on M&A Performance**

To explain the variance in M&A performance, scholars have used “cultural fit” concepts that focused on the detrimental relationship between pre-merger cultural differences (both corporate and national) and post-merger integration effectiveness (For recent reviews, see among others, Björkman, Stahl, and Vaara 2007; Stahl and Voight, 2008; Weber, Tarba, and Reichel, 2009). But as with strategic fit, the empirical evidence of the effects of cultural compatibility on M&A performance is mixed and confusing. On one hand, organizational cultural differences have been negatively associated with various accounting measures and with stock market value following domestic M&As (e.g., Chatterjee et al., 1992; Datta, 1991). Studies also found this negative effect under conditions of both low and high integration level, when autonomy was removed from the acquired managers (Lubatkin, Schweiger, and Weber, 1999; Very et al., 1997; Weber, 1996).

On the other hand, some studies have recently argued that cultural differences do not always have a negative impact on M&A performance. Indeed, some have shown that cultural differences can also have a positive effect on post-acquisition performance (Reus and Lamont, 2009; Weber, Shenkar, and Raveh, 1996). For example, Weber (1996) found a positive moderating effect of autonomy removal on financial performance. He associated this finding with better coordination between the two merged firms, which in turn enabled better synergy realization. But synergy potential was not a variable in this, as well as in most studies.

Several possible explanations exist for the lack of consistency that permeates recent studies on the relationship between cultural differences and M&A performance. For example, Teerikangas and Very (2006) focused on the sources of complexity underlying these relationships. Others suggested that different measures of performance (Zollo and Meier, 2008), ignoring negotiation process (Weber, Tarba, and Belkin, 2011b), or micro- *or* macro-levels of analysis only, and *either* pre- or post-merger variables are not enough to find consistent relationships (Weber, Shenkar, and Raveh, 1996; Weber, 1996). Despite these

criticisms, however, the study of cultural differences altogether ought not to be abandoned. Rather, the implication is that more elaboration is needed in the cultural analysis of the various processes and mechanisms involved. For instance, scholars have examined how “attractive” one organization is compared with another, and the types of integration approach adopted by acquirers (Nahavandi and Malekzadeh, 1988). Veiga et al.,(2000) examined changes in cultural compatibility and found that the best performances were in cases where pre-merger cultural incompatibility turned into cultural compatibility after the merger. Larsson and Lubatkin (2001) found that successful acculturation is possible even in conditions of significant cultural differences, as long as the acquiring firm invests in formal and informal social control strategies.

### **Post-acquisition Integration Effects on M&A Performance**

All value creation in M&A takes place after the acquisition, and it hinges on the combined firms’ ability to effectively integrate their operations. The term *integration* is used rather loosely in the literature, and few studies have attempted to define it directly (Schweiger and Goulet, 2000). But it is generally agreed that merging firms transfer capabilities, cut costs, and achieve synergy by integrating management decision-making as well as departments and functions, such as marketing, inventory, and others. Effective integration may produce positive overall M&A performance (Larsson and Finkelstein, 1999; Weber, 1996; Zollo and Meier, 2008).

In practice, integration is an interactive and gradual process in which individuals from the two organizations must learn to work together and cooperate. “Creating an atmosphere that can support it [the integration] is the real challenge” (Haspeslagh and Jemison, 1991: 107). To achieve effective post-merger integration, the acquiring top management typically intervenes in the decision-making process of the acquired management team and imposes standards, rules, and expectations on it. The intended integration may negatively affect the commitment of the acquired top management to the acquiring team and its cooperation with it (Weber and Schweiger, 1992; Weber, Shenkar, and Raveh, 1996). Furthermore, the intervention of the acquiring top management team in the decision making of the acquired management results in a loss of autonomy that elicits tensions and negative attitudes toward the merger. The result raises questions about the efforts invested in exploiting the synergy potential. Such efforts can cause human problems, destroy the synergy, and compromise the success of the integration process.

There is a clear trade-off between levels of integration and exploited synergy. High levels of integration may be needed to exploit high levels of synergy, but a high level of integration may cause intense culture clash and human resource problems that can destroy the value of the acquired firm and increase costs to an extent that offsets the benefits expected from the merger. Moreover, in case of very high synergy potential, it is possible that even under conditions of high cultural differences, which may destroy some of the synergy, M&A

performance still increases. Thus, high cultural differences may be associated with improved M&A performance when the level of synergy is very high. This example may explain the conflicting findings about the relationship between relatedness or cultural differences and merger performance, when other variables are not controlled. For example, some studies found that integration is positively associated with performance (Larsson and Finkelstein, 1999; Weber, 1996), whereas others found integration to be non-significant to M&A performance (Datta, 1991; Morosini, Shane, and Singh, 1998), and others yet found that performance was negatively related to integration (Calori, Lubatkin, and Very, 1994; Lubatkin, Schweiger, and Weber, 1999). For example, Lubatkin, Schweiger, and Weber (1999) found that the greater the level of integration (autonomy removal through the intervention of the acquiring top management in the decision-making process of the acquired top management), the greater the turnover of the acquired top managers. The turnover of these executives is viewed as a serious loss of valuable resources, which reduces the value of the acquired firm. And studies found that the greater the rate of turnover of top executives, the lower the performance of the acquiring firm (Hambrick and Cannella, 1993). A recent meta-analysis of the existing body of research (Stahl and Voigt, 2008) suggested that the relationship between cultural differences and post-acquisition performance is complex, and that unidentified moderator variables may be obscuring the effect of cultural differences on the performance of the acquiring firm.

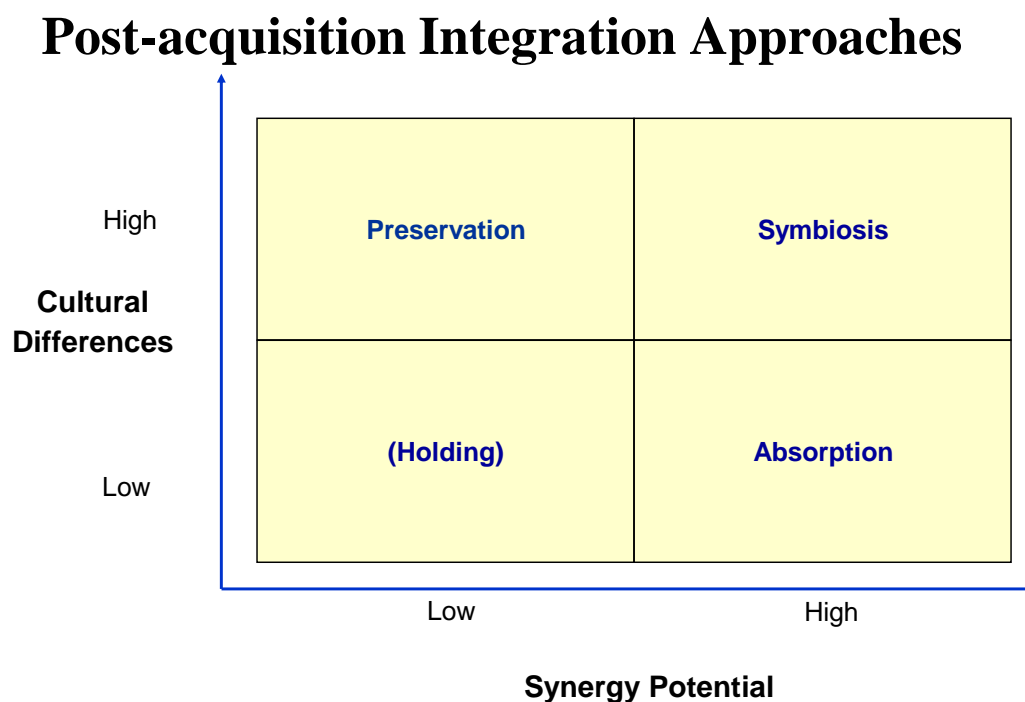
In sum, individually taken, the variables of cultural differences and synergy potential are not sufficient to explain M&A performance. Post-merger integration is a complex process that appears to need a better conceptualization than the simple linear relationship suggested by the studies mentioned above. The following sections suggest using a combination of these two factors together with the concept of configurational fit to explain integration effectiveness.

### **Post-Acquisition Integration Approaches**

The combined firm's choice of integration approach is one of the most critical decisions affecting merger success (e.g., Haspeslagh and Jemison, 1991; Nahavandi and Malekzadeh, 1988). Integration approaches differ mainly in the emphasis placed on two crucial factors: synergy potential and implementation efforts necessary to realize them. Cultural differences, however, were not included in the above typologies of integration approaches. But based on findings of the last two decades, we argue that these implementation efforts depend also on the scope of cultural differences between the two firms engaged in M&A, as well as on the choice of the level of integration. Recent studies have highlighted the differences in management practices (Ellis, 2004; Ellis, Weber, and Raveh, 2003) and cultural features (den Hartog and Verburg, 2004) between integration approaches.

In light of the above literature reviews and of the importance of cultural differences to integration effectiveness, we propose to revisit the framework for integration approaches. Figure 1 presents the recommended integration approaches affected by synergy potential and cultural differences. The proposed framework uses the terminology of Haspeslagh and Jemison for integration approaches because (a) it describes clearly the differences between these approaches, (b) it has received some recent empirical support (Ellis, 2004; Ellis, Weber, and Raveh, 2003), and (c) it has been widely used (Child, Faulkner, and Pitkethly, 2000; Graebner, 2004; Schweizer, 2005; Weber, Tarba, and Reichel, 2011).

Figure 1. Proposed matrix for post-acquisition integration approaches



The straightforward synergy potential dimension in the matrix parallels the dimension in other frameworks such as relatedness (Nahavandi and Malekzadeh, 1988) and need for strategic interdependence (Haspeslagh and Jemison, 1991). But the suggested framework uses the “cultural differences” variable as the determinant of the recommended integration approach instead of the “need of autonomy” (Haspeslagh and Jemison, 1991) or cultural attractiveness and multiculturalism (Nahavandi & Malekzadeh, 1988). Several reasons based on the literature review have led to this approach. First, since Haspeslagh and Jemison (1991) suggested this framework, empirical findings have clearly indicated the critical importance of the effects of culture clash on integration effectiveness (e.g., Cartwright and Cooper, 1992, 1993; Datta, 1991; Chatterjee et al., 1992; Weber, 1996; Weber and Pliskin, 1996), on



international M&As (e.g., Datta and Puia, 1995; Morosini, Shane, and Singh, 1998; Lubatkin et al., 1998), and on both (e.g., Weber, Shenkar, and Raveh, 1996).

Second, the need for autonomy of the acquired managers has not been measured directly in previous studies, but other measures were used that suggest its importance to M&A performance. The empirical findings are not clear, however. For example, Larsson and Finkelstein (1999) hypothesized about a positive relationship between level of integration and employee resistance. This hypothesis was not supported. And although some studies show that autonomy removal is positively related to performance (e.g., Weber, 1996), other studies point in the opposite direction (Calori, Lubatkin, and Very, 1994; Weber, Shenkar, and Raveh, 1996) or have found no relationship (Datta, 1991).

Third, the extent of cultural differences reflects to some degree the need for autonomy. According to Nahavandi and Malekzadeh (1988), when considering the acquired managers' preferences, the question is how much do members of the acquired firm want to preserve their own culture and organizational practices? The answer may depend on the degree of differences. It is difficult to believe that when cultural differences are extensive, acquired members willingly relinquish their culture and most of their organizational practices, and completely give up their autonomy. Indeed, culture clash and employee resistance arise from the need to retain autonomy vis-à-vis a different culture. Weber, Shenkar, Raveh (1996) suggested that in international M&As, where cultural differences are clear, senior managers may regard themselves, and be perceived by others, as champions of the national culture they represent, which may stand against the national culture of the other party in the merger. In such cases of clear cultural differences, the need for autonomy is unmistakable. Thus, in certain cases the dimension of cultural differences can serve as a proxy for the need for autonomy dimension, but at the same time it is much richer and represents a wider spectrum of situations, even if the need for autonomy turns out not to be a problem at all. Finally, Haspeslagh and Jemison (1991) acknowledged the importance of cultural differences when choosing an integration approach (1991:145).

The integration approaches are absorption, preservation, and symbiosis. Absorption, implies a high level of integration and the lowest level of autonomy for the acquired management. It is recommended for achieving a high level of synergy when the level of cultural differences is low. Preservation implies the lowest level of integration and the highest autonomy for the acquired management. It is recommended for low synergy potential and high cultural differences. Symbiosis, with both high levels of synergy and cultural differences, implies a sophisticated level of integration to be considered in challenging situations (Haspeslagh and Jemison, 1991).

## **Hypotheses**

### **Appropriate integration approach**

Matrices that proposed integration approaches (Haspeslagh and Jemison, 1991) and modes of acculturation (Nahavandi and Malekzadeh, 1988) implied that there is a relationship between the selection of the appropriate integration approach and integration effectiveness. By contrast, the framework presented here is based on a different set of factors and considerations, and treats integration choices as ideal types to be applied in specific situations. Thus, a given integration approach, based on a fit between the recommended integration approach and the actual choice of integration approach being implemented, consistent with the characteristics of a specific M&A (synergy potential and cultural differences), can lead to superior integration effectiveness. Because cultural differences may be of critical importance to performance, the framework presented here takes them into consideration in the decision-making process that leads to the choice of the best integration approach. Thus, the proposed framework includes both synergy potential and cultural differences as major determinants of the recommended integration approach for high integration effectiveness. This point of view combines the pre- and post-merger stages. It suggests that both cultural differences and synergy potential should be considered as part of the choice of integration approach, and that a fit between the recommended and actual integration approach can lead to an effective integration process.

No integration approach fits all. Managers must determine the best integration approach that fits their specific M&A and leads to effective post-merger integration. The choice of the appropriate integration approach based on synergy potential and cultural differences should lead to effective integration of functions, capability transfer, etc. In other words, if the acquiring top management actually implements the appropriate integration approach, a fit emerges between the "right" integration approach (according the framework presented here) and the approach being implemented. This leads to the following hypothesis:

H1: A fit between the appropriate integration approach, based on synergy potential and cultural differences, and the actual integration approach implemented leads to higher integration effectiveness than when no such fit exists.

### **Synergy**

The objective of the integration process is to seize the synergy potential through transfer of capabilities and resource sharing, leading to cost savings and increased revenue. During the integration process, each task aims to capture synergy can generate its own performance and together produce high integration effectiveness. But if there are no true synergies, the merger can yield only negligible benefits and low integration effectiveness. Therefore, the higher the level of synergy potential, the higher the integration effectiveness will be.

. The reason for the conflicting results of previous studies may lie in the broad terms in which relatedness and synergy have been defined, often using similarity and complementarity synergies interchangeably, or ignoring complementarity altogether (Makri, Hitt, and Lane, 2010). Synergy can be achieved through "economies of sameness" (Larsson and Finkelstein, 1999), such as the accumulation of similar operations and technologies, and through "economies of fitness" that arise from different products, markets, and knowledge that enhance one another and create synergistic complementarities. Whereas synergetic similarities arise from cutting costs of overlapping activities, the combination of complementary capabilities cannot be easily duplicated by other firms, and it provides M&As with outstanding potential for performance (Björkman, Stahl, and Vaara, 2007; Makri, Hitt, and Lane, 2010). The distinction between the two types of synergy leads to the following hypotheses:

H2a: The higher the synergistic similarities, the higher the integration effectiveness is.

H2b: The higher the synergistic complementarities, the higher the integration effectiveness is.

#### **The fit of integration approach as mediator**

Although the synergy potential determines the level of performance that can be achieved during the integration process, the "process perspective" on M&A success suggests that the realization of synergies depends largely on the ability of the acquirer to manage the post-merger integration process (Jemison and Sitkin, 1986; Haspeslagh and Jemison, 1991) and choose the appropriate integration approach. Therefore, only the fit between the selected integration approach and the appropriate integration approach, taking into account the specific level of synergy potential and problems of implementation due to cultural differences, can minimize the problems created by culture clash and harness the potential synergy. In other words, the fit of integration approach mediates the relationship between synergy potential and cultural differences and makes possible the achievement of synergy benefits during the integration process. Given different types of synergy, we hypothesize that:

H3a: The fit of integration approach mediates the relationship between synergistic similarities and integration effectiveness.

H3b: The fit of integration approach mediates the relationship between synergistic complementarities and integration effectiveness.

H3c: The fit of integration approach mediates the relationship between cultural differences and integration effectiveness.

## Methodology

### Sample

The sample of firms was drawn from an exhaustive list of mergers that took place during 2004-2006 obtained from the archive of the Israel Antitrust Authority. A sample of M&As was selected based on the following criteria: the acquiring company gained a controlling interest in the acquired firm, the mergers were related (i.e., from the same industry), and the names and addresses of the top managers affiliated with the acquiring companies immediately before the merger were available. Data were collected during 2007-2008. This sample included M&A with different integration approaches.

We focused on a sample of symbiotic mergers because the symbiotic integration approach is the most challenging one to implement (Haspeslagh & Jemison, 1991). The M&A characteristics leading to the recommendation to implement a symbiotic approach for the integration process are high synergy potential and high cultural differences. Managers in symbiotic M&As find themselves torn between the competing needs of preserving the culture of the acquired company and encouraging cooperation between managers from both companies to harness the synergy (Haspeslagh and Jemison, 1991). The high synergistic potential requires intense efforts and sophisticated processes of interaction and coordination (Weber and Tarba, 2010) to avoid the human resources problems resulting from cultural differences and to achieve high commitment and cooperation from both management teams (Lubatkin, Schweiger, and Weber, 1999; Weber, Shenkar, and Raveh, 1996; Weber, 1996; Weber, Rachman-Moore, and Tarba, 2011). Therefore, the need to select the appropriate approach to achieve high integration effectiveness is more important in symbiotic M&As than in other types of M&A, which require preservation or absorption integration approaches. For example, in an absorption M&A, the high synergy potential combined with relatively low implementation challenges due to low cultural differences can produce an effective integration even if the implementation process is not perfect. Similarly, in a preservation M&A with low synergy potential, the challenge of realizing the synergy is reduced because cooperation and interaction are less important, and the costs involved in these efforts are lower. Symbiotic M&As are therefore best suited for studying the effect of the fit of integration approach on overall integration effectiveness. Therefore, symbiotic M&As were identified from this sample of Israeli M&As, yielding a sample of 52 mergers.

Response rate for the large sample was 24%. Potential non-respondent biases were checked by comparing respondent and non-respondent firms with respect to the time that had elapsed since the date of the merger. This variable may affect the emotions and objectivity of the managers, and therefore their perceptions (Chatterjee et al., 1992; Lubatkin, Schweiger, and Weber, 1999). The t-test of mean differences was not significant, showing no evidence of a non-respondent bias.

### Questionnaire and procedure

Ideally, cultural differences are investigated before the merger, and the results compared with data collected after the merger. It is very difficult, however, to gain access to such data in large samples during the negotiation period, and it is also inefficient because many negotiations do not result in M&As. This problem is compounded by another difficulty associated with the measure of corporate culture. Many elements of culture are unclear to its members because people take them for granted (Schein, 1985). Dramatic events, such as M&As and contact with other cultures, however, make differences salient (Louis, 1983), especially in conflict situations (Sales and Mirvis, 1984). Greenwood, Hinings, and Brown (1994) pointed out that it may take months or years for the acquired managers to form stable impressions about the compatibility of the merging organizations' culture. Therefore, retrospective data can be useful in studying the cultural differences and attitudes of top managers. It has been observed that attitudinal and behavioral data do not become less accurate over time, even after periods of 10 years (Finkelstein, 1992; Gutek, 1978; Pettigrew, 1979). Studies of this type, however, should follow the recommendations of Huber and Power (1985) regarding access to top management and the use of retrospective data.

A second methodological difficulty has to do with how data on corporate cultural differences and their outcomes are collected. Recently, several studies have used questionnaires to measure perceived organizational culture (e.g., Cartwright and Cooper, 1993; Hofstede, Neuijen, Ohayv, and Sanders, 1990) and perceived cultural differences in M&As (Chatterjee et al., 1992; Lubatkin, Schweiger, and Weber, 1999; Weber, Shenkar, and Raveh, 1996), and found them to have high reliability and validity. Self-report questionnaires of perceived cultural differences that can be used to reach large sample also have the additional advantage that people's behaviors and attitudes are determined by their perceptions rather than the "actual" or "objective" situation (Rentch, 1990). Finally, perceptual outcomes, such as the effectiveness of the integration process, are useful because they provide a direct connection to cultural values (Earley and Singh, 1995).

All respondents were guaranteed anonymity (the only identification on the questionnaires was the name of the acquiring company). The completed surveys were returned directly to the authors. Because the unit of analysis was not the individual manager but the merger management, responses were summed and averaged for each variable to arrive at merger management means (see Enz, 1988). This procedure permitted control for team size variations across firms. Similarly, the aggregation of respondent perceptions to arrive at group scores resulted in findings that were less distorted by individual biases (Schneider, 1975). Such distortion was further reduced by the fact that top managers were asked to evaluate not their own perception of cultural differences but those of the merger management. Moreover, multiple-respondent evaluations of each merger management made it possible to check reliability through a later calculation of consensus. Responses were aggregated only if a high level of consensus was demonstrated between the perceptions of

top managers in each merger. Finally, to avoid problems of common method variance and creating pseudo-relationships between variables by methodological and process artifacts, provisions were made against consistency and priming effects following the recommendation of Podsakoff et al. (2003). As explained below, the most important variable, the fit of integration approach, was evaluated by a procedure that involves respondents only partially, and therefore pseudo-relationships are minimized.

### Measures

**Cultural Differences.** The instrument used by Chatterjee et al. (1992), Lubatkin, Schweiger, and Weber (1999), Weber, Shenkar, and Raveh (1996), and Weber (1996) to measure corporate culture differentials was employed. Based on the assumption that relative phenomena are best suited for comparison, particularly in contrast situations (Louis, 1983), respondents were asked to indicate the degree of pre-merger similarity between the acquired and acquiring top management on each item. Items were constructed to elicit responses about cultural differences on a 5-point scale, ranging from "very similar" to "very different." Following a test for inter-rater reliability, described below, a cultural difference index was computed across seven dimensions, each consisting of three to five items, with a total of 29 items. The seven dimensions (and the number of items used to measure each) were: innovation and action orientation (five items); risk-taking (five items); lateral integration (four items); top management contact (three items); autonomy and decision-making (five items); performance orientation (three items); and reward orientation (four items). Following the preliminary analysis described below, we collapsed the data into a single cultural difference index (Cronbach's alpha = 0.97) by summing the scores for all 29 items and taking their average.

**Synergy from Similarities.** Based on the concept of "economy of sameness" (the synergy that can be achieved from accumulating similar operations) and its measurement (Larsson and Finkelstein, 1999), synergy from similarities was measured by 11 items about the similarity of various operational functions such as marketing operations (geographic markets, customer groups, and industries) and production operations (types of input, process, and product).

**Synergy from Complementarities.** Based on the concept of "economy of fitness" (synergies that can be achieved by combining different but complementary operations) (Larsson and Finkelstein, 1999), synergy from complementarities was measured by 11 items about the complementarity of various operational functions such as marketing operations (possible transfer of marketing capabilities to new markets and products) and complementarity of production operations (possible transfer of production capabilities).

### *Fit of Integration Approach*

To determine whether the fit between the appropriate integration approach and the one actually implemented by management was present in the merger, both recommended and actual integration approaches were evaluated separately and compared. To evaluate the

recommended integration approach, the values of corporate culture differences and synergy potential were classified into two categories, that is, two levels of dichotomy were determined for every variable: low and high. The cross-tabulation of the categories between the two variables created four groups, which made it possible to identify the integration approach that was recommended after completion of each individual M&A. Symbiotic M&As, with high cultural differences and high synergy potential, were selected for reasons explained earlier.

To identify the integration approach actually implemented by the M&A, managers were asked to choose the description of integration process from a list of descriptions of integration approaches used by Ellis (2004). The characteristics of integration approaches consistently described by Haspeslagh and Jemison (1991), Nahavandi and Malekzadeh (1988), and Marks and Mirvis (1998) served as the basis for developing the coding scheme in the list of integration approaches. They included descriptions of the primary motives for the current acquisition; the extent to which the combined firm would follow the operating procedures of the acquiring firm or seek to identify the best practices of both firms; whether any plans existed for restructuring and downsizing initiatives; and whether words such as assimilate, absorb, blend, or retain were used in describing the process of integrating the operations of the two firms. Statistical analysis comparing these integration approaches significantly confirmed the presence of differences between them (Ellis, 2004). Note that these descriptions of the integration process do not use any evaluation of synergy potential or cultural differences, to prevent creating any association between the two evaluations of the integration approach that may results from methodological and process artifacts. Evaluation of the fit produced 30 symbiotic mergers with a fit out of the 52 symbiotic mergers.

**Integration Effectiveness.** The instrument used by Weber (1996) to measure integration effectiveness was employed. The effectiveness of the integration process measure was based on 12 questionnaire items that addressed effectiveness along organizational dimensions, such as operations, production, marketing, research and development, and personnel. The use of key informants to assess effectiveness is common in organizational research, and the self-report measures provide respondents with an opportunity to incorporate implicitly economic and non-economic considerations (e.g., Dess, 1987). A 5-point scale, ranging from "very ineffective" (1) to "very effective" (5) was used.

## Results

Table 1 presents the means, standard deviations, reliabilities, and inter-correlations of the seven dimensions of cultural difference measures based on the larger sample. Statistical analyses of the original sample showed that all the inter-correlations among the seven cultural difference dimensions are high (at least 0.33), significant ( $p < 0.01$ ), and internally consistent (Cronbach's alpha ranging from a low of 0.70 to a high of 0.82). In keeping with the theory underlying the construction of the culture measures, the dimensions demonstrated

discriminant validity (Cronbach's alpha for each dimension was higher than the dimension's correlations with all or most of the other six dimensions).

*Table 1. Mean, standard deviation, and Pearson correlations between dimensions of cultural differences and reliabilities*

<i>Dimension</i>	<i>Mean</i>	<i>S.D.</i>	<i>IAO</i>	<i>RA</i>	<i>LI</i>	<i>TMC</i>	<i>ADM</i>	<i>PO</i>	<i>RO</i>
<i>IAO</i>	3.07	0.87	(0.81)						
<i>RA</i>	3.06	0.81	0.80	(0.81)					
<i>LI</i>	2.86	0.88	0.56	0.53	(0.79)				
<i>TMC</i>	3.04	0.95	0.51	0.57	0.65	(0.71)			
<i>ADM</i>	3.00	0.75	0.68	0.71	0.67	0.70	(0.73)		
<i>PO</i>	2.77	0.92	0.52	0.47	0.40	0.33	0.39	(0.73)	
<i>RO</i>	2.62	0.80	0.56	0.56	0.49	0.42	0.49	0.69	(0.75)

The data also provide strong evidence of convergent validity, indicating, as expected, that the seven dimensions are part of the same general construct (Buchanan, 1974; Rosenthal and Rosnow, 1984). Although each dimension measures a unique aspect of the phenomenon, all the dimensions refer to the same content domain, making it possible to combine them all into a single index, a procedure for which prior research provides theoretical and statistical support (e.g., Buchanan, 1974; Chatterjee et al., 1992; Porter et al., 1974). The combined internal consistency of the single cultural difference index was high (Cronbach's alpha = 0.94).

Table 2 presents the means, standard deviation, reliabilities, and inter-correlations of the two synergy measures. Each construct demonstrates a high level of internal consistency (Cronbach's alpha of 0.86 for synergistic similarities and 0.79 for synergistic complementarities). The inter-correlation between the two dimensions is low ( $r = 0.09$ ) and non-significant, and therefore, as expected, these two constructs are different.

*Table 2: Mean, standard deviation, and Pearson correlations between dimensions of synergy potential and reliabilities*

	<i>Mean</i>	<i>S.D.</i>	<i>Synergy Potential: Similarities</i>	<i>Synergy Potential: Complementarities</i>
<i>Synergy Potential: Similarities</i>	2.93	0.74	(0.86)	
<i>Synergy Potential: Complementarities</i>	3.31	0.66	.086	(0.79)

Table 3 shows the means, standard deviations, and inter-correlations of the key constructs of the study. The results confirm that cultural differences are significantly and



negatively associated with integration effectiveness, and lend partial support for the hypotheses of the study. Consistent with hypothesis 1a, the fit is significantly and positively associated with integration effectiveness ( $r = 0.34$ ,  $p < 0.05$ ). Moreover, consistent with hypothesis 2a, synergistic similarities are positively associated with integration effectiveness ( $r = 0.34$ ,  $p < 0.05$ ). By contrast, no significant association was found between overall M&A performance and fit or between integration effectiveness and synergistic complementarities.

Table 3: Mean, standard deviation, and Pearson correlations between the variables

	Mean	S.D.	Fit Integration Approach	Synergy Potential: Similarities	Synergy Potential: Complementarities	Organizational Culture Differences	Effectiveness of Integration
<i>Synergy Potential: Similarities</i>	2.93	0.74	.028	(0.86)			
<i>Synergy Potential: Complementarities</i>	3.31	0.66	.141	.086	(0.79)		
<i>Organizational Culture Differences</i>	3.18	0.47	.055	-.358***	.103	(0.94)	
<i>Effectiveness of Integration</i>	3.45	0.71	.344**	.335**	.222	-.328**	(0.83)

Table 4 presents the regression results for synergy potential. The results confirm that synergistic similarities explain a significant variance in the integration effectiveness of the symbiotic approach in a manner consistent with theory and as predicted by hypothesis 2a. Again, hypothesis 2b, concerning the effects of synergistic complementarities, is not supported.

Table 4: Regression results of synergy components on effectiveness of integration

Independent Variables	Dependent Variable	
	Effectiveness of Integration	
	Beta	Std. Err.
<i>Intercept</i>	1.869***	0.585
<i>Synergy Potential: Similarities</i>	0.319**	0.128
<i>Synergy Potential: Complementarities</i>	0.194	0.143
<i>Model (N=51)</i>		
<i>F-statistic</i>	4.229**	
<i>R<sup>2</sup></i>	.150	

Most interesting are the results obtained for the mediation hypotheses. The present study is based on the implicit assumption that the effects of synergy and cultural differences on integration effectiveness are completely mediated by the fit of integration approach. To illustrate the principle involved, the complete mediation model has the form  $X \rightarrow M \rightarrow Y$ , where  $X$  (here, synergy potential and cultural differences) are the antecedents,  $M$  (here, fit of integration approach) is the mediator, and  $Y$  (here, integration effectiveness) are the consequences. The antecedent  $X$  is expected to affect the consequences  $Y$  only indirectly, through the mediator  $M$ . The indirect transmission of influence from  $X$  to  $Y$  via  $M$  indicates that all of the effects of  $X$  on  $Y$  are transmitted through  $M$ . Therefore, the typical mediation model is based on the premises that (a) functions  $M = f(X)$  and  $Y = f(M)$  represent linear, additive, and recursive (unidirectional) functions, and (b)  $M$  transmits all the influence of antecedent  $X$  to consequence  $Y$ , implying that  $X$  and  $Y$  are indirectly related and that the relation between  $X$  and  $Y$  vanishes if  $M$  is held constant (cf. Cook and Campbell, 1979; James and Brett, 1984; James, Mulaik, and Brett, 1982). If the predictions of the complete mediation model are confirmed empirically, one may infer that the model has been corroborated and is useful in explaining how  $X$  is related to  $Y$  through the intervening mediator  $M$  (James and Brett, 1984).

To test the theoretical model for complete mediation, we used the procedure described and illustrated by James and Brett (1984). This procedure is based on hierarchical regression analysis that checks whether the addition of the antecedent  $X$  (here, synergy and organizational culture) has significantly contributed to the explanatory power of the equation, as indicated by the R-square when  $M$  is held constant. The first step is to test whether cultural difference and synergy are related to integration effectiveness. Correlations and regression results indicated that cultural differences and synergistic similarities are related to integration effectiveness, whereas synergistic complementarities are not.

Therefore, to test whether the relationships of cultural differences and similarities were completely mediated by the fit of integration approach, these variables were added to the regression equation with the fit held constant. A non-significant increment in R-square due to the inclusion of the two antecedent variables would confirm the prediction that the fit of integration approach completely mediates the influence of cultural differences and synergistic similarities.

Table 5 presents the results of the regression analysis. The results show that the inclusion of synergy and organizational culture is not significant after the fit of integration approach was held constant in the equation. The results confirm hypotheses H3a and H3c that the fit of integration approach completely mediates the relationship between synergistic similarities and organizational culture on one hand and integration effectiveness on the other.

Table 5: Regression results of the fit of integration approach, synergy similarities, and organizational culture on effectiveness of integration

Independent Variables	Dependent Variable	
	Effectiveness of Integration	
	Beta	Std. Err.
<i>Intercept</i>	3.751***	0.844
<i>Fit of Integration Approach</i>	0.352***	0.179
<i>Synergy Potential: Similarities</i>	0.230	0.126
<i>Cultural Differences</i>	-0.265	0.199
<i>Model (N=51)</i>		
<i>F-statistic</i>	6.263***	
<i>R<sup>2</sup></i>	0.286	

## Discussion and Conclusions

The findings of the present study provide the first systematic evidence linking integration approach to integration effectiveness in M&As. Specifically, when management selects a symbiotic approach for the integration process, which fits the specific M&A situation (high level of synergy potential combined with high level of cultural differences), the integration is highly effective. If there is no fit between the selected and the appropriate integration approach, the integration process is not effective. The findings also highlight the importance of the integration approach as a mediator of the relationships between both synergy potential and organizational culture on one hand, and integration effectiveness on the other. Put differently, the positive effect of synergy potential and negative effect of cultural differences are completely transmitted through the appropriate integration approach to create high integration effectiveness. These findings suggest a direction in the quest for solving the long overdue paradox of M&A success. Consistent positive association between the synergy potential and M&A success can be found when the management of the acquiring company selects the appropriate integration approach. Finally, the findings are of practical importance because they show that managers who choose the appropriate integration approach can seize the synergy potential and at the same time mitigate the negative effect of cultural differences. The implication is clear: the management of the acquiring firm must pay at least as much attention to issues of integration approach to be implemented after the pre-merger search process, as they do to issues of strategic and organizational fit.

Measuring M&A success based on integration effectiveness is an attempt to bring the dependent variable of interest closer to the phenomenon under investigation. Traditional accounting and financial measures of M&A performance are problematic especially when examining internal process of integration. Similarly, assessing the overall M&A potential based on similarities and complementarities is more direct than relying on Standard

Industrial Classification (SIC) codes or other classification schemes that cannot differentiate between the various sources of value creation. The positive significant relationship between synergistic similarities and integration effectiveness reported here provides some support for this perspective.

The findings concerning the synergy effects on integration effectiveness are also of interest in light of recent studies that focus on synergistic complementarities rather than synergistic similarities. Although complementarities showed positive effects (Kim and Finkelstein, 2009; Makri, Hitt, and Lane, 2010) and other studies found that synergistic benefits are more likely to produce abnormal returns when based on complementarities rather than on similarities (Harrison et al., 2001), the present study shows that similarities are essential for integration effectiveness, at least in M&As in which the symbiotic integration approach is the most appropriate one.

Selection of the integration approach is often cited as an essential element in M&A success (e.g., Haspeslagh and Jemison, 1991; Graebner, 2004; Schweizer, 2005; Nahavandi and Malekzadeh, 1988), but no study has examined statistically its importance in a relatively large-scale sample of M&As and in conjunction with cultural differences. The present study clearly shows that despite the negative effect of high cultural differences on M&A performance (Chatterjee et al., 1992; Weber, 1996) and of other detrimental effects during the post-merger integration process, such as top executive turnover (Lubatkin, Schweiger, and Weber, 1999), it is possible to realize synergy potential if the management selects the appropriate integration approach that fits the characteristics of the merger. This finding is consistent with those of many previous studies (Larsson and Finkelstein, 1999; Schweizer, 2005; Weber, Shenkar, and Raveh, 1996; Weber and Tarba, 2010; Weber and Drori, 2011) and suggests that high synergy potential is not sufficient for M&A success: certain practices and structural changes must be undertaken to realize these synergies.

There are ample opportunities for further research following the findings and the theoretical framework presented here. For example, the present study warrants replication using an interdisciplinary approach, other forms of measurement (anthropological and other non-survey methods), expanded samples, sample containing other integration approaches (such as absorption), and unrelated as well as related mergers. Unrelated mergers may use a preservation mode of integration, and Absorption mergers have different operational synergies, and can be expected to show different synergistic similarities and complementarities. These types of M&A can be expected to show different types of contact between the combining management team which may attenuate or accentuate the findings of the present study. Replication studies should also try to measure M&A performance with other constructs (Zollo and Meier, 2008) and management perceptions, over different time frames, to establish stronger causal links between the fit of integration approach and overall M&A performance. Although access to such data may be difficult, any attempt at

triangulation would be useful in supporting both the internal and external validities of the present study.

Other research efforts could be directed toward understanding the fit of integration approach, degree of fit, its practices, and its effect on other factors in the post-merger integration process, for example, how the degree of fit affects such factors (observed in previous studies) as the turnover of top executives (Lubatkin, Schweiger, and Weber, 1999), intergroup conflict (Weber, Shenkar, and Raveh, 1996), drop in job commitment (Weber, 1996), identification with the merger (Rouzies, 2011), and the influence of leadership (Vasilaki, 2011).

### **Limitation of the Study**

It is possible to argue that the present findings are a statistical artifact because of the reliance of the study on the perceptions of managers. It is essential, however, that some variables be measured based on the response of the top managers who are most knowledgeable about the merger process. Therefore, we took precautionary measures in constructing the questionnaire to avoid consistency and priming effects and limit situations of common method variance (Podsakoff et al., 2003). Evaluation of the most important variable in the study, the fit of integration approach, was carried out by a process that relied only partially on direct involvement of the respondents to minimize pseudo-relationships between variables due to methodological and process artifacts. Furthermore, the results of validity and reliability tests are grounds for sufficient confidence in the measures employed in the present study. Finally, to reduce the personal involvement of respondents, the questions addressed the perceptions of the top management team and of the merger team in general rather than respondents' own perceptions. The perceptions of individuals with moderate levels of emotional involvement are less likely to be distorted (Huber and Power, 1985), and the social desirability and consistency effects should be lower.

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## MERGERS AND ACQUISITIONS PROCESS: THE USE OF CORPORATE CULTURE ANALYSIS

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### Abstract

The purpose of this paper is to advance cross-cultural management during mergers and acquisitions (M&A) an issue that remains poorly understood despite a large body of literature accumulated over many years of study and experience. Based on literature review and case studies of both successful and unsuccessful companies, this paper clarifies the concept, the assessment and the use of corporate culture and its dimensions during all mergers and acquisitions stages, and as such shows its role as an important and influential milestone in the international business environment exploration.

The paper arrives at the conclusion that the enduring paradox of the high rate of M&A failure vs. the growing activity of M&A may be due to lack of synchronized activities of all merger stages. The paper presents frameworks and managerial tools that can help researchers and practitioners conduct better corporate culture assessment during all stages of the M&A, including screening, planning, and negotiation, and enhance the effectiveness of interventions carried out during post-merger integration process.

The paper offers insights into corporate culture and its impact during pre-merger stage, negotiation, and the post-merger integration process.

**Keywords:** Culture, mergers, acquisitions.

### Introduction

There is no other area of an M&A that is more frustrating for their management and consultants than culture integration and change during post merger stage. Usually, it is a combination of misunderstanding of the role of culture in all stages of M&A and management that is ill prepared to face the role of different dimensions of culture during integration process. The current paper aims to clarify the concept, the assessment and the use of cultural dimensions in all M&A stages. Thus, it may help executives and consultants to handle cross cultural issues in all stages of the M&A process to best promote cross-cultural management.

"There is a good way and a bad way to handle the implementation of mergers and acquisitions. Both require the same effort and time investment. The difference is that one leads to success, the other to failure." Former VP of Teva (the largest generic pharmaceutical company)

Mergers and acquisitions (M&A) activity around the world has been booming for the last three decades, but the intense M&A activity stands in sharp contrast with the high rate of failure and dissatisfaction with its performance. An analysis by the Hay Group in 2007 of more than 200 major European M&As over the preceding three years found that senior business leaders believe that only 9% were "completely successful" in achieving their stated objectives. Unfortunately, merger integration consultants are often not brought in until problems arise late in the post-combination aftermath stage, long after the merger or acquisition has been consummated (Buono, 2005).

The cross-cultural differences factor in merger and acquisition (M&A) success has been the subject of contradictory and perplexing findings (Teerikangas and Very, 2006; Weber, Tarba, and Reichel, 2009). On the one hand, many studies during the last two decades provide corroborative evidence that cultural differences have negative impact on M&A performance. On the other, several recent studies point to the fact that cross-cultural differences can have both negative and positive effects on M&A performance (e.g. Ahammad and Glaister, 2011a; 2011b; Reus and Lamont, 2009; Sarala, 2010; Slangen, 2006; Vaara, Sarala, Stahl, and Björkman, 2011; Weber, Tarba, and Rozen-Bachar, 2011).

The theoretical literature and empirical findings of the last 20 years suggest that the influence of culture differences on the post-merger integration process is crucial for M&A success (e.g., Brannen and Peterson, 2009; Chakrabarti, Gupta-Mukherjee, and Jayaraman, 2009; Graebner, 2004; Weber, Tarba and Reichel, 2009). In practice, however, cultural differences in the M&A decision-making process seem to be neglected. For example, cultural assessment appears to be low in the priorities of executives in the due diligence process (Angwin, 2001). Time and again, cross-cultural management is mishandled by top executives in M&As and eventually results in failure, as in the case of Daimler Chrysler merger (e.g., Kuhlmann and Dowling, 2005). There are two main reasons for the apparent divergence between conventional academic wisdom and executive practice. First, the scholarly literature focuses on the role of national and corporate culture only in the last stage of M&A, namely, post-merger integration, rather than on all M&A stages, including planning and negotiations (Weber, Belkin, and Tarba, 2011a). Second, the concept of culture is not entirely clear to executives, and therefore difficult to implement in practice, as for example in the assessment and measurement process (Weber and Tarba, 2010; Weber and Tarba, 2011).

The current paper aims at closing these gaps. First, it explains why corporate culture assessment is not being used in all stages of M&A. Second, it clarifies the concept of corporate culture by articulating the seven dimensions that were found to reliably predict human

resource problems in the post-merger integration process and overall M&A performance. Third, it suggests how to measure cultural differences. Finally, it suggests how to use culture assessment at various stages of the M&A process to best promote cross-cultural management.

### **Lack of culture assessment in the early stages of M&A**

It is common knowledge today that M&As have a high chance of failure and that corporate culture, especially cross cultural management (Weber, Rachman-Moore, Tarba, forthcoming) is a key factor in the successful integration of two organizations (Stahl and Voight, 2008; Stahl, Mendenhall and Weber, 2005). For example, for Teva (the worldwide largest generic pharmaceutical company) that its fantastic growth based on successful M&A (Almor, Tarba, and Benjamini, 2009) the cultural issue play major role:

*Post-merger implementation focuses mainly on cultural integration with Teva, talent management, retention, and adapting to local cultures. Once the acquisition of a company has been approved, cultural and economic issues are primary when it comes to integration. (Claus, 2006)*

It is surprising, therefore, that differences in organizational culture have yet to become an important factor in the decision making of directors and senior management regarding such matter as the choice of the appropriate M&A, determining the price of the transaction, planning the integration of the two organizations, as well as in seeking to retain the human capital of the acquired company, which tends to leave shortly after the merger.

Two main independent streams of management research have studied either the *pre*-acquisition or *post*-merger integration stages. One stream that focuses on the pre-acquisition stage examined the relationship between firm-level measures of financial performance and the strategic fit between buying and selling firms (Singh and Montgomery, 1988; Palich, Cardinal, and Miller, 2000), with a focus on the potential synergy and added value of the acquisition to the buying company, in other words, on choosing the right merger. But a recent meta-analysis (King et al., 2004) failed to find a consistent relationship between performance gains and the degree to which the merging firms share similar functions, or other related financial factors such as the choice of payment methods. The authors indicated that other factors must be investigated, in addition to the financial ones, to understand M&A performance.

The second stream of research focuses on the post-merger stage and examines the cultural fit of the buying and selling firms, and its impact on the success of the merged company (Chatterjee, Lubatkin, Schweiger, and Weber, 1992; Sarala and Vaara, 2010; Stahl and Voight, 2008; Weber, Shenkar and Raveh, 1996; Weber, 1996; Weber, Tarba and Reichel, 2009; 2011). But findings are not always conclusive (Stahl and Voight, 2008). These studies have paid little attention to cross-cultural management, for example, to the role of HR practices, given the effect of cultural differences on the success or failure of domestic and international M&As. Note that the various bodies of literature on M&A seem to exist in a state of splendid

isolation. This issue has been raised by several scholars many years ago (e.g., Weber, Shenkar and Raveh, 1996), but the situation has not changed much since then. Although they share some definitions and terms, authors writing about pre-merger and post-merger issues generally refrain from stepping onto each other's territory, thereby missing out on opportunities to fully understand the M&A process and the effects of each stage on M&A performance.

Scholars and executives must understand that to seize the potential of M&A that is usually identified in the pre-merger stage, the steps to be taken in the integration process must be discussed as part of the merger choice. For example, with its breadth of acquisition experience, Teva has structured HR tools for due diligence. Due diligence covers all HR aspects (legal, economic, structural, demographic, and turnover data) as well as other "soft" issues especially culture (Claus, 2006).

Finally, the negotiation is also an essential part of a successful M&A (Weber, Belkin, and Tarba, 2011b). For example, in Electrolux, well known for its impressive growth based on many successful M&A, Ghoshal and Haspeslagh (1990) indicated that "It was standard Electrolux practice to have a broad but clear plan for immediate post acquisition action well before the negotiation process for an acquisitions was complete (1990: 7). Similarly, in Teva:

*"With this breadth of acquisition experience, Teva has structured HR tools for due diligence. Due diligence covers all HR aspects (legal, economic, structural, demographic, and turnover data) and other "soft" issues (culture)." Says Director of Labor Economics Muki Gilat, "If one of the three core disciplines [R&D, operations, and HR] does not recommend the deal, Teva will not acquire the checked company."*

It is important to understand, therefore, that all stages are pre-requisites of M&A success (Jemison and Sitkin, 1986). One of the main reasons that culture and cultural differences are not assessed in the pre-merger period, and therefore not taken into account at the negotiation stage, is the use of various consultants, technical staff and specialists in strategic decisions about the merger (Jemison and Sitkin, 1986; Haspeslagh and Jemison, 1991). Chief impediments in the M&A process, especially in the assessment during the pre-acquisition stage, are activity segmentation and fragmented perspectives. The technical complexity of the analysis requires experts from various fields such as transaction advisor (i.e. legal, accounting, finance, auditing, investment banking and more) and post merger integration consultants, each responsible for part of the analysis. For example, in the pre-combination stage of preliminary planning, transaction advisors typically drive the process without the involvement of merger integration consultants. Makov, former CEO of Teva explained:

*After planning there is the due diligence review. "This stage is frightening. You always find skeletons in the closet, and you have to decide which ones are important. If you leave it to the accountants and lawyers, the deal will never go through, because they'll turn every skeleton, or shadow of a skeleton, into a dinosaur* (Weinreb, 2008).

Ideally, the consultant's interventions should span all M&A stages. However, much M&A consulting is far more piecemeal and reactive, as different consultants are brought in to help resolve a particular problem that emerges in one aspect or another in the overall M&A process (Buono, 2005). Individual teams work in isolation from one another, and the difficulties in coordinating the various areas of expertise and methods result in a strong emphasis on quantification of estimates and their translation into financial numbers. The outcome is usually the omission, or underestimation, of factors that are difficult to quantify, such as culture and cultural differences. This is because the concept of culture is not clear and the way to measure culture and cultural differences is not known. The following quote is typical to many problematic M&A:

*"I think Alcatel-Lucent was a merger that sounded good in a PowerPoint presentation," said Mark Sue, an analyst at RBC Capital Markets in New York. "But there have been a lot of serious integration challenges, including cultural issues, that were underestimated and still linger." (Jolly, 2008).*

Such situation has further implications on HR issues that make M&A unsuccessful. As former CEO of Creo-Scitex merger noted:

The processes of the merger moved slowly; Michelson admits, "The primary conflicts that arose after the merger were on the management culture and methods." and "The senior managers of Scitex left since they did not internalize Creo's management style." (Ginsburg, 2001).

Thus, in unsuccessful mergers the timely assessment of post-merger integration problems and related HR challenges due to culture clash remains outside the negotiation stage and the decision-making process at the pre-merger stage, while in successful merger, those assessment in pre-merger stage are implemented immediately after the deal is sign according to early planning. For example, in the case Electrolux-Zanussi merger "a matter of hours after the signing of the final agreement, {Electrolux management} announce complete change in top management of Zanussi....Rossignolo was seen as an ideal bridge between the two companies and their vastly different cultures and management styles (Ghoshal and Haspeslagh, 1990:8).

. The following sections clarify the concept of culture, cultural differences, and the way in which to assess them and measure cultural differences.

### **Evaluating and measuring differences in management culture**

Many managers know that it is far easier to close an M&A deal than to implement it in the years following the signing of the agreement. Countless research studies and surveys of senior managers have shown that one of the main causes of the failure to properly integrate the two organizations is rooted in differences in management culture and their implications on the human factor, such as the departure of managers and key personnel from the acquired company (Hambrick and Cannella, 1993; Cannella and Hambrick, 1993; Lubatkin, Schweiger

and Weber, 1999). For example, 20 out of 25 senior Scitex managers left the company in the first year after its acquisition by Creo, despite efforts to retain them in the merged company. In this case, differences of national culture apparently exacerbated the difficulties (Weber, 2003).

Many mergers fail because of a lack of methodical and thorough measurement of culture differences. One of the better known examples is the acquisition of NCR by ATT at the beginning of the 1990s. The conservatism and centralized management of NCR did not suit the openness and creativity of ATT. Eventually, NCR was sold at half its market value, and ATT lost three billion dollars. By contrast, in the acquisition of the Morris Aviation Company by the Southwest Aviation Company, the acquiring company invested two months in learning the culture before the agreement was signed, and ended the integration process in eleven months instead of the three years allocated during the initial evaluation.

### **What is organizational culture?**

The word “culture” has many meanings, various connotations, and different definitions, and there is no agreement among researchers as to its exact meaning. But there is one definition of management culture that points to the ability to predict many phenomena, including the success or failure of M&As. According to this definition, management culture is **a developing system of beliefs, values, and assumptions shared by the managers about the desired way of managing the organization so that it can adjust to its environment** (Chatterjee et al., 1992; Lubatkin, et al., 1999; Migliore, 2011; Rosenblatt, 2011; Schein, 1985; Weber and Pliskin, 1996; Weber, 1996).

This definition focuses on the process of measurement and analysis by management. The focus on management approaches and style has many advantages in the M&A context and makes it possible to measure and evaluate corporate culture, including beliefs, values and fundamental assumptions, ceremonies, dress code, and other aspects of the organization at a relatively low cost. The important aspects for M&As are the ones that are included in the definition proper; the rest provide additional information for confirmation of the findings.

The system of beliefs and fundamental assumptions about work methods and approaches that lead to success evolves from the accumulated experience of the organization's management and workers in the course of dealing with the competition and with various factors in the business environment. Dealing with management challenges in this way requires interpreting the information that has been collected and taking action on the basis of the interpretations. Thus, corporate culture is an acquired system of knowledge and frameworks of reference that make possible the understanding and explanation of what occurs in the organization, in the sector, and in the world at large. Culture is critical in the preparation of programs and the making of decisions for coping with various management challenges on an ongoing basis. Because the interpretations depend on additional factors, such as the nature and background of the people involved, the actions undertaken, and the

interpretation of the success of these actions, every management team develops a different management culture even when the organizations and their managements operate within the same sector and in the same country.

All the beliefs, assumptions, and fundamental hypotheses of the management team become a complete system with unique content that shapes the processes of decision making and influences the choice of strategies, policy, principles, and behaviors in the organization. For example, a management group may decide upon its financial goals and significantly increasing its debts, while other management team will avoid an increase of debts. This different course of action followed from the beliefs and assumptions of each management team regarding the risk that should be taken during strategic operations. Assumptions of this type influence, among others, the levels of investment in areas of research and development in various projects, the testing operations, the level of autonomy granted to managers, the organizational structure, and many actions adopted by various divisions within the organization.

The system of beliefs that constitutes the organizational culture operates as a filter through which members of the organization perceive the reality they confront (Schein, 1985). As such, it plays two essential roles. First, the system of beliefs enables the translation of a complex world and of considerable uncertainty into familiar, comprehensible terms. Second, it provides continuity and stability when changes threaten to undermine the knowledge accumulated by experience. Thus, the culture supplies control functions that allow deviations from the accumulated knowledge and experience. These roles make the culture important to those who share it, but at the same time they make it difficult to carry out necessary changes, as in the case of a M&A, and become the root cause of conflict between the two cultures that meet in a M&A. In the same vein, the study conducted by Dolan and Raich (2009) indicated that failure by the senior management to perceive the changes or to take action can lead to catastrophic consequences for the incumbent organizations, and concluded that there is a great need to change the fundamental principles away from dominance towards partnership and care.

### **Dimensions of organizational culture**

The beliefs and basic assumptions that managements hold are subjective and relate to an infinite variety of topics. Nevertheless, the literature shows that it is possible to isolate and measure with high reliability and validity several important assumptions and beliefs that characterize cultures of organizations (Chatterjee et al., 1992; Weber, 1996; Weber et al., 1996; Weber and Tarba, 2011). Beliefs are not necessarily good or bad, and we can find any number of successful organizations in the same industry that have their own, different cultures. Most important, as M&A research has consistently showed these beliefs and assumptions can help predict critical phenomena that affect the success of M&As (Chatterjee et al., 1992; Weber, 1996; Weber et al., 1996; Weber and Tarba (2011)). This M&A research also elaborate how on

how the different beliefs and assumptions can be assembled into seven areas that constitute the dimensions of organizational culture.

### **Approach to innovation and activity**

Managers with a strong orientation for innovation and dynamic activity encourage rapid response to changes and to competition in the outside environment. They attempt to exploit opportunities for new products and markets. Organizations with a different corporate culture prefer stability, intensive planning, and a relatively high level of formality. They do not try to seize every opportunity, are mindful of the risks inherent in uncertainty, and believe that "haste is of the devil." This difference in management approaches derives from different perceptions about the urgency of response to changes.

### **Approach to risk**

Management philosophy and beliefs about risk taking are among the main factors that differentiate between organizations. The tendency to take risk affects many decisions such as investment in new initiatives, acquisition and investment in production equipment and technologies, the level of investment in research and development, management of cash flow and credit, and even the way in which pension funds are handled. A relatively high correlation has been found between this dimension and the previous one, approach to activity and innovation (Chatterjee et al. 1992; Lubatkin et al., 1999; Weber et al., 1996). For example, to achieve a competitive advantage using innovation requires investment in R&D, which can be risky because of uncertainty in the company's development capabilities, the required time, and the fit to market. The degree of the perceived urgency reflects management's perception of the threat and of the risk of failing to respond. The same is true for the exploitation of opportunities: the degree of urgency that follows from the approach to risk affects the approach toward activity and dynamism.

### **Horizontal relationship**

Managements have different approaches to the importance of cooperation and connection between units of the organization for the achievement of enterprise goals or the encouragement of competition between units to increase motivation and effort. Some organizations have complex coordination mechanisms, whereas others use simple means of synchronization, such as schedules and standardization. The importance ascribed by management to cooperation and communication is reflected in the encouragement of knowledge sharing, understanding the difficulties and problems of parallel position holders, and help offered to other units within the organization.

### **Vertical-hierarchical contact**

This dimension addresses management beliefs about attitudes toward subordinates, such as support, understanding, and encouragement. These beliefs have to do with human nature and therefore can vary extensively, for example, reflecting the X and Y theories that used to



be prevalent in the past. Thus, the assumption that people tend to let go, become sluggish, and avoid responsibility (the X theory) leads to an organizational culture diametrically opposed to one that is based on the Y theory. Managers differ in the degree to which they encourage subordinates to attempt new ideas, be creative, and take risks, in the same way that they differ in allowing employees to overtly criticize the management and discuss conflicts.

### **Autonomy and decision making**

A fundamental characteristic of management is the belief about the level of autonomy and responsibility that should be delegated in important decisions. These beliefs affect the form of the organizational structure, the definitions of the roles and procedures within the organization, and the level of formality of these definitions.

### **Approach to performance**

The requirements placed on managers and employees and the focus on performance evaluations are important aspects management culture. Managements differ in their beliefs about the need to require constant improvement and achieve goals, at times challenging ones. For example, the motto of an Israeli high-tech company is “Can do – will do,” in other words, everything that can be done will be done, whatever the difficulty (Weber, 2003). Other beliefs reflect the importance of the requirement for managers to assume responsibility for their performance and the expectation that performance will be measurable. Differences exist also in the emphasis on the types of performances, for example, between the requirement for efficiency and the manner of task performance as opposed to the effectiveness and the achievement of goals, even at the expense of efficiency.

### **Approach to rewards**

Organizational culture can also be expressed in the manner in which rewards are granted. The answer to the question “Who is rewarded and why?” provides a clear indication of the beliefs and values favored by management. Management approach to rewards is related to beliefs about the need to reward fairly and competitively relative to other organizations in the industry and to link reward with performance, and it affects the extent to which this linkage is reflected in salary, benefits, and other related aspects.

These dimensions of culture are important predictors of manager and employee behavior, including executive and employee turnover, and of the expected success of the merger. But these are not the only areas important for the understanding of management and organizational culture, an understanding that is instrumental for proper analysis of the situation before the agreement and for preparing the programs needed to cope with the differences in culture after the agreement, during the process of integration. The additional areas include considerations of labor relations and the influence of worker committees within the organization and ownership of the organization (private vs. public). Table 1 shows

culture differences in other areas of activity (in addition to the seven dimensions of culture) presented to the CEO of a company that was considering a merger.

Although there are no inherently good or bad management preferences, certain organizational cultures are not well-suited for activity in a given industry, resulting in poor performance. Thus, organizational culture is related to the organization's performance, but there is no single culture that produces a high level of performance; rather, there can be several organizational cultures, each one leading the organization to adequate performance.

The seven dimensions of culture come into play also when examining mergers between organizations from different countries. In the case of international mergers, it is necessary to examine *several additional* dimensions of international differences of culture, such as Hofstede's (Hofstede, 1980; 2001; Minkov and Hofstede, 2011) and GLOBE's (House *et al.*, 2004) dimensions, that can raise difficulties in the integration processes.

Finally, it is also important to examine management priorities with regard to certain beliefs. Even if organizations have similar beliefs, and it would appear that they have similar organizational cultures, the emphases and priorities of the various beliefs may be different. For example, managers in many organizations ascribe importance to discipline, but Intel is one of the few organizations that until recently placed discipline at the top of its priorities.

*Table 1: Differences in Management Culture (in Addition to the Seven Dimensions of Culture)*

<i>Areas of Activity</i>	<i>Company M</i>		<i>Company H</i>
<i>Structure and decisions</i>	<i>Cooperation</i>	<i>vs.</i>	<i>Hierarchical, centralized</i>
<i>Labor relations</i>	<i>Harmony</i>	<i>vs.</i>	<i>Conflict, unilateral, top-down</i>
<i>Communication</i>	<i>Diplomatic</i>	<i>vs.</i>	<i>Direct</i>
<i>Individuality</i>	<i>Group / teamwork</i>	<i>vs.</i>	<i>Individualized</i>
<i>Time orientation</i>	<i>Flexible</i>	<i>vs.</i>	<i>Defined, rapid</i>
<i>Ownership</i>	<i>Public</i>	<i>vs.</i>	<i>Private</i>
<i>Management approach</i>	<i>Engineering, process</i>	<i>vs.</i>	<i>Financial, costs</i>
<i>Worker committees</i>	<i>Yes – significant</i>	<i>vs.</i>	<i>No</i>

## Measurement and evaluation of culture differences

The principles of measurement and evaluation of culture differences in M&A are described here briefly. Note that part of the planning process includes the evaluation of culture differences that is undertaken before the merger, and during the negotiation process. In other words, it is important to perform at least the evaluation, if not the measurement, of culture differences as early as possible and before the due diligence process.

The evaluation of culture and cultural differences is a complex task. Methods of evaluation can be based on direct or indirect contact with the company to be acquired. If there is considerable contact with the target company, it is possible to use primary sources of

information (from the company itself). If there is no contact (or very little contact) with the target company, secondary sources of information must be resorted to, outside the company. During the planning process, reliance is primarily on secondary sources of information provided by companies that collect information about competitors, suppliers, etc. within the framework of business intelligence operations. The following sources can provide *ad hoc* information about the target company:

- Information published by the company itself, describing its characteristics, credo, mission statement, and more. The company's presentation on its website and press releases are good sources for this type of information.
- Articles and interviews in the press with senior managers from which it is possible to glean the management approaches to various issues, and articles that appear about the organization in the business press.
- Lectures and speeches delivered by members of the target company's management team.
- Research divisions of various organizations collect information on many companies in the industry sectors in which they operate.
- Interviews with managers and employees of your organization who have worked or had a business relationship with the target company.
- Conversations and interviews with clients, suppliers, and competitors who have worked with the target company.
- Conversations and interviews with information holders, such as accountants, lawyers, management consultants, investment bankers, etc. who have been in contact with the managers of the target company.
- Conversations with the managers and employees of the target company at various events and encounters, such as workshops, seminars, exhibitions, etc.

In the case of a public company, it is possible to examine its financial reports that generally contain announcements from the CEO to the stockholders, which can provide valuable information about the organizational culture. And there is always a great deal of interesting information the company makes public when it raises capital.

The evaluation of culture and cultural differences is undertaken on the basis of the dimensions of culture and of the additional areas of activity described above, ranking the target company on the various dimensions. All the collected information is cross-checked for reliability and examined against other content to ensure validity. Ranking may be carried out using two or three raters, allowing a comparison of the reliability of the various scales. Raters can be two executives from the same organization, or executive and employee each from different unit, etc..

Data collection must also be performed in the course of the negotiations. Negotiations are generally conducted by a team, and team members must undergo training. Each team member can collect information and rank the culture of the target company or the cultural differences on the various dimensions and areas of activity. Data collection about organizational culture in the course of the negotiation process can include the following:

- Questions prepared ahead of time, during preparations for negotiations, about management approaches, focusing on the dimensions described above.
- Direct questions about the company's management culture.
- Observation of the behaviors, rituals, and language of the other team.
- Observation of the attitude toward various issues that arise in course of the negotiations that shed light on the company's mode of operation. For example, the manner in which team members refer to the use of loans and outside capital, the importance ascribed to investment in R&D, the way in which performance is rewarded, the organizational structure, the delegation of authorities, the degree of formality in the decision-making process, etc.
- Request for documents that can serve as indicators of management style, way of thinking, and other characteristics.

The information collected by the team members during the negotiations is coded, ranked, examined for reliability, and cross-checked against information gathered from other sources.

### **Implications for the various M&A stages**

The measurement of culture differences makes an important contribution to all stages of M&A: planning, negotiations, and the integration of the organizations (see Table 2). For example, during the stage of planning and evaluation of the profitability of the M&A, the level of culture differences on the different dimensions serves as an indication of the challenges to be anticipated in the implementation process, can help determine the integration approach to be followed after the agreement, the time frame and the costs needed for integration, and can serve to assess the ability to realize the synergy potential.

Table 2 - Uses for the Measurement of Differences in Management/Organisational Culture in Management of Mergers/Acquisitions

Stage 1 - Planning
<p>Measurement and Analysis of Cultural Differences</p> <p>Identification, analysis, and measurement of the organization's management culture</p> <p>Characterisation of the cultures of the firms that are candidates for merger/acquisition</p> <p>Analysis of the cultural differences between the organisation and the firm that is a candidate for merger/acquisition:</p> <p>Strength of the cultural differences</p> <p>Areas of cultural differences (risk, decision making processes, rewards, etc.)</p> <p>Cultural differences in functions (marketing, R&amp;D, etc.)</p>
<p>Significance of Integration of the Merger/ Acquisition and Realisation of Synergy</p> <p>Evaluation of the challenges in the implementation of the merger/acquisition strategy for each candidate</p> <p>Determination of the appropriate integration approach for the merger/acquisition (preservation, absorption, symbiosis)</p> <p>Evaluation of the duration of time required for integration of the organisations after the agreement</p> <p>Evaluation of the degree to which the synergy potential is exploited after the merger (in marketing, R&amp;D, collaborations, etc.)</p>
<p>Financial Assessments</p> <p>Expenses required for implementation</p> <p>Postponement of income due to integration difficulties</p> <p>Influences on cash flow</p> <p>Value assessments</p> <p>Anticipated influences on EPS in different types of financing (loan, payment in stock)</p>

Stage 2 –Negotiations
<p>1. Preparation for Negotiations</p> <p>Understanding of the obstacles in communication following differences in management culture</p> <p>Preparation of managers for negotiations (strategies, tactics, red lines, etc.)</p> <p>Identification, location, and confirmation for analysis of the culture differences in the framework of the negotiations process</p> <p>Cost of merger/acquisition. Set the maximum price (abandonment price)</p> <p>Set the modes of payment (cash, shares)</p> <p>Set the payments according to the integration progress</p>
<p>2. Negotiations Stage</p> <p>Creation of appropriate atmosphere.</p> <p>Use of culture differences and implementation difficulties anticipated for the achievement of the negotiations objective.</p> <p>Tools for the performance of due diligence within the limits of knowledge, speed, and confidentiality.</p>
<p>3. At the Signing of the Contract</p> <p>Acceptance of the correct price, taking into account cultural differences and implementation difficulties.</p> <p>Determination of implementation plan and cooperation.</p> <p>Determination of payments on the basis of progress in implementation.</p> <p>Determination of the price before change of share value after the agreement.</p>

<i>Stage III – Process of Integration of the Organisations</i>
<p><i>1. Set the Appropriate Integration Approach</i></p> <p><i>2. Choose units in the organisation for integration with focus on</i></p> <p style="padding-left: 40px;"><i>Strength of the differences</i></p> <p style="padding-left: 40px;"><i>Type of the differences</i></p> <p style="padding-left: 40px;"><i>Functions of the differences (marketing, R&amp;D)</i></p> <p><i>3. Definition of the Desired Shared Culture</i></p>

Information about the extent of cultural differences and integration difficulties can facilitate the evaluations of expected cash flow, the anticipated effects on EPS, the effects on the change of stock prices after the agreement, and the risk inherent in each alternative. In this way, during the stage of planning, screening and classification of several potential mergers, it is possible to compare the advantages and disadvantages of each candidate for merger.

During the negotiation process, managers must be prepared for the negotiation stages and for the evaluation of cultural differences in order to identify expected obstacles in communication caused by differences in corporate culture, and to acquire tools for the bargaining stages. Understanding the challenges of implementation will affect the setting of the maximum price to be paid and the mode of payment, taking into account the expected course of the integration process. The price must also take into consideration the anticipated implementation difficulties and make it possible to link payments to progress in implementation, or setting of the final price based on the expected change in the value of the shares after the agreement.

During the integration stage, correct analysis of cultural differences can determine the choice of units that are to be integrated during the early or late stages of the process, according to the types and strength of the differences. When the cultural differences between the organizations become clear, it will be possible to define a desired shared culture. This will make it easier to cope with the challenges raised by the human factor, prevent the leaving of managers and key personnel, and preserve commitment, cooperation, and motivation, all of which are important factors in the post-agreement period. A fundamental understanding of cultural differences makes it possible to prepare and implement various HR practices such as communication methods, staffing, recruitment, and training, (Weber and Tarba, 2010) as well as implementation program by integration task forces with planning, identification, and capture of the synergy potential. Finally, measurable values of management culture

and cultural differences enable good supervision, feedback, and improvement until the objectives of the M&A are achieved.

## Conclusions

The aim of the present paper is to foster the application of cultural difference assessment and measurements in all stages of M&As. Much of the academic literature describes cultural differences as essential for post-merger integration but less so for other M&A stages, such as planning and negotiation. The present paper emphasizes that consideration of cultural differences is also essential in making the choice of the right partner for M&A, and should be assessed and measured during pre-merger planning and negotiation stages. Thus, the major implication of this paper is that merger integration consultants will share the table more frequently with transaction advisors, and earlier in the process of due diligence. Consulting engagements should become longer term, going beyond isolated interventions that focus on one particular problem of M&A integration. One thing will not change. To achieve better success, M&A consulting interventions will need to be based more on measurement of cultural differences

The frameworks presented here also provide for a systematic research of the relationships between cultural difference assessment and M&A performance. First, the relationships between the level and depth of cultural assessment in the pre-merger phase and the negotiation outcomes should be investigated, together with the relationship between the use of cultural differences in the negotiation stage and post-merger integration success. Second, the present paper suggests the need to formulate multiple hypotheses based on the above (and other) relationships between cultural assessment and various factors in the M&A decision-making process on one hand, and overall performance on the other. For example, Angwin (2001) found that acquirers from different countries assign different levels of priority to cultural assessment during the due diligence process. It is therefore reasonable to hypothesize that those who pay less attention to assessing cultural differences during the pre-merger stage will also pay less attention to it in the post-merger stage, and are likely to face more problems of post-merger cross-cultural management and achieve lower success. Finally, the frameworks presented here can help consultants and executives conduct better cultural difference assessment during all stages of the M&A, including screening, planning, and negotiation, and enhance the effectiveness of interventions carried out during post-merger integration process. As such our study emphasizes the role of the corporate culture analysis as an important and influential milestone in the international business environment exploration.

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## IDENTIFYING FUTURE RESEARCH OPPORTUNITIES IN ONLINE CONSUMER REVIEWS: THE CASE OF TRAVEL REVIEW WEBSITES

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### Abstract

The aim of this article is to identify future research opportunities in online consumer reviews, especially for travel review websites such as TripAdvisor.com. The literature review covers the Internet and growth of eTourism, virtual communities, virtual community typologies, and the importance of TripAdvisor.com for travel research, electronic word-of-mouth (eWOM), social networking and the impact of online travel reviews on consumers. Propositions and future research opportunities are then raised.

**Keywords:** online consumer travel reviews, Trip Advisor, consumer purchase intentions, ETourism, eWOM, virtual community typologies

### Introduction

We are all becoming more networked than ever. A recent survey of 22 countries for the Global Attitudes Project<sup>88</sup> showed Internet, cell phone and computer usage have increased and social networking via websites such as Facebook.com, MySpace.com and YouTube are particularly widespread across early adopter countries such as USA (46%), Poland (43%), Britain (43%) and South Korea (40%). The Global Attitudes Project also found significant demographic differences in social networking between age and educational level across the countries, but little gender difference. In general, social networking and Internet usage is popular amongst the younger (under 30s) and college educated. Education gaps of 50 percentage points or more were found between college educated and other education levels in Jordan, Egypt, Kenya, Brazil, Turkey and Mexico. Whereas in Norway, a national survey found<sup>89</sup> (Statistics Norway, September 2010) 93% of the population having used the Internet over the last three months. These statistics show some demographic trends in Internet usage across the globe, as well as the general shift for people to become more “technologically connected” and “socially networked.” At the same time, there is an increasing “technology divide” between those who have Internet, cell phone, computer and social networking website access and those who do not.

In terms of this research paper, the aim is to identify future research opportunities in one type of virtual community, the online consumer review website. There is an emphasis placed

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<sup>88</sup> In Pew Internet Report, April - May 2010 - Global Attitudes Report - see online references

<sup>89</sup> In Eurowatch New Media Trends Norway statistics - See online references

on travel review websites such as [www.TripAdvisor.com](http://www.TripAdvisor.com). The literature review starts by covering the Internet and growth of eTourism then moves to virtual communities and virtual community typologies. Following this, the importance of TripAdvisor.com for travel research is then covered followed by electronic word-of-mouth (eWOM), social networking and the impact of online travel reviews on consumers. Propositions and future research opportunities are then raised. The paper now begins with the Internet and growth of eTourism.

## **Literature Review**

### **The Internet and growth of eTourism**

Having reviewed 149 eTourism research articles over the past twenty years, Buhalis & Law (2008) state how there are few service industries that have experienced so profound and fast-moving change to their business strategy, structures and processes over this period than for travel and tourism. These changes occurred alongside rapid growth in Information and Communications technologies (ICT), such as establishment of the Computer Reservation Systems (CRSs) in the 1970s, Global Distribution Systems (GDSs) in the 1980s and development of the Internet in the late 1990s. In terms of pre-Internet strategy, tourism suppliers had no choice but to use traditional intermediaries, such as travel agents and tour operators for distribution functions, as well as CRSs and GDSs for intermediation processes (O'Connor, 2003; Sheldon, 1997, Buhalis & Law, 2008). Buhalis & Licata (2002) showed how traditional electronic intermediaries were being replaced by new tourism eMediaries selling direct via the Internet including; tourism suppliers, destination management systems, web-based travel agencies, offline travel agent, internet portals, vertical portals, media companies, television networks, online last minute agencies, reversed pricing agencies and auction sites. Buhalis and Law (2008) added Web 2.0 or Travel 2.0 providers and price prediction sites to these earlier categorisations. Buhalis & Law (2002) saw conditions for emergence of new eMediaries being based on three ePlatforms; the Internet, Interactive Digital Television (iTV) and mobile devices if forecasting forward by 5 and 15 years. Buhalis & Law (2008) uncovered three main themes in the tourism and hospitality literature regarding eTourism: a) consumer and demand dimensions; b) technological innovations and c) industry and business functions. Consumer and demand dimensions relate to aspects such as online information search, impact on pricing, consumer behaviour, security and privacy issues, virtual communities, expanding consumer choice, use of recommendation systems, complaints and feedback systems, as well as differential online tourist market segments. Technological innovations cover increased multimedia developments, increased web design functionality, usability and progress in mobile and wireless technologies and increased interoperability and ontology. Industry and business functions cover strategic and operational dimensions of ICTs for tourism strategy, including changes to marketing and distribution. Buhalis & Law (2008) note how previous tourism research has used Porter's Five Forces (1979, 1980, 2001) to

show how the Internet has changed conditions for competition in the marketplace. Buhalis & Law (2008) saw the Internet promoting mass-customisation of tourism products, supporting the industry to target niche markets in different geographical locations and as a means of boosting interactivity between partners to maximise value-added to customers. Finally, Buhalis & Law (2008) see eTourism research being in its' infancy with future research being centred on understanding consumer-centric technologies that support organisations to dynamically interact with their customers. Future innovative technologies will support interoperability, personalisation and constant networking. Dynamic interaction via virtual communities and website types are now covered below.

### **Virtual communities and virtual community typologies**

Community has been at the heart of the Internet since its inception. For years, scientists used the Internet to share data, collaborate on research and exchange messages (Wang et al, 2002). This scientific emphasis expanded to cover commercial online activities and during the 1990s there was a convergence of email, groupware systems and the World Wide Web that provided the general public with the opportunity to participate in groups where there was little or no face-to-face interaction (Cothrel & Williams, 1999). Online communities, virtual communities and electronic communities are all synonyms for what Rheingold (1993) originally termed the "virtual community." See Table 1 for Rheingold's definition.

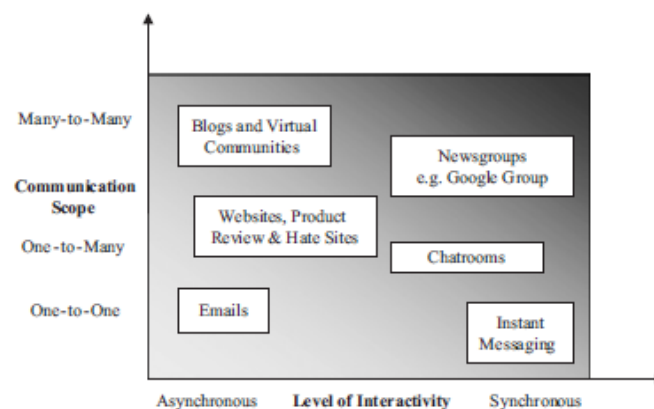
Armstrong & Hagel (1997) discussed the need for virtual communities from both a vendor and member perspective. They saw virtual communities aggregating people and providing an engaging environment for interaction. People are drawn to virtual communities to fulfil four basic needs; a) interests b) relationships c) fantasy d) transactions (Armstrong & Hagel, 1997). Preece (2000) see online communities consisting of a) people who interact as they strive to satisfy their own needs or perform special roles; b) a shared purpose of people with shared interests, needs, information exchange or service requirements c) policies that guide people's interactions d) the computer systems that support and mediate the social interaction and facilitate a sense of togetherness. Wang et al (2002) provide a theoretical foundation for the concept of virtual community, including core characteristics of virtual communities and fundamental needs of community members. The core characteristics of virtual community are; a) virtual community as place b) virtual community as symbol and c) virtual community as virtual (Wang et al , 2002). Place is where people can develop and maintain social and economic relationships whilst exploring new social organizations centred around certain communalities such as fellowship, profession or interest. Symbol refers to the symbolic dimension of meaning that humans attach to the community. Virtual refers to the new communication element i.e. the computer that is used in the process of community building online. It is just the means of communication that differs. Also in line with Fernback (1999), Wang et al (2002, p. 411) see,

“The virtual communities are characterized by common value systems, norms, rules and the sense of identity, commitment and associations that also characterize various physical communities”

Wang et al (2002) also saw virtual communities fulfilling three fundamental user needs; a) functional needs b) psychological needs and c) social needs.

Virtual community website typologies, both general and travel specific, have also been created. Kozinets (1999) pinpoint five different types of virtual communities of consumption based on social structure and group focus. These include a) boards, b) rings c) lists, d) dungeons e) chat rooms. In terms virtual community travel typologies, constant networking, personalisation and interoperability (Buhalis & Law, 2002, p. 620) have already impacted heavily on the ways in which consumers search for travel information on the Internet and make their consumer choice behaviour. For example, pricing and quality information has become more transparent over the past 10 years, as consumers seek information through a variety of social media sources that appear in their search engine in the context of travel-related searches. Fernández-Barcala et al (2010) differentiate between a) sales websites b) advice website in this context. However, Litvin et al, (2008) note how online searches are carried out through company-sponsored websites as well as via independent sources such as product review sites or even hate sites. Litvin et al (2008) provide their breakdown of websites as part of a general typology of electronic word-of-mouth (eWOM) channels. This can also be applied to the travel and tourism industry. The typology is shown as Figure 1.

Figure 1: A typology of electronic word-of-mouth (eWOM) channels (Litvin et al, 2008)



Litvin et al (2008) see interpersonal communications and eWOM as key when consumers purchase intangible products, such as a hotel room booking or beach holiday. The article helps position social media websites within a eWOM context and highlights the increasing importance of online sources in the consumer's decision-making process. Xiang et al's (2008) study of travel information searches using the Google engine found travellers only access a small fraction of information on the domain and a relatively small number of websites

dominate the search results. In a follow-up study, Xiang & Gretzel (2010) found significant differences in both type and frequency of social media websites uncovered by the Google search engine when searching for travel information purposes. Only a relatively small number of unique domain names (335 Websites) formed a core of the results. The top 20 unique domain names represented approximately 50% of all the 1150 websites. The largest of these domains was TripAdvisor.com. Virtual communities (40%), consumer review websites (27%) and blogs (15%) were the largest three social media website types represented in the findings. Differences in information search were also found by Pavlou & Dimoka (2006). Here, customers rarely viewed feedback comments online beyond the first two pages on the website EBay.com. The articles from this section are now summarised in Table 1.

**Table 1: Virtual Communities & Virtual Community Typologies**

Article	Type	Main Concepts	Travel Specific?
Armstrong & Hagel (1997)	Book	Virtual communities are required from both a vendor and member perspective. People are drawn to <b>virtual communities</b> to fulfil 4 basic needs; <i>a) interests b) relationships, c) fantasy d) transactions</i>	No
Cothrel & Williams (1999)	Review Article	The history of online community growth	No
Fernández-Barcala et al (2010)	Research Article	In their empirical research, the authors differentiate between two types of hotel quality information providers on the Internet <i>a) sales websites</i> (fee financed) <i>b) advice websites</i> (advertising financed)	Yes
Kozinets (1999)	Conceptual Article	Kozinets created a typology of 5 <b>virtual communities of consumption</b> , based on loose versus tight structure and group focus. The typology includes <i>a) boards, b) rings, c) lists, d) dungeons, 5) chat rooms</i>	No
Litven et al (2008)	Conceptual Article	The authors created a typology of <b>different electronic word of mouth (eWOM) channels</b> , which included blogs and virtual communities. This is applied to hospitality and tourism management. Channels in the typology are differentiated by <i>a) communication scope</i> (many-to-many, one-to-many or one-to-one) and <i>b) level of interactivity</i> (asynchronous versus synchronous)	Yes
Pavlov and Dimoka (2006)	Research Article	Empirical research using the website EBay.com. The findings revealed differences in <b>information search online</b> . Customers rarely view comments beyond the first two pages of feedback text comments	No
Preece (2000)	Research Article	<b>Online communities</b> should consist of; <i>a) people who interact to satisfy needs or perform roles b) a shared interest, need, information exchange or service requirement c) policies d) computer systems</i>	No
Rheingold (1993, 1997)	Book	Was first to define the <b>virtual community</b> as, “ <i>Social aggregations that emerge from the Internet when enough people carry on those public discussions long enough, with sufficient human feeling, to form webs of personal relationships in cyberspace.</i> ” (p. 5)	No
Wang et al (2002)	Review article	Review the virtual community literature, define the <b>virtual tourist community</b> and draw conceptual models <i>a) pinpointing the core characteristics of virtual communities</i> (virtual, place and symbol) <i>b) fundamental needs of community members</i> (functional, social and psychological)	Yes
Xiang and Gretzel (2010)	Research article	U.S.-based research into the patterns of consumer travel information searches whilst using the Google search engine. The findings revealed significant differences in the type and frequency of social media websites visited when searching for travel information search purposes. The top 20 unique domain names represented approximately 50% of all 1150 websites visited in the study. The largest of these was TripAdvisor.com, with other social media websites also well positioned in the top 20 ranking of domain names. Virtual communities (40%), consumer review websites (27%) and blogs (15%) were the largest three social media website types represented in the findings. The research also uncovered a relationship between social media type and search query keywords a traveller is likely to use. The findings revealed <i>a) virtual communities more closely tied to “core” tourism businesses such as attractions, activities and accommodations; b) consumer review sites related to shopping, hotels and restaurants, c) social networking sites, blogs and photo sharing sites related to events, nightlife and parks.</i>	Yes



### **Why use TripAdvisor.com in travel research**

Findings from Xiang & Gretzel (2010) show TripAdvisor.com holds a strong and powerful place as a unique domain name in the Google information search for travel information relating to 9 U.S. cities. This makes TripAdvisor.com an important consumer review website for research purposes. TripAdvisor® Media Group is operated by TripAdvisor LLC and attracts more than 50 million unique monthly visitors across 18 popular travel brands (ComScore Metrix, Worldwide, August 2010). The TripAdvisor-branded sites alone make up the largest travel community in the world, with more than 40 million unique monthly visitors (ComScore Metrix, Worldwide, August 2010), 20 million members, and over 45 million reviews and opinions. The sites operate in 27 countries worldwide. TripAdvisor.com sells its' services as an advertising agency Trip Advisor for Business that offers advertisers the vehicles to reach Trip Advisor's large customer base. As Xiang & Gretzel (2010) show, TripAdvisor.com holds a dominant position in consumer online travel reviews and on this basis, should form the object of analysis for future online consumer travel review research, particularly concerning attitude towards reviewer.

### **Electronic word-of-mouth (eWOM) and social networking**

In Europe, social networks are playing an increasing role in everyday life, particularly in terms of online travel information search and decision-making. A recent poll of 1,000 UK holidaymakers surveyed respondents about the impact of social media during their decision-making phase. 64% of the sample did not use social media sites. But within the remaining 36%, Trip Advisor was the most popular site, with 66% of those polled consulting the site. Around 34% referred to Facebook, 21% to YouTube and 17% to Twitter. Travel and tourism chat rooms and forums attracted 28% of the social media users & blogs 9%. WTM's research found that 42% of social media users went ahead and booked their original choice, but more than 35% changed their hotel as a result. (HOTELMARKETING.COM, November 2010)<sup>91</sup>. This shows the real impact social networking sites are having on consumer decision-making in the travel and tourism sector and yet little research exists in this area. This also applies to eWOM in a travel context, so three general eWOM research findings now follow.

Electronic word-of-mouth (eWOM) has been defined as,

"any positive or negative statement made by potential, actual, or former customers about a product or company, which is made available to a multitude of people and institutions via the Internet." (Hennig-Thurau et al, 2004, p.39)

Building on Balasubramanian and Maharan 's (2001) earlier eWOM framework which included three types of social interaction utility; focus-related utility, consumption utility and

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<sup>90</sup> In Eurowatch New Media Trends Norway & UK statistics - See online references

<sup>91</sup> In Eurowatch New Media Trends UK statistics - See online references

approval utility, Henning-Thurau et al (2004) extended the typology to include moderator-related utility and homestase utility. Henning-Thurau et al (2004) extracted 8 factors that impact on consumer motives for eWOM which were; platform assistance, venting negative feelings, concern for other consumers, extraversion/ positive self-enhancement, social benefits, economic incentives, helping the company and advice seeking. The findings showed social benefits having the strongest positive impact on consumer platform visiting frequency and on the number of comments written on virtual platforms. Social benefits were closely followed by concern for other consumers and extraversion/ positive self-enhancement in terms of strength of positive impact. Whereas, platform assistance and venting negative feelings had a negative impact on consumer platform visiting frequency and the number of comments written. Hennig-Thurau et al (2004) also used cluster analysis to segment the customers into the following types; a) self-interested helper b) multiple motive consumers c) consumer advocates d) true altruists. This study provides understanding of different consumer motives for their eWOM communication and the impact of eWOM on consumer behaviour.

Sen & Lerman (2004) examined negative consumer reviews on the web and found that product type; whether hedonistic or utilitarian moderated strength of valence of consumer review. Review readers also exhibited negativity bias but for utilitarian product reviews only. Utilitarian products are where utility is measured as a function of the products' tangible attributes (Drolet, Simonsen & Tversky, 2000), such as with consumer durables. Hedonic products are those where consumption is primarily characterised by an affective and sensory experience of aesthetic or sensory pleasure, fantasy, and fun (Hirshman & Holbrook, 1982). Hedonistic products satisfy emotional wants.

This section highlighted nuances in eWOM, as well as consumer motives towards communicating via eWOM. In terms of social networking and online travel website usage, the effects on consumers will now be covered.

### **The impact of online travel reviews on consumers**

The existing research regarding impact of online travel reviews on tourism service, quality and consumer behaviour/ consumption patterns is still in its' infancy. Some of the most current research will now be reviewed.

Vermeulen & Seegars' (2010) analysed the impact of online hotel reviews on consumer consideration sets in Holland. The study used review valence, hotel familiarity and reviewer experience as independent factors. Findings supported the view that exposure to online reviews enhances both positive and negative attitude towards hotel consideration in consumers. In addition, positive reviews actually improved attitude towards hotels. This effect was stronger for lesser-known hotels than for well-known hotels. Ye et al (2009) also provided a review of impact of review polarity (positive versus negative) on hotel sales using the largest travel website in China, [www.ctrip.com](http://www.ctrip.com). Ye et al (2009) found positive online

reviews significantly increase the number of hotel bookings. A 10 % improvement in reviewer rating increased sales by 4.4%. Additionally, variance/polarity of word-of-mouth for reviews had a negative impact on sales volumes. A 10% increase in review variance decreased sales by 2.8%. Ye et al (2009) found hotels with higher star ratings received more online bookings, but room rates had a negative impact on the number of online bookings. Finally, the GDP (CityRank) of the host city had a positive impact on online bookings. In summary, Ye et al (2009) found online consumer-generated reviews having an important impact on online hotel bookings.

Two studies detail hotel quality and appraisal on the Internet. Cunningham et al (2010) compared TripAdvisor.com review ratings of Irish and Las Vegas hotels from 2007-2009. They found an improved rating for Irish hotels but not Las Vegas hotels. The reason Cunningham et al (2010) state for this finding is that the Irish hotel sector is a relative newcomer to Trip Advisor whereas the Las Vegas sector is mature. So, Las Vegas hotels will already have improved service levels reacted on customer feedback from online reviewers, unlike Irish hotels. In the second research, Fernández-Barcala et al (2010), compared star ratings for 744 Spanish hotels on sales websites (fee financed) such as booking.com versus advice websites (advertising financed) such as TripAdvisor.com. They showed sale websites provide an assessment quality of hotels on average 7% higher than the equivalent assessment of advice websites. This difference was found to significantly increase with hotel category, with a 9% increase found for 5-star hotels. These results show that there are systematic differences in quality appraisal between the two difference types of information providers.

In terms of analysing the effect of gender and/or age of reviewer on consumer travel purchase intention, this review revealed one existing study by Kim, Lehto & Morrison (2007) relating to gender differences in information seekers' attitude towards information channels and their search behaviours in the online travel environment. Kim, Lehto & Morrison (2007) found women more positive towards website functionality than men, searched using different keywords, used both online and offline information sources and become more involved in the online search process. So, further research could pinpoint gender and/or age-based differences in information search on travel online review sites.

Future research may also pinpoint gender and/or age differences in hedonistic versus utilitarian travel product searches online. Smith et al (2005) examined the effects of online peer versus editorial recommendations, trust and choice in virtual markets. Smith et al (2005) differentiate between utilitarian and hedonistic product types. Smith et al (2005) propose when shopping goals are utilitarian, consumers will rely on peer recommenders' level of expertise as a cue to judge trustworthiness. Conversely, when shopping objectives are hedonic, consumers will rely on level of perceived rapport or closeness shared with the recommender to judge trustworthiness. Smith et al's (2005) findings showed many online consumers seek and accept recommendations in order to effectively manage the amount of

information available during the online search process. In terms of travel-based online reviews, Smith et al (2005) and Sen & Lerman (2007) could prove useful in determining differences in holiday product type (hedonistic versus utilitarian travel needs). From Smith et al (2005) perceived rapport and similarity between reviewer and consumer may play a role in a consumer's strength of purchase intention. So it would be interesting to explore, which elements of the reviewer profile consumers share a high level of trust or rapport with? Does same gender, nationality or similar age impact on the consumer's strength of purchase intention? This is a substantial gap in both the mainstream consumer behaviour and online travel research.

Country of birth /origin cues have been researched and show how consumers are often positively biased in their evaluations in favour of domestic products versus foreign alternatives (Verlegh , 2007) From this perspective, we might expect Trip Advisor reviewers to review home country travel offerings more positively than foreign alternatives and for this bias to be evident in consumer attitude too. In their cross-cultural analysis of travel service consumer evaluations, Crotts & Erdmann (2000) found significant differences between respondents' evaluations dependent on the respondents' country of birth. Differences related to country level of masculinity or femininity from Hofstede's (1980) Value Survey Module (VSM). The research used tourist in-flight and airport surveys from respondents with 5 different "countries of birth" i.e. the United Kingdom, Brazil, Taiwan, Japan, Germany. The sample was split into; high masculinity (Japan), middle masculinity (UK, Germany) and low masculinity (Brazil and Taiwan). Findings showed respondents from high masculinity countries (Japan) raised more complaints about airline and airport facility quality, had lower evaluation scores and more often sat in business or first class on the aircraft than respondents from medium (UK, Germany) and low masculinity (Brazil, Taiwan) countries. So, firms who serve visitors from masculine countries where assertive behaviour is encouraged should expect lower average satisfaction measures when compared to visitors from more feminine countries. The VSM (Hofstede, 1980) contains four further scales a) power distance b) individualism c) uncertainty avoidance d) long-term orientation. These national culture dimensions could also affect consumer online review ratings, so future research could pinpoint differences in consumer reviews and consumer attitudes to purchase travel services that fit the Hofstede (1980) dimensions.

Table 2 summarises some potential future research propositions, based on the literature reviewed in this paper. Propositions 1-9 largely summarize existing research findings, whereas proposition 10- 17 represent potential new research ideas. Many of these new research directions were first proposed by Vermeulen & Seegars (2010, p. 127) and Litvin et al (2008, p. 466).

Table 2: Propositions for Future Research

<i>Proposition Number</i>	<i>Proposition</i>	<i>Research referenced</i>
1	<i>Positive online travel reviews will yield positive consumer purchase intention</i>	<i>Vermeulen and Seegars (2010), Ye et al (2009)</i>
2	<i>Negative online travel reviews will yield negative consumer purchase intention</i>	<i>As 1 above</i>
3	<i>Exposure to positive reviews increases consumer purchase intention more for lesser-known hotels than for well-known hotels</i>	<i>As above</i>
4	<i>Exposure to the online reviews increases hotel awareness</i>	<i>As above</i>
5	<i>Hotels with higher star ratings will result in more positive consumer purchase intention</i>	<i>As above</i>
6	<i>City/ Regional GDP will impact positively on consumer purchase intention</i>	<i>As above</i>
7	<i>Price of room will impact negatively on consumer purchase intention</i>	<i>As above</i>
8	<i>Consumers will use sales websites and advice websites for different purposes in their online search process</i>	<i>Cunningham et al (2010), Fernández-Barcala et al (2010)</i>
9	<i>Consumers will trust advice websites (such as Trip Advisor) more than sales websites (such as Booking.com)</i>	<i>As above</i>
10	<i>Male consumers will show greater purchase intention than female consumers when solely one source of information is provided during the information search process</i>	<i>Kim, Lehto &amp; Morrison (2007), Vermeulen and Seegars (2010)</i>
11	<i>There will be a positive correlation between same gender (male or female) of both the reviewer and consumer and positive purchase intention.</i>	<i>Sen and Lerman (2007), Smith et al (2005)</i>
12	<i>There will be a positive correlation between similarity of age of both the reviewer and consumer and resulting consumer purchase intention</i>	<i>As 11 above</i>
13	<i>The strength of purchase intention may be moderated by differences in product/ service type (hedonistic versus utilitarian).</i>	<i>As 11 above</i>
14	<i>There will be a positive correlation between consumer purchase intention and similarity of location (country) stated in the profile of the reviewer and the consumer's country of birth</i>	<i>As 11 above</i>
15	<i>Consumers will be more positive towards consumer reviews for home country travel offerings (such as a hotel room) than for foreign country alternatives</i>	<i>Verlegh (2007)</i>
16	<i>There may be a relationship between national country differences in the star rating level and nature of consumer review, dependent on the reviewer's nationality. The effect on consumer purchase intention might be either positive or negative.</i>	<i>Crotts &amp; Erdmann (2000), Hofstede (1980)</i>
17	<i>There may be a positive relationship between consumer purchase intention and similarity of cultural dimension(s) Hofstede (1980) of the reviewer's home country and the consumer's nationality.</i>	<i>As 16 above</i>

## Conclusion

This literature review used TripAdvisor.com as it's' research focus, and pinpointed substantial research gaps in our current understanding of consumer review websites. Some research gaps are summarised in Table 2 above. The paper highlights the role of demographic reviewer profile, such as gender, age and nationality cues on strength of valence (positive and negative) perception of the review and reviewed. The paper also shows how national cultural dimensions, can play in information search strategies and actual reviewer ratings on online travel review websites. Further, the literature review has revealed eWOM and social networking sites being of increasing importance to both travel and tourism industry and firms in general. Understanding more about attitude towards reviewer profile can help form a basis for future research into the growing size and role of such social networks.

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## A COMPARATIVE INQUIRY INTO CSR PERCEPTIONS AND PRACTICES OF OWNER-MANAGERS AND PROFESSIONAL MANAGERS

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### Abstract

This research contributes to the literature regarding the similarities and differences of professional managers and owner managers in terms of their corporate social responsibility (CSR) perception and practices. The sample is composed of 60 top executives from the largest Turkish companies. Stratified random sampling method is used. In depth interviews, archival documents and observation techniques are used to gather data. The findings indicate significant differences between owner managers and professional managers along CSR perception and practices. The latter having a certain consciousness of CSR, tend to perceive it as an instrumental issue, as other managerial tools, often without culturally oriented values. The owners, on the contrary, present a variety of attitudes toward CSR. However this variety in perception and practice is basically observed in the case of male executives. No perception difference could be detected when female owner managers and female professional managers are contrasted. They usually appeared to be more sensitive to CSR issues independent of the fact whether they are owner or professional.

**Keywords:** Professional managers, corporate social responsibility

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### Theoretical Background

Business organisations are increasingly expected to contribute to community and society in which they operate alongside their primary contribution of adding value to economy through wealth generation and employment. Particularly as firms grow in size and influence, they are expected to reconcile and skilfully balance multiple bottom lines; meet the demands and interests of multiple stakeholders and develop capability to act more independently as moral agents (Jamali, 2006; Jamali et al. 2008; Tengblad and Ohlsson, 2009). Discussions about the expectations from the firms are elaborated within the framework of corporate governance



(CG) and corporate social responsibility (CSR) which are characterised by a wide range of conceptual definitions. Explicit definitions of those key terms are therefore important. Corporate governance is defined as “the system by which companies are directed and controlled” (Cadbury, 2000:8) from an enforced system and accountancy perspective (MacMillan, Money, Downing and Hillenbrad, 2004; Jamali et al., 2008). This is a rather narrow approach to defining corporate governance that highlights its normative aspect. As noted by Aguilera, Desender and Kabbach-Castro (2011), corporations, irrespective of the legal constraints imposed on them, have significant degrees of freedom to choose whether to implement different levels of a given corporate governance practice depending on their labour and product markets and the frameworks of the financial markets with which they co-exist.

An in-depth exploration of internalisation of governance practices can be achieved by approaching the topic from a ‘process-relational perspective’ (Shotter, 2006) that calls for an emphasis on understanding and managing relationships between different stakeholders. In this view governance is defined as a chain of relationships that encompass a range of policies, strategies that executive managers and directors develop and implement in order to manage themselves and fulfil their responsibilities to internal and external stakeholders (McNulty, Roberts and Stiles, 2005). Similarly, for Huse (2005), stakeholder perspective (e.g. Freeman, 1984; Clarksson, 1995; Jones, 1999) is not new to the study of organizations in general and to that of corporate governance and social responsibility in particular. The so-called ‘process-relational’ approach does more than doing justice to the emphasis on stakeholders. This view highlights three key elements of governance: First is corporate leadership and hence strategy development and implementation. Second is integration of stakeholders into the equation. Third is its multi-layered nature: the antecedents and impacts of corporate governance operate at multiple levels (Judge, 2011). Leadership and strategy development aspect has significant bearings on the exercise of power and decision making in an organisation. Leadership is instrumental in moving organisations forward toward a long-term vision of the corporation, while according due regard to their responsibilities towards stakeholders (Mallin, 2005; Jamali et al., 2008). Business leaders are responsible for using power, autonomy and discretion that they possess to produce fair and generous outcomes for their various stakeholder groups. Therefore, deeper investigations about different groups of business leaders are needed to further shed light to our understanding of CSR. The relevance of business leaders in corporate governance and CSR induced us to compare the CSR perception and practices of owner CEOs and professional CEOs to have a better understanding of the topic.

### **Strategic leadership**

Although strategic leadership in general and CEOs in particular are well studied topics, CEOs are usually treated as a single category regardless of his/her kinship ties. However, there might be significant differences between family and non-family CEOs. Poza et al. (2004)

found that perception of managerial practices of family CEOs were different than that of the rest of the family as well as non-family executives. According to modernization argument, professional managers are better equipped because of their technical managerial knowledge, skills and tools they possess to run business enterprises more efficiently and effectively (Church, 1993; Scott, 1997). In Turkey, professional managers appear to have a higher education level compared to owner CEOs (Yamak and Üsdiken, 1997; Yamak, 2008). In general Turkish top executives in private sector are found to have a high level of education (Yamak, 1998; Yamak & Üsdiken, 2006). However, better education of the younger generation family members who typically occupy CEO position is also becoming common along with their long experience in the family business starting from early ages (Alpander, 1966; Buğra, 1994). The background differences of owner managers and professional managers may influence their CSR perception and practices.

A growing body of literature looks into perceptions and practices of owner-managers in the area of social responsibility and highlights significance of owner-managers in developing and implementing CSR, particularly in SMEs (e.g. Jenkins, 2006; Murillo and Lozano, 2006; Perrini, 2006; Russo and Tencati, 2008; Del Baldo, 2010). There is a dearth of studies, however, examining perceptual differences between owner-managers and professional managers. One particular study conducted by Tafel-Viia and Alas (2009) has analysed such differences as source of conflict in the context of Estonian SMEs. The authors argue that the focus of emphasis differs for owner-managers and professional managers mainly due to their different roles in the organization. Owner-managers tend to develop and use CSR as a strategic tool in order to relate to certain interests groups and stakeholders such as state, politicians, media and public opinion, whereas professional managers focus on other stakeholder groups such as suppliers, customers and employees.

Our study has explored perceptual differences of owner-managers and professional managers pertaining to CSR strategies and practices in the context of the largest Turkish companies. Turkish business context is dominated by the family business holdings which grant to owner managers a privileged position. However, as companies grow in size and go through generations of owners, a community of professional managers also emerges. Therefore, it is worth investigating the relative perceptions and practices of both owner managers and professional managers to have a better view of corporate governance and corporate social responsibility in an emerging country context.

### **Corporate Social Responsibility**

CSR is often considered to be a new mode of governance, which can overcome the weakening of legal frameworks whose applications are usually confined within national boundaries (Bethoux, Didry and Mias, 2007). This weak legal structure brings about the fact that managerial discretion and decision making become important factors in designing CSR

policies. Therefore, it is worth understanding how owner managers and professional managers perceive and practice CSR.

CSR is not a new concept and it has been defined and discussed from various angles. Carroll's (1979, 1981, 1999) definition of CSR has been often cited and applied in the field. In her classic article, she has argued that "the social responsibility of business encompasses the economic, legal, ethical and discretionary expectations that society has of organizations at a given point in time" (Carroll, 1979, p. 500). Drawing on Carroll's aforementioned four pillars of CSR, Wood (1991), for example, has suggested CSR principles of social legitimacy (institutional level), public responsibility (organizational level) and managerial discretion (individual level). Business for Social Responsibility (2001) defines CSR as socially responsible business practices that are aimed to strengthen corporate accountability, respecting ethical values in the interests of all stakeholders. The underlying philosophy is to improve the quality and opportunities of life by empowering people and invest in communities where a business operates. European Commission's (2006) definition echoes this view and adds the voluntary dimension to the definition. CSR is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis (EC, 2006). CSR is defined, for the purposes of this study, as the organisation's commitment and active response to issues beyond the narrow economic, operational, legal and ethical requirements of the business (Carroll, 1979, 1991, 1999); it is the organisation's evaluation of the impacts of its decisions and activities on the internal and external social system in a way that will ensure social benefits alongside the traditional economic gains (Matten and Moon, 2008; Argandoña and Hoivik, 2009). This expanded notion of CSR differs from a conventional understanding of CSR in terms of philanthropy, and from a normative perspective on CSR that places emphasis on compliance with standards relating to corporate behaviour (Epstein, 1987; Deakin and Whittaker, 2007), and from that of the market orientation perspective (Brik, Rettab and Mellahi, 2011) that insists on the relationships between CSR and the firm's increasing competitive advantage as a consequence of serving effectively to its customers as a dominant group of stakeholders. Hancock (2005) suggests four pillars of CSR as strategic governance, human capital, stakeholder capital and environment. His argument is centred on the notion of value creation, which is contingent upon leveraging human, stakeholder and environmental capital through good strategic governance. CG and CSR are organically related in this view, which is consistent with the findings of Elkington (2006) and Jamali et al (2008), who claim a salient two-way relationship between CG and CSR.

Departing from the premise that CG and CSR are intricately connected, in this paper we seek to explore the perception and practice of CSR by both owner managers and professional managers as a governance tool in managing relationships between different stakeholders through a qualitative study in the Turkish context. More specifically, we address the following research questions: How do the owner managers and professional managers

perceive and practice CSR? What are the reasons behind the possible convergences and divergences between these two groups?

A central contribution of this study is to show the significant difference between owner managers and professional managers in the perception of corporate social responsibility. The position of the manager vis-à-vis the capital is an important indicator to of his/her notion of CSR. On the other hand, the size and the historical background of the firm plays also an important role to determine the manger's attitude which varies on a continuum, going from a lack of the notion of CSR to the highly institutionalized practices referring to a certain macro view of the society.

The idea that we, as scholars, are charged with the responsibility of generating and disseminating useful knowledge generated through an active engagement with, and study of, real organisational issues and phenomena is gaining increasing recognition in academic spheres (Kilduff, 2006; Van de Ven, 2007; Vermeulen, 2007; Sandberg and Dall'Alba, 2009; Ozbilgin, 2010; Corley and Gioia, 2011; Sandberg and Tsoukas, 2011). This accounts for relevance to practice in a much more substantive manner. The investigation of CSR perception of different groups of business leaders may have important practical implication by providing useful hints on how to improve CSR understanding and practices. The findings delineating different patterns of perception and practice on the part of owner managers and professional managers may help companies in their design of CSR policies by clearly showing the possible shortcomings and advantages of the perceptual differences between the two groups.

In the next part, we will explain the research process with associated methods of data collection and analysis which is followed by the section covering research findings. Last, there is discussion of the findings.

## **Research Methodology**

The sample of the study was drawn from the owners and the managers of the largest 500 Turkish companies ranked by the Istanbul Chamber of Industry. A total of 60 interviews were conducted. Since we were keen to have a representative sample of Turkish business elites covering the whole country, a stratified random sampling was used. For this purpose we have taken into consideration the regional breakdown of the largest 500 companies in Turkey and the sample included top managers from both rising and declining regions in Turkey. Our sample included companies from 3 main zones as identified by Pamuk (2008) and also the remaining periphery zones. Thus, the proportion of the largest companies in different regions was taken into consideration by using stratified random sampling. About 45 percent of these companies originate from Istanbul and the remaining 55 percent from the rest of the country.

This is an exploratory study which assumed an interpretive paradigm. An interpretive qualitative study consists of a research design involving the exploration of a research topic or

theory rather than being a test of it (Myers, 2009:23). We gathered a triangulated qualitative data set, including interviews, non-participant observation, and documentary searches (Eisenhardt, 1989) during this study. We developed our semi structured questionnaire based on literature and feedback from pretesting. A total of 60 in depth interviews were conducted with one of the key informants with executive roles such as CEO, chair or vice chair of the board in each company. Respondents were ensured that their responses would be kept strictly confidential and they would only be used for scientific research. At least two researchers were present in each interview except for two cases. Interviews lasted typically two to three hours, of which 58 were audio taped. Only in two cases we were not allowed to tape-record and we took detailed notes during the interview. Field notes were taken independently by each researcher on the observations. A wide range of archival documentary materials were collected regarding each interviewee and his/her company. Furthermore, through observation (offices, building, etc) extensive notes were taken about the symbols. The data was collected starting from October 2009 up to October 2010. Discourse analysis is conducted to analyze the data.

For the analysis we build up codebooks as suggested by Boyatzis (1998). We have provided labels and long descriptions for each code. We have prepared a list of inclusion and exclusion criteria for each label and identified typical and atypical examples as described by Bernard and Ryan (2010). For reliability two different researchers independently coded the data. The interrater reliability was around 83 percent. When an agreement could not be reached among the two researchers the theme was dropped from analysis or reconstructed until arriving to full agreement between the researchers (Boyatzis, 1998). By using NVIVO 9, we have developed profile matrices which contain measurements of variables for a set of items.

Top managers are differentiated in this study depending on whether they have a kinship tie with the owner/founder of the company. Top executives who possess ownership stakes in the company or those who are relatives of the owners and/or founders are taken as owner managers. Family membership included both the immediate and extended family such as the spouse, children, grandchildren and siblings of the founder(s), spouses of their children, grandchildren and siblings, nephews and nieces of the founder(s) and spouses of these as well as the cousins and their spouses. Professional managers are defined as top executives who do not possess any kinship link with the founder/owner family.

## **Research Findings**

The findings of the discourse analysis display differences at both inter and intra group level between owner managers and professional managers. Based on the findings of the discourse analysis, we tried to construct a typology of CSR awareness and practices along a continuum which gathers different tendencies among owners and professional managers. This enabled us to compare them as main categories, but also along their inner varieties. Both extrapolations seem to have a crucial functionality for a better understanding of, not only

CSR practices, but also, the significant discrepancies between the perceptions of the very concept of CSR itself. Indeed, as it is shown below, before finding out different projects and values underlying them, we have noted that there exists a series of differences among business elites, on the conception of the CSR. The CSR perception of the owners and the professional managers seem to differ considerably from each other. Differences do not only appear at the perception level, but also in the level of involvement into CSR projects. The mentality of the owner appears to be entirely identified with his/her capital and capitalistic posture. The professional manager, on the other hand, identifies him/herself with the activity and rationale of managing.

### **Owner managers**

Most intriguing finding in the owner managers group was the absence of the CSR notion in some interviewees. Indeed, some of them had a certain difficulty to understand the concept when pronounced as such or reformulated differently, if not totally misunderstood it. When those who take CSR as inner organizational activity of the firm (in form of a system of mutuality at best, or as an ad hoc obligation pragmatically-driven by external pressures, such as requests coming from the public political actors, particularly the local ones) is added to this first cluster of those who are totally unaware of CSR, we can tell that a not-negligible part of business elites do not agree upon the definition of a CSR. But this ignorance of CSR was only observed in the case of owner managers. Professional managers seem to be more familiar with the concept, though they act differently in accordance to their managerial policies. Therefore, there are, significant discrepancies between the two groups about the CSR awareness. Although a few, some of the owner managers appeared really unaware of the concept and did not seem to have an idea about what CSR meant. However, one of the CEOs in this same group was able to lead a sound discussion on debates related to CSR and even capable to name major thinkers in the field such as Friedman.

Owner managers display variance in terms of CSR perception and practices. On the one end of the continuum there are owner CEOs who are unaware of the CSR concept. Next comes those who define CSR as *“providing what municipality asks from us”* Male, 51 yrs, owner of a large industrial firm. The same person stressed the *“need of getting along with the municipality which otherwise may make life hard for the business”*. He told that he constructed a basketball play ground for the municipality upon request. Same comment was repeated by several others as well. So, for this owner managers group, CSR is perceived as a tool for easing the life of the firm through networks with local regulatory institutions. So it is instrumental. There is not an awareness of and sensitivity to different stakeholders. For example, downsizing is perceived as a necessary and useful tool to safeguard profits without considering the responsibility to employees. This “low awareness” group’s CSR activities are also characterized by unsystematic efforts about what is considered as CSR. The activities are performed as request arises. There is no institutionalized pattern or department or team about CSR.

Next point on the continuum is composed of the owner managers who display sensitivity to stakeholders within the limits of their interests. *"We started the restoration of an old mosque from Seljuk period"* Male, 54 yrs, owner of a large industrial firm who also collects antiquities. *"In the production of the feed for our animals, we collaborate with the local farmers by bearing all the costs. So this is rather social activity"*. Male, 54 yrs, owner of a large industrial firm and animal farm.

Further ahead on the continuum, we see first generation owner CEOs aiming to contribute to society. These are among the new elites who appeared after the adoption of liberalization program in 1980. They are usually personally and highly involved in CSR activities along different lines. This is a self actualization for them. *"My mission is to satisfy the needs of masses at macro level. I expect also my son to serve humanity by fulfilling another unsatisfied need"* Male, 40 yrs, Owner manager of a large industrial company. The focus of these owner managers is on macro issues which involve the whole society and not only the small surrounding. *"My mission is to improve the conditions of women in Turkey. I devote considerable time to these activities by activating different chambers of commerce, universities and NGOs in different cities. I organize my business along this mission"* Female 59 yrs, owner manager of an industrial group.

The very end of the continuum is composed of second generation owner CEOs. *"My mission is to prove that succeeding in business and preserving values may coexist. I have inherited from my father a value system along with a business. I define our company not by its products and services but by its values which I try to preserve. Contributing to the community is a must"*. Male 61 yrs, Owner manager of a large family holding. In that case the CSR perception is value-based. Ethics is very much emphasized. The same owner manager affirms that his company invests only in the sectors where ethical behaviours do not harm competitive position, and quits the industries which are subject to unethical behaviours. Such owner managers are actively involved with CSR activities along different lines such as education, arts and sports. These are institutionalized and systematic activities. The owners are also personally involved in the projects which create for them an opportunity of self actualization.

It is also observed that the presence of a social entrepreneur within the previous generation (father, grandfather and grandmother) is a common characteristic for this type of owner managers. Although CSR seems, at first sight, as a pragmatically-oriented activity, the rational use of it, necessitates, nevertheless, a cultural acquisition of the CSR as attitudes and activities. When conceived and lived as a trans-generational practice, CSR becomes rather as a part of a habitus. This is also the passage of the CSR notion from the traditional obligations to political strategies. Arts seem to be most frequent topic in this group which is followed by education.

Owner CEOs and their families are usually the final decision-makers about the CSR activities. Furthermore, some of the owner managers affirm explicitly, and mostly proudly, this fact of being the sole or final decision-maker, and there seems to be a naturalized form of

domination, linked to a traditional, if not feudal, conception of autocratic management. Thus, CSR becomes, in such context, the exclusive grant of the well-intentioned boss. Consequently, the choices made by these autocratic managers are products of their own interests and conception of CSR.

### **Professional managers**

Contrary to owner CEOs, all the professional CEOs seem to be aware of the CSR discourse. On the other hand, professional managers tend to perceive CSR as a marketing or reputation management tool. They are very much business-oriented and perceive CSR as a tool to avoid regulatory pressures, to improve company reputation and to increase sales. This is consistent with the growth focus of the professional managers. In fact, several researchers point to managers' preferences for growth (Amilhud & Lev, 1981; Bethel & Liebeskind, 1993) to advance their future career alternatives. Therefore, professional CEOs are more inclined to consider micro-issues at firm level as possible CSR topics.

If we try to locate on a continuum different types of professional CEOs in terms of their CSR perception and practice, at the one end, we see the most institutionalized and systematic CSR activities related to *reputation management*. Indeed, this tendency is observed as a generalized underlying idea. Nevertheless, this kind of manager for whom CSR activity is exclusively based on the need to promote the reputation, prioritizes CSR activities as tactical issue. Yet, s/he perceives them as an obligation rather than a well-rationalized managerial conception. This obligation mostly appears as a transposed extension of traditional/religious imperative (helping the poor, expiating the commercial gain), into relatively more contemporary capitalistic circumstances. The most important aspect in the eyes of the manager, seems to develop a fully pragmatic schema of survival in social-political conditions where CSR is one of the best ways to keep the capitalistic activity functioning. Apparent motives differ, but the underlying motivation is the same.

This group is followed by the professional CEOs who perceive the CSR as a *marketing tool* to increase the sales of different brands. Activities are directly associated with the brands and products. Given that professionalism inevitably necessitates a highly rationalized conception of business, converting every single activity related to work, into profit-generation possibility, the professional managers tend much more strictly to conceive CSR as a growth opportunity for the firm. This will also strengthen the relatively precarious position they occupy, in comparison to that of the owner manager who is well anchored to his/her capital.

Next group is the professional managers who act within *logic of balance*. They admit that they pollute the environment and to balance the harm caused by their activities they initiate environmental activities such as planting trees, etc. This group can be, in a sense, conceived as an ideal-type representing the ever-existing unconscious or hidden idea that the industrial activity, anyway, creates a social, and mostly ecological harm, which is engraved into the mind of the entrepreneur. As the most explicitly formulated attitude concerning this



structural particularity of the industry, the logic of balance perceives CSR as a mechanism of compensation, while trying also, if possible, to derive from it, a certain material and non-material gain, this, on the other side, could help to support the firm's social reputation. The most characteristic aspect of such attitude is the fully instrumental perception of CSR.

The next typology in our sample of professional managers is the *enlightened manager* who confesses his own previous unconscious behaviours regarding different stakeholders (often the natural environment) and takes corrective action. They usually think and act within the framework of the company or its close surrounding. So they are mostly focused on micro issues.

Macro thinking is relatively limited in the case of professional managers. It is only observed in a very limited number of cases where the professional manager tried to improve industry in one region. Moreover, they arise as fully conscious actors, in relation to CSR notion, values and practices. They usually adopt CSR for macro-level social-political involvement, in any case hold a *wide vision of society* implying an historical responsibility toward it. These professional managers display strong social entrepreneur characteristics. They are not capital owners but they are among the founders of their respective companies.

Due to the dominance of family businesses in Turkish business life, the fact that the owner managers continue to be the major decision-makers limits the power of professional managers (Yamak, et al., 2006). Similarly, in the decisions regarding the CSR activities owning family members are among the major decision makers. Therefore, professional managers seem to have limited discretion on CSR activities too. This fact may further induce them to perceive CSR as a PR or management tool rather than a system of thinking.

An interesting finding of the study is about the female top managers. Being an owner manager or a professional manager does not make any difference in the CSR perception and practice of female executives. Both groups seem to be equally aware and very sensitive to CSR issues. Women managers display a variety of CSR activities integrated also with their business activities.

## Discussion

The evidence derived from our field research depicts variations in the perception and practices of CSR activities among top executives. As is well-known, corporate social responsibility is not only the philanthropic initiatives, but also a series of values and actions conjugated in terms of these values. Our study enables us to constitute a typology in relation to strategic leadership and CSR. The concept of CSR presents a vast variety of uses and perceptions. At the basic level, we observed that an important part of the managers do not even have the notion of corporate social responsibility. Certain others, on the contrary are not only fully aware of the CSR notion, but they derive a macro vision of society from it. Therefore, measuring the CSR values and practices confirms the existence of traditional and

autocratic management forms. However, there are also multiple ways, meanings and expectations of CSR. The most apparent finding of our research is the significant difference between owner managers and professional managers. The latter having a certain consciousness of CSR, tend to perceive it as an instrumental issue, as other managerial tools, often without culturally oriented values. The owners, on the contrary, present a variety of attitudes toward CSR. We should note, in this context, that the cultural capital owned and mastered by the manager plays a crucial role in developing a long-range policy of CSR, along with the expansion of the economic capital. Consequently, as the firm gets older through generations and adopts a tendency to increase its capitalistic capacities toward a global market, the CSR policy becomes systematic, rational, not traditionally-determined (e.g. supporting the poor because of a religious motive), and it assumes the mission of designing the country's socio-economic scope. In other words, when sufficiently uprooted and well-established, a capital group not only constantly generates pertinent and continuous projects, but it also aims to be an intervening force into the national politics, by mostly indirect forms. Thus, in such case, CSR projects and the values linked to them, are functioning on a higher register than the ordinary philanthropic activities held by the economic actors. This can be perceived as a form of doing politics without concretely entering in the domain of the *realpolitik*. Therefore, CSR applications are over-passing the corporate or managerial objectives, and of course the traditional acts of social assistance, to become a way of political involvement without being the part of established politics. Paradoxically, the less the firm adopts macro-policies of CSR, and pretends avoiding doing active politics, the more it is subjugated to the direct oppressions of the political actors who demand the satisfaction of various local public needs.

The degree of consciousness observed in professional managers should be understood, not in terms of personal interests or cultural dispositions, but rather, of the fact that they are situated at relatively precarious positions, even when they are considered as pillars of the firm, in comparison to the owner, who is the explicit representative of the capital. The difference between owners and professionals is also a matter of identification with the business. In other words, as professionals are ideologically identified with the capital they manage, but, in most of cases they do not possess it, nor they have not the underlying control of it, but the symbolic use of it, they always appear as well-equipped and highly rational individuals. Consequently, CSR is conceived by the professional managers always as a rationally taken and instrumentally used asset, while owner managers present a much more varied set of motives in their involvement with the CSR notion and values.

As a not-too-surprising result is the gendered situation of CSR in the business world. Indeed, without meaningful differences between owners and professionals, women managers seem to have developed a visibly more multi-faceted and sincere sensibility to social issues, which are, in their business practices, transformed, as far as it is possible, into well-interiorized values related to the social consequences of the work they do, and, of course, a

series of projects with which they seem extremely identified. Here, we observe a dramatic difference between men and women managers, at the degree of self-devotion to the concept and practice of CSR. Once again, we notice that women, irrespective of capital ownership, can develop a strong sense of social responsibility. This is of course due to the fact that womanhood is deeply engraved into their minds, so that they act not only business-oriented persons, but also as highly gendered individuals who import their gender roles (female roles associated with protective and organizational attitudes) into their business, even in a highly male-dominated field. Nevertheless, it is also possible to decipher the same fact from the opposite side, while emphasizing that women managers are encircled by two main sources of pressure: (1) Surviving in a male-dominated field through the obligation of being equal to the men's performance; (2) being better than men in their job to surpass the stereotyped perception of women in powerful positions. This leads them, in our view, to take initiatives for social responsibility, and frequently for the improvement women's social status.

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## DOES FREEDOM LEAD TO HAPPINESS? ECONOMIC GROWTH AND QUALITY OF LIFE

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### ABSTRACT

The preoccupation with economic growth has not led to increase in happiness in the developed world. While it has increased the standards of living, by some measures, it has also increased crime and incarceration, substance abuse and the erosion of social capital, it fuelled the fast food and sex industries, and led to the largest financial and economic crisis since the beginning of the previous century. The current crisis has also revealed another problem: the developing world is financing the developed world, than the other way around, through investments in government bonds of the developed economies. Modern technologies and contemporary organizational structures have created a unique capacity for increasing consumption power through economic growth. However, we do not seem to be concerned with producing those things worth consuming with the economic power so created.

The work of Nobel Laureate Amartya Sen on Development as Freedom showed us a positive way for economic growth through the expansion of instrumental freedoms. However, the economics of happiness have also shown us that people cannot always choose what will make them happy, at least in the long run. Is there a paradox? And if not how is this apparent paradox resolved? These two questions are addressed in this paper.

### NINJA Lessons

In his ironic novel *Blindness*, Jose' Saramago tells the story of a man who succumbs to white blindness while waiting in his car for the traffic light to change. He visits an ophthalmologist who does not know what to make of the case – and goes blind himself as he is studying his textbooks. This marks the beginning of a white blindness epidemic. The government interns the blind and those who came in contact with them in a lunatic asylum to contain the epidemic, but to no avail. A utopian organization of the community of blind is developed where all hitherto known norms of behavior break down --- until people start to see again, as suddenly and unexpectedly as they went blind. Life returns back to normal – but does it really?

An epidemic of white blindness might as well explain the financial crises of 2008 and the worst economic crisis it provoked since World War II. How could nobody see the dangers

lurking when something as noble as a mortgage-backed security --- a financial instrument that allowed banks to raise capital and give out mortgage loans so people could put a house over their heads --- mutated into NINJA loans and caused a housing bubble to grow and then to burst.

NINJA, in this case, is not the team of anthropomorphic mutated teenage turtles of Mirage Studios and Nickelodeon. NINJA stands for “No Income, No Job, No Assets” and refers to mortgage loans given to individuals that had no income, were unemployed and had no assets to put as collateral. These loans were highly risky of course, and when issued in large quantities provided cheap credit that fueled a housing market bubble. When the bubble burst the banks found themselves with a large portfolio of “sub-prime” loans: loans for a house worth much less than the value of the loan itself. Several prominent institutions worldwide were driven into bankruptcy or were bailed out using taxpayers money. The magnitude of the bailout taxed several national economies and increasing budget deficits or national debts to unsustainable levels. In the most severe case of national distress, Iceland saw all three of its major commercial banks going into bankruptcy, the stock market index dropping by 76%, and the krona declining more than 35% against the euro. An extensive account of the crisis is given in (Krugman, 2009; Roubini and Mihm, 2010).

What are the mechanisms at work that could lead to such catastrophes? The process starts with a set of loans given out to individual homeowners. A prudent bank will ask for collateral of, typically, 20% of the value of the property. A homeowner who wants to purchase a 100,000USD apartment has to put down 20,000USD and get a loan for the remaining 80,000USD. The down payment serves several purposes. First, it holds the borrower responsible for the property as the house is bought in part by his or her savings. Second, it provides a security cushion for the bank. That is, if the market prices drop and the homeowner stops paying the mortgage loan and walks away from the house, there is still enough value in the property to recover the amount of the loan. Only if prices drop by more than 20% the bank will lose its own money.

But the story does not stop here. Banks do not hold these loans on their balance sheet. They pool loans together, securitize them in what are known as *mortgage-backed securities* and sell these securities to investors, such as pension funds, insurance companies, investment banks and so on. The investors receive interest on these securities equal to the interest paid by the homeowner on the loan (minus the banker’s service fee) and also benefit from any market price appreciation in the value of the security. By selling the loans the bank now raises more capital and can give out more loans. These noble ideas originated in the US, especially from agencies such as FannieMae and FreddieMac and financed successfully the American dream of home-ownership (Zenios, 2007; Fabozzi, 1988).

But the story does not stop here either. Investment banks, who bought some of these mortgage backed securities, realized they could extract more profits out of them by first



pooling several securities together and then slicing them up into tranches of different riskiness: a low-risk tranche receives priority payments from all the mortgages in all the pools, while a high-risk tranche has low priority. There is usually a tranche of intermediate riskiness, known aptly as *mezzanine*. Hence, if a few mortgage owners default the low-risk tranche will still receive all its payments. Of course the risky tranche will lose every time a homeowner defaults and hence it is more risky than the average mortgage backed security. These tranches are known as *toxic products*. With this slicing the investment banks would allow investors in mortgages to assume more or less risk than the average mortgage in the pool --- based on their risk appetite --- by buying the high-risk, mezzanine or low-risk tranches, respectively.

Nothing wrong so far. These financial innovations fueled a significant growth in the mortgage market and allowed home ownership in the United States (and other countries who adopted similar innovations) to be much higher than countries where no such facilities were available. These are noble goals indeed. They were made possible using advanced models from financial engineering to design these products, such as those described in Zenios, successful marketing from the banks, and absence of government regulation to restrict such innovations (Allen and Gale, 1994).

But then things did go wrong. The thinking was that banks would keep the toxic products on their own balance sheet, hence having an incentive for close monitoring the underlying mortgage loans for their riskiness. However, the banks found out that they could offload these products to investors as well, simply by offering a high enough rate of return. Once this was done all the risk from the originated mortgage loans was passed on to investors outside the bank. The banks lost any incentives for careful monitoring the risks, and focused on maximizing the revenues from loan origination. How do you do this? By giving out more loans: if the loans pay back you win, if they default someone else loses. Voila---recipe for unlimited profits! The alchemists of Wall Street discovered the philosopher's stone. The banks started going after every possible borrower, giving NINJA loans and offering a no-payment start up period conveniently known as *teaser* to overcome the resistance of even the most hesitant borrower. (There were other innovations involved in bringing about a crisis of such magnitude, such as excessive leverage, unregulated shadow banking and unsuitable CEO compensation policies, but the essence is captured by what we described so far. A detailed account can be found in (Roubini and Mihov, 2010)).

Table 1 tells the story in numbers. In the period from 2001 to 2006 origination of subprime loans grew to 20.1% of the total mortgage origination; 80.5% of these loans were securitized. The result of loose credit in the mortgage market was the bubble in housing prices, as reflected in the S&P/Case-Schiller US National Home Price index in Figure 1.

	<i>Total mortgage Originations (Billions)</i>	<i>Subprime Originations (Billions)</i>	<i>Subprime Share in Total Originations (% dollar value)</i>	<i>Subprime Mortgage Backed Securities (Billions)</i>	<i>Percent Subprime Securitized (% dollar value)</i>
<b>2001</b>	\$2,215	\$190	8.6%	\$95	50.4%
<b>2002</b>	\$2,885	\$231	8.0%	\$121	52.7%
<b>2003</b>	\$3,945	\$335	8.5%	\$202	60.5%
<b>2004</b>	\$2,920	\$540	18.5%	\$401	74.3%
<b>2005</b>	\$3,120	\$625	20.0%	\$507	81.2%
<b>2006</b>	\$2,980	\$600	20.1%	\$483	80.5%

Table 1. Mortgage originations and the growth of the subprime loan market from 2001 to 2006. (Data quoted in (Franke & Krahen, 2008).)

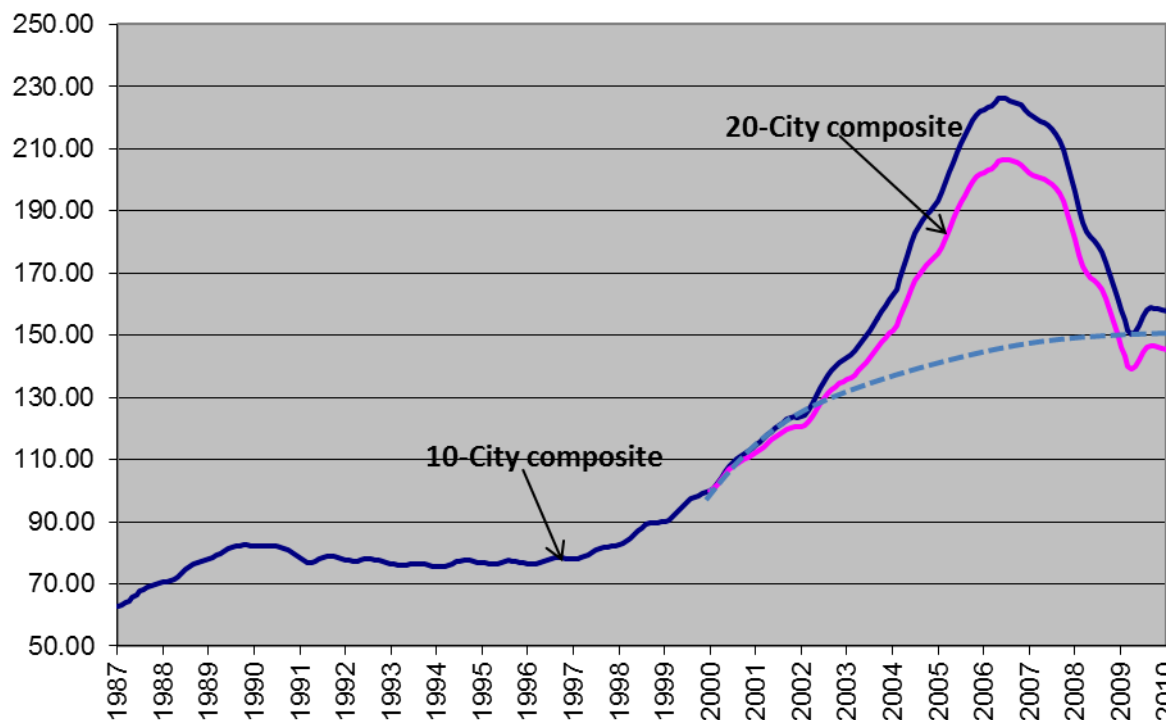


Figure 1: S&P/Case-Schiller Home Price Index. (Dotted line indicates the estimated path of the index without the 263 billion USD subprime mortgages that were eventually written off.)

Note the bubble inflating after 2000 and the burst starting at 2007. If we calculate the growth in subprime mortgages from 2001 to 2006 by about 300%, using the data of Table 1, and notice the growth of the 20-city composite index during the same period by 190% we infer a growth of 0.6% in the housing index per 1% increase in the subprime loans. What happens when these risky loans start defaulting? During the period 2007–2008 there was a write-off of 263 billion USD in bad subprime loans, which is about 45% of the originated

loans. A 45% default of subprime loans would then translate to  $45 \times 0.6 = 27\%$  drop of the housing index from its peak of 206 to 150. The 20-city index stabilized to almost 150 by 2010. That is where it should have been without the bubble caused by the subprime loose credit policy. The lesson from this simple calculation is this: the value added of the subprime loans eroded with the default of the loans, and the subprime loans appear to have been the major factor explaining the growth and decline of the housing market.

After the fact of course everything is clear. Saramago's blind all of a sudden recover their vision. But while the market may have stabilized, the burst of the bubble did cause considerable harm as manifested by the global financial crisis that it provoked through contagion effects on the worldwide economy. Iceland, a country at the top of the UN Human Development Index in 2007, and ranked by the Organization for Economic Cooperation and Development as the fifth richest nation on earth per capita, was facing bankruptcy.

How come nobody saw it coming? And why nothing was done to prevent the bubble from growing and bursting?

Some authors did see it. Still others, with a history of crying wolf, at last saw themselves vindicated. We refrain commenting on who was right and who was a crybaby and stay on the fact that nothing was done to prevent the crisis. Perhaps nothing could be done. Major bubbles have a remarkable ability of reappearing in different forms, as soon as the collective memory forgets the traumatic experience of the previous bubble. This is about once every 50 years, i.e., once every two generations (Perez, 2002). The fascinating book by Charles Mackay, *Extraordinary Popular Delusions and the Madness of Crowds* (MacKay, 1841) records many such bubbles: the Mississippi Scheme, the South Sea bubble, the Year of Panic 1825, the Great Railway Mania, the Tulipomania, and of course the Great Crash of 1929. And while some notable authors did see it coming, and warned extensively about it (Gray, 1998) and Paul Krugman in many editorials, see (Krugman, 2009)), no mechanisms were in place to protect the market from going astray. Whether the bubble was fuelled by foolish investors or whether people followed foolishly the bubble over the abyss is a question that economists are still trying to understand.

While all the facts may be obvious ex post, there is a disturbing lesson to be drawn. The increased "freedom of transaction" brought about by the financial innovation of mortgage securities, only temporarily brought increased prosperity and happiness through the ownership of a home. In the long run it caused a financial crisis, a global economic crisis, high unemployment levels and increased unhappiness. Should these freedoms have been curtailed? And is there a flaw in Amartya Sen's famous arguments that instrumental freedoms are both the primary ends and the principal means of development? (Sen, 1999)

Knowledgeable students of Sen's work will point out that the NINJA example violates one of Sen's instrumental freedoms: There were no transparency guarantees in the process of securitization and re-securitization. Hence, we emphasize at the outset that this paper does

not set out the goal of arguing against freedom. Instead, we will argue, as the NINJA lessons taught us, that freedom does not always lead to happiness. Care must be taken to understand the conditions under which adverse effects of free choice may be manifested. Whether we would opt for a “dictator” to impose these conditions by curtailing some freedoms or we take other steps to ensure that the right conditions exist so freedom does lead to happiness is up to us.

The kingdom of Butan opted in part for the former approach in pursuing a policy of improving Gross National Happiness (Bok, 2010: 3). This paper expects to assist with the later approach. We start from the beginning, and the next section outlines our argument.

## **Introduction**

The question of the title is an old one. John Stuart Mill, in his 1859 treatise *On Liberty* devoted a chapter on individuality as one of the elements of well-being. Mill’s inspiration came from the utilitarian theories of Jeremy Bentham. Bentham articulated the opinion that liberty is a good that --- even though it is not something that is a fundamental value --- reflects the greatest happiness principle: that is, freedom produces the greatest amount of happiness for the greatest number of people.

Our paper offers to this long-standing debate a novel narrative. We link research carried out over the last couple of decades on freedom as the primary end and the principal means for development (Sen, 1999) with the findings of research on economics of happiness (Bok, 2010). We use the economy --- within which freedom is practiced and where happiness is experienced --- as the medium to link the two concepts of the title. Our narrative is constructive. Not only it identifies cases, such as the NINJA example above, where freedom does not lead to happiness, but it also offers suggestions on what needs to be done, so this (apparent) paradox is avoided.

This paper is a dialogue between two contemporary ideas of broad impact: Development as Freedom and Economics of Happiness. When the ranges of reach of these two powerful ideas (their “horizons”) intersect, a potential conflict, arises. This paper contributes to “broadening the horizons” of these two ideas --- to use Gadamer’s famous phrase. This broadening of the horizons is a purpose of dialogue (Gadamer, 1975), and this is pursued by the narrative of this paper.

At the same time, the tension created between these two ideas needs to be managed, that is diverted towards useful ends. We need to give meaning to the area of overlap of the two horizons, and this is the constructive part of the paper. Giving meaning to the world, and creating something new in order to bridge any gap or conflict arising at the borders, is Freire’s main thesis in *Pedagogy of the Oppressed* (Freire, 1972), and this is pursued by the prescriptive part of the paper.

A summary of our argument is as follows:

Sen's "development as freedom" argues that the main end and the primary means of development is the expansion of instrumental freedoms and the ability of individuals to act as free agents. A summary of these arguments will be given in the next Section 3: Freedoms and Happiness. At the same time, recent studies of the economics of happiness have shown that people cannot always choose what makes them happy in the long run, and that the increase in economic prosperity of the last several decades has not led to improvements of well being and of happiness. A summary of this line of inquiry is also given in the next section. When we put these two arguments together --- and study some examples, where the expansion of economic freedoms has not increased happiness, and even caused unhappiness -- then one could make a case against freedom, and this is addressed in Section 4: Some evidence against freedom. This is where the narrative part ends, but it is not the conclusion of this paper. This must be clear from the outset: we are not arguing against freedom. Section 5: What needs to be done, is the prescriptive part of the paper and addresses the question raised in Section 4. Can we avoid the conflicts suggested by Section 4, without curtailing freedoms while at the same time following Bentham's greatest-happiness principle?

Before we proceed to the next section we need to inquire on the relevant contemporary context of our discussion. What is today, in the context of current economic development, the relevance of these issues?

First, the currently prevailing system of liberal democracy and free markets has increased substantially people's freedoms. In addition, the model of economic development through consumption urges consumers to use their expanded economic freedoms. Production and consumption together create a "virtuous" cycle of economic growth, whereby production leads to increased employment, increased employment provides income and expands the consumers' capability for consumption, increased consumption leads to increase demand for production and therefore employment, and the process goes on (Galbraith, 1996). And just in case a consumer is reluctant to run the treadmill of consumption, the art of marketing will take care of it. As Galbraith (1958: 124-125) put it, "a man on arising each morning [is] assailed by demons which instill in him a passion sometime for silk shirts, sometimes for kitchenware, sometimes for chamber pots and sometimes for orange juice...". And he reaches the incisive conclusion: "Production only fills a void that it has itself created".

Second, technology has empowered the individual agent for action. In all walks of economic life new technology-enabled institutions or instruments, or the technological innovations per se, expand our freedoms and our capabilities. We can get loans with convenient terms or invest the surplus of our labor in any activity we choose through the international markets. (A relevant example for our discussion is the capabilities offered through "vice investing", that is the investment strategy that targets companies selling products related to human vices, such as alcohol, tobacco, gambling, and weapons.) At the same time globalization has made the impact of our free-will choices felt wider and deeper

than in times past. A characteristic comment on the power of technology is that of Jody Williams --- the 1997 Nobel Peace Prize laureate for her work against anti-personnel mines --- when asked how she managed to coordinate 1000 NGOs for her fight. Her one-word reply is revealing: "Email".

Third, and this is relevant to the happiness side of the debate, the current state of economic growth of the developed world placed most of us beyond the need to satisfy some basic physical needs and the needs for safety. Modern economies, as a result of automation mainly, produce in abundance some basic consumer products such as food, clothing and shelter. Hence, individuals seek to satisfy emotional needs, and the quest for happiness is becoming dominant.

It is within this general state of affairs that we now develop our arguments.

## **Freedoms and Happiness**

### **Freedoms**

We will focus on the concept of freedom as articulated in *Development as Freedom* (Sen, 1999). All references to his work, unless specified otherwise, are from the First Anchor Books Edition, August 2000.

First, what does he mean by development? The word "development" seems to be taken for granted in this work. After all, the book was a byproduct of a series of lectures given as a Presidential Fellow at the World Bank in 1996, and "development" is part of the World Bank set of core values that has been ingrained in everybody in the audience. The word does not even appear in the book's "index by subject". Nevertheless, the preface talks about the "persistence of poverty and unfulfilled elementary needs, occurrence of famines and widespread hunger, violation of elementary political freedoms as well as basic liberties, extensive neglect of the interests and agency of women, and worsening threats to our environment and to the sustainability of our economic and social lives. [...] Overcoming these problems is a central part of the exercise of development." (Sen, 1999:xi). We take this to be his definition of development.

Second, what is the main argument in the book? There are two tightly interlinked lines of reasoning.

- *Development is a process of expanding the real freedoms that people enjoy.* The narrower view of identifying development with the growth of GNP or with rising personal incomes, or with industrialization, or with technological advance, or with social modernization, is ignoring the point that all these are nothing but the means to expanding the freedoms enjoyed by the members of the society. Important as they may be, growth in GNP or personal income is nothing but the means to an end, and the end of expanding freedoms depends on other determinants, such as social and economic arrangements, as well as political and civil rights. Access to facilities for

education and health are used as examples here, together with the freedom to participate in public discussion and scrutiny. Clearly, in the author's view, an increase of personal incomes that does not come with improved access to healthcare or education, is not contributing much to the exercise of development. (Sen, 1999: 3-4). This is one of the two reasons why freedom is central to the process of development, and the author calls this the *evaluative reason*. That is, progress has to be assessed primarily in terms of whether the freedoms that people have are enhanced. This line of reasoning views freedom as the *primary end* of development, and is the "constitutive role" of freedom in development.

- *Freedom is the principal means of development.* Freedoms have an "instrumental role" in development, since development is thoroughly dependent on the free agency of the people (Sen, 1999: 36). When people are deprived of some freedoms then their capabilities are restricted, and their effectiveness in the exercise of development is curtailed. The author calls this the *effectiveness reason* (Sen, 1999:4), and a good part of the book (especially chapter 1) is devoted to providing empirical support for this argument. Seen from this perspective, freedoms not only contribute to the process of development, but they also contribute to the strength of free agencies of other kinds, thus creating positive multiplier effects on the development process.

What are the instrumental freedoms that contribute to the success of development? Instrumental freedoms contribute directly or indirectly to the overall freedom people have to live the way they would like to live. The instruments involved are quite diverse, but Sen finds it convenient to identify five distinct types of freedom that are particularly worth emphasizing and appear in the empirical part of the analysis. These are: (1) political freedoms, (2) economic facilities, (3) social opportunities, (4) transparency guarantees, and (5) protective security (Sen, 1999: 38). One particular type of freedom is of interest to our work, that of market transactions, falls under the category of economic facilities, and we turn our attention to what the author has to say on this.

What is the role of markets? Sen argues that markets should be valued not only for their contribution to economic growth --- for which they are already acknowledged in the literature. Quoting Adam Smith, he argues further that markets should be valued for providing freedom of exchange and transaction that is itself part and parcel of the basic liberties that people have reason to value (Sen, 1999: 6). He also argues that the freedom to participate in the labour market is one of the ways of avoiding keeping people in bondage and captivity. Hence, the freedom to enter markets can be in itself a significant contribution to development, aside from whatever the market mechanism may or may not do to promote economic growth or industrialization (Sen, 1999: 7). In chapter 5 "Markets, State and Social Opportunities" the author examines the results that markets ultimately generate, but also makes the more immediate case for the freedom of the market transactions as an important

freedom itself. In this paper we examine the effect on happiness of economic facilities and the freedoms provided by the markets.

One final argument is needed before we can use Sen's work as the building block for our own arguments on happiness. In particular, we need to expand his definition of development to include the pursuit of happiness. Maslow's theory of human motivation of (Maslow, 1943) provides the missing link. The basis of Maslow's theory is that human beings are motivated by unsatisfied needs, and that certain lower physiological needs need to be satisfied before higher needs can be addressed (Figure 2). According to this theory there are general needs which have to be fulfilled before a person is able to act unselfishly. These are the so called "deficiency needs". While people are motivated to fulfil these basal desires, they continue to move toward growth and eventually self-actualization. We note now that Sen's definition of development, as outlined above, refers to the base of Maslow's hierarchy of human needs. Indeed, Sen refers to "unfulfilled elementary needs" independently from Maslow's hierarchy (If Sen was aware of Maslow's work, it does not seem to have played any role in his arguments and Maslow is not cited in the book.)

Can we apply Sen's arguments to the pursuit of other needs as part of the development exercise? Or is his work restricted to overcoming only those problems described in his definition of development? Nowhere in his argument is the evaluative aspect of freedom is restricted to the freedom to satisfy specifically safety needs or any needs for that matter. It is a main end of development, and hence we can deduce that Sen's arguments apply independently of any hierarchy of needs, Maslow's or anybody else's. The instrumental aspect of freedom contributes "to the expansion of the "capabilities" of persons to lead the kind of lives they value --- and have reason to value" (Sen, 1999: 18). Indeed, the notion of "capabilities" and the "agency aspect" of the individuals to help themselves and influence the world are central to Sen's work. Freedom is seen as the instrument of expanding capabilities and strengthening the agent. There is no reason we know to restrict the application of capabilities only to the satisfaction of the lower level needs and hence we take it that Sen's development process applies to an incremental satisfaction of a hierarchy of needs. (Seeing no reason is not a proof that no such reason exists. To be rigorous, one would have to work out the details of Sen's thesis within a broader definition of development.)





Figure 2: Maslow's hierarchy of needs.

### Happiness

In his ethical work Aristotle addressed the issue of living a successful life. The notions of *eudaimonia* or *makariotita* --- translated as “happiness” or “blessedness”, respectively (Barnes, 1995: 199-205) --- feature in his works. Buddha, in his earliest known work ascribed to him, the Dhammapada, expresses the view that what we are is the result of what we have thought, concludes that “If one speaks or acts with a pure thought, happiness follows one, like a shadow that never leaves”. These seem to be the earliest references to happiness and influenced significantly the development of both eastern and western thought. But it was the enlightenment in the eighteenth century, and Jeremy Bentham's work on felicific calculus --- the algorithm that allows one to calculate the amount of pleasure that a specific action is likely to cause --- that moved happiness from the abstract realm of philosophical ideas to the pragmatic domain of policy-making. Felicific calculus would allow a society to pursue the greatest-happiness principle to produce the greatest amount of happiness for the greatest number of people. Bentham pronounced this as the overriding aim of government (Burns and Hart, 1996).

The writings of political philosophers of the Benthamite school, like John Stuart Mill, influenced political actions. Paraphrasing a phrase by Locke the Declaration of Independence of July 5, 1776, proclaimed “life, liberty and the pursuit of happiness” as part of the unalienable rights bestowed upon all men by their Creator. The French constitution of June 24, 1793, declared the goal of society to be general happiness. Thus happiness acquired the status of a real good that can be identified, measured and accumulated. It became a constitutional right, and a government's obligation to guarantee. (While Bentham (1748--1832) gained enduring fame for the creation of the utilitarian school, it was when Bentham was one year old that Ludovico Antonio Muratori published a book titled *Della Publica Felicità*, and introduced the word “public happiness”; quoted in (Dixon, 1997: 1812)).

Readers interested in the history of happiness may consult McMahon (2006). In our work we are concerned with the contemporary issues relating to happiness and in particular the research findings of the last decades on the “economics of happiness”; for an extensive book

treatment see (Bok, 2010). We turn our attention to the major findings of the last thirty years of research that are relevant to our thesis.

Research on this topic, virtually non-existent before 1970, grew rapidly since then. While some authors talk about “happiness”, others talk of “well-being” or “life satisfaction”. The following comprehensive definition seems to cover the essence of what all authors mean: “a person is said to have high [well-being or happiness] if she experiences life satisfaction and frequent joy, and only infrequently experiences unpleasant emotions such as sadness or anger. Contrariwise, a person is said to have low [well-being or happiness] if he or she is dissatisfied with life, experiences little joy and affection, and frequently feels unpleasant emotions such as anger or anxiety”. (Diener et al., as quoted in (Bok, 2010: 9-10).

Can happiness or well-being, thus defined, be measured? Psychologists and social and political scientists answer affirmatively. Lately economists have joined the group. Psychologists find it natural to ask people how they feel. “Not too happy”, “pretty happy” or “very happy” are the available choices in the General Social Surveys in the US. The Eurobarometer asks respondents to rate their life-satisfaction with answers ranging from “not at all satisfied” to “very satisfied”. An alternative approach followed by some researchers is to ask individuals about their feelings at different times during the day. One issue raised in the psychology literature is whether such measures are reliable and valid. The consensus is affirmative, and self-reported measures have been demonstrated to be correlated with objective characteristics such as unemployment, recall of positive or negative life experiences, assessment of one’s happiness by friends and family members, physiological responses to stress and psychosomatic illnesses such as headaches and digestive disorders, electroencephalogram measures of prefrontal brain activity, and duration of so called Duchene smiles --- the smiles that occur when two sets of facial muscles fire simultaneously, and are considered genuine smiles. An overview of the psychology literature on the reliability and validity of happiness measures is given in Blanchflower and Oswald (2004).

The findings of numerous research investigations address a wide range of diverse questions. Researchers look not only for categorizations, but also for trends in the data as well as linking happiness measures with objective characteristics or event’s in one’s life.

For instance, surveys rate nations by the average satisfaction with life of their citizens, or by “quality life years”, which is a composite index of quality of life times life expectancy (Bok, 2010:24-25). The distribution of life satisfaction on scale of a 1 (unhappy) to 7 (very happy) shows an “optimistic” bias with the majority of the population and their average being above the midpoint. Figure 3 summarizes the data for Britain, but similar findings hold in almost all advanced industrial nations (Bok, 2010: 25-26).

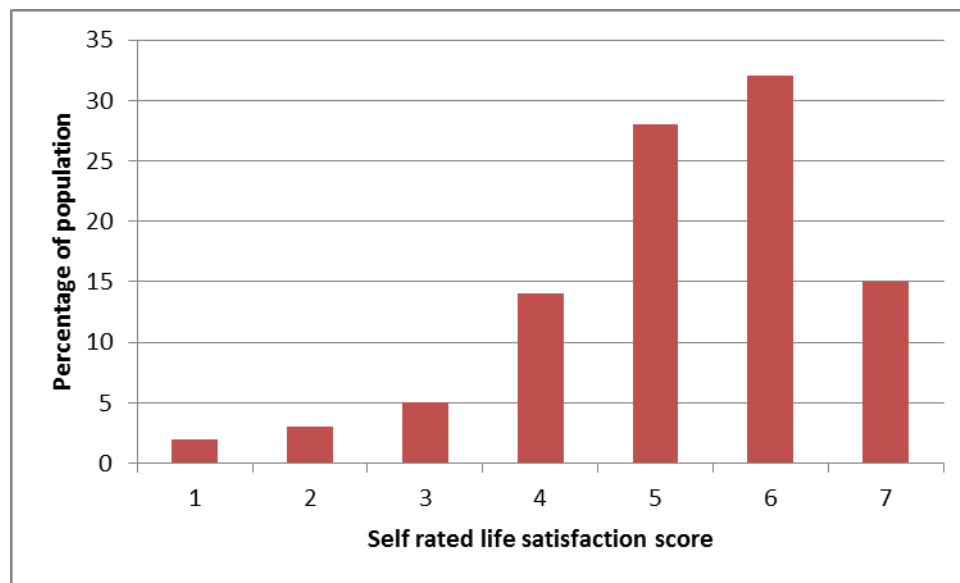


Figure 3: The distribution of life satisfaction in Britain, where 7 is completely satisfied (adopted from Oswald, 2009: 4)

Happiness for different age cohorts has a U-shape, with happiness levels declining from our teenage years until our mid thirties, but after that people tend to grow happier well into old age. Tracking events such as marriages, employment, child bearing etc reveals that married people tend to be happier than unmarried people, divorce causes unhappiness for three years before and after the event but people eventually bounce back, children do not appear to be causing any significant increase in happiness and unemployment makes people very unhappy. Experience sampling has allowed Kahneman and his colleagues (Kahneman et al, 2004) to study the effect of specific activities on happiness. Table 2 is interesting in its own right and will be useful to our arguments later on.

Trends analyses show how the happiness levels of various groups change with time. The major finding was the so called *Easterlin Paradox*. In a seminal paper (Easterlin, 1974) studied time series on the happiness level in the United States since 1946. His conclusion that “higher income was not systematically accompanied by greater happiness” (Easterlin, 1974: 118) sparked a controversy, as it seemed paradoxical that increased prosperity would not make a nation happier on the average. Many explanations have been offered to the paradox. Perhaps the most notable is that growing GDP does not make one better off relative to all his neighbors, and as people are comparison animals, the increased prosperity of all increases the happiness of none. Inconsistencies in the time-series data were also used to explain the paradox, with (Oswald, 1997) pointing out that the longest consistent set in Easterlin’s data shows a marked increase of the percentages of Americans reported as very happy, with a comparable decrease in the percentages of those reporting as not very happy. Oswald’s finding in the same paper (1997: 1818) that “happiness with life appears to be increasing in the United States, but the rise is so small that it seems that extra income is not contributing dramatically to the quality of people’s life” gives us a weak version of the Easterlin Paradox.

	<i>Hours spent per day</i>	<i>Effect of activity on happiness (on a scale from 1 to 5)</i>
<i>Intimate relations</i>	0.2	4.74
<i>Socializing after work</i>	1.2	4.12
<i>Dinner</i>	0.8	3.96
<i>Relaxing</i>	2.2	3.91
<i>Lunch</i>	0.5	3.91
<i>Exercising</i>	0.2	3.82
<i>Praying</i>	0.5	3.76
<i>Socializing at work</i>	1.1	3.75
<i>Watching TV</i>	2.2	3.62
<i>Phone at home</i>	0.9	3.49
<i>Napping</i>	0.9	3.27
<i>Cooking</i>	1.1	3.24
<i>Shopping</i>	0.4	3.21
<i>Housework</i>	1.1	2.96
<i>Child care</i>	1.1	2.95
<i>Evening commute</i>	0.6	2.78
<i>Working</i>	6.9	2.65
<i>Morning commute</i>	0.4	2.03

Table 2: The effect of specific activities on happiness.

(adopted from Kahneman et al 2004: 429).

### Some evidence against freedom

Given the current state of knowledge on happiness as outlined above, can we infer that freedom leads to happiness or is there evidence to the contrary? If we identify cases where freedoms have been expanded while happiness has decreased, that would be an argument for not answering positively to our question. We use one type of instrumental freedom, that referred to by Sen as “economic facilities” and in particular the freedoms afforded by the markets, and use economic indicators as proxies for market freedoms. If we identify cases where economic indicators have improved while happiness has decreased, that would be an argument for not answering positively to our question.

Note that a non-positive answer is not the same as a negative answer. While some statistics may show that a freedom has been expanded while happiness has decreased, there may be other reasons depressing the happiness levels: some freedoms curtailed as others were increased, the increased freedom had an inadvertent negative effect on other freedoms, the expanded freedoms did not improve the capabilities of all the population, the population did not make use of the expanded capabilities they acquired with the expanded freedoms. These are some potential explanations. Nevertheless, any evidence against freedom questions whether we can pursue freedom and happiness simultaneously.

Some may already see the Easterlin paradox as evidence against freedom. This would be true if increased in prosperity was accompanied by a decrease in happiness, instead of non-increasing happiness. But this is not the case. The strong version of the Easterlin paradox would lead to the conclusion that freedom is irrelevant to happiness. The weaker version of the paradox, as articulated by Oswald and quoted above, suggests that freedom has a marginally positive impact on happiness. However, more recent work --- using more reliable and extensive time-series of data and more refined mathematical regressions --- found a significant negative time trend of happiness over time. According to Blanchflower and Oswald (2004) "America is becoming systematically less happy (in the eyes of the Americans themselves)" with a negative time trend estimated at -0.0027 with a sufficiently large t-statistic to reject that hypothesis that the time trend is zero. Hence, the increased in prosperity brought about by increased freedoms in the US over the last quarter of the twentieth century brought about a decline in happiness.

Hence, expanded economic facilities and market freedoms reduced happiness levels and this would be evidence that freedom does not lead to happiness. However, other evidence than time-series analysis tells a different story: richer people tend to be happier than poor people. Some evidence to this is found in the table 3.

	<i>Lowest-income quartile people</i>	<i>Highest-income quartile people</i>
<i>Very happy (%)</i>	18.8	28.4
<i>Pretty happy (%)</i>	54.5	58.5
<i>Not too happy (%)</i>	26.7	13.1

*Table 3: The microeconomics of happiness in Europe 1975-86.  
(adopted from Oswald 1997: 1822).*

This table does not provide rigorous evidence, however, that higher income implies higher levels of happiness. To test the hypothesis that money buys happiness we compare the average happiness of the population of two sets of countries: the EU-27 countries with per capita GDP above the median (wealthy) and those with per capita GDP below the median (not so wealthy). We use Eurostat data measuring GDP per capita in Purchasing Power Standards (PPS). USA, Japan, Turkey, Norway, Iceland and Switzerland are also included in the sample. Happiness data were obtained from the ASEP/JDS databank. The level of happiness is measured using the 'Happiness Index' that is defined as the rate of those declaring themselves as 'Very happy' or 'Quite happy' less the rate of those declaring themselves as 'Not very happy' or 'Not at all happy', plus 100. This index ranges from 0 to 200, with the happiest countries going to 200 and the less happy countries going to 0. 100 is the mid-point value for countries that have a similar rate of persons quite or very happy and persons not very or not at all happy. Our regression analysis of happiness index as a function of GDP found a statistically significant positive coefficient 0.367. The same story is confirmed when we compare the mean happiness of the wealthy with the not-so-wealthy group. The

not-so-wealthy group has a mean happiness index of 151.97 while the wealthy group has a mean 184.07 and the difference is significant using t-test.

Hence, GDP data do not paint a conclusive picture. While having the freedom and capabilities to place oneself in the group of wealthy countries improves happiness, the improvement of GDP of a country across time does not improve happiness and was even found to reduce it. The best explanation offered to this is that happiness is driven by comparisons, and a tide that raises all the boats does not make anyone relatively happier. But overall it seems that wealth and happiness live happily together.

*Exhibit 1.* Problems seem to be lurking below the surface of a happy symbiosis between GDP and happiness. We compare the use of drugs in the two sets of wealthy and not-so-wealthy EU countries. (Data on the use of drugs is taken from European Monitoring Centre for Drugs and Drug addiction). When it comes to lifetime prevalence in the percentage of the population who use either cannabis or cocaine the wealthy countries had more users on the average than the not-so-wealthy countries. At the 95% confidence level, usage of cannabis by citizens of wealthy countries is between 3.8% and 18.1% higher than the usage by citizens of not-so-wealthy countries. When it comes to the use of cocaine the difference is between 0.4% and 4.0%, again at the 95% confidence level.

Hence, expanded freedoms for these countries may have led to increases in GDP and the purchasing power of its citizens, but part of this power has been used on activities that only in the very short run make one feel happy.

*Exhibit 2.* Blanchflower and Oswald analysis (2004) includes some interesting findings for subgroups of the US population. While the population at large is becoming marginally unhappier with economic growth from 1972 to 1998 (coefficient -0.0027), there are stronger trends for subgroups. The coefficient of their regression model for women is -.0062, and this is statistically significant. Over the period of testing, the percentage of American women considering themselves as very happy dropped from 36% of the population to 29%. Similar evidence is provided with the British data. The authors' conclusion (2004: 1381) is a direct answer to our question: "Whatever the consequences of anti-female discrimination policy elsewhere in society, it has apparently not been successful in either country in creating a feeling of rising well-being among women." We hasten to add, though, that evidence in the same paper shows that differences in well-being of racial groups in the United States has narrowed over time. Blacks have made up ground, and became happier during the period of Blanchflower and Oswald's study.

*Exhibit No. 3.* Some compelling evidence that people can not choose themselves what makes them happy is provided when we study how Americans spent their free time, as reported in (Bok, 2010: 76). From 1965 to 2003 both men and women saw their leisure time increase. Depending on the definition of leisure used in the studies this increase ranged from 5.6 to 8 hours for men, and 3.7 to 6.8 hours for women. How was this extra time used? Watching

television increased by 7.4 hours per week while the number of hours devoted to reading dropped by 3.1 hours and the time spent socializing with friends by 3.9 hours. If we refer now to the data in table 2, we observe that people did not use the extra free time on those activities that according to *them* bring them more happiness. While their self-reported data show that socializing brings them the most happiness, they reduced their socializing time to watch television which gives them much less happiness. No surprise then that Blanchflower and Oswald find the population becoming less happy during most of Bok's period: while their income may have grown and so did their free time, they spent their expanded freedoms in front of the television.

*Exhibit. 4.* The report of the Commission on the Measurement of Economic Performance and Social Progress setup by President Sarkozy is full of statements that point to underlying problems even as freedoms are expanded (Stiglitz et al, 2010). We quote a few:

"In Russia, declining life expectancy suggests there are underlying problems, even if GDP per capita is increasing." (p. xix). This observation is coming at a period where Russia has seen its freedoms significantly expanded through democratic reforms in the post-communist era.

"There may be an increasing disparity between average income and median income (the income of the representative individual); one may be increasing while the other is declining." (p. xxi). Hence, while the average freedoms are expanded, the capabilities of the average Joe and Jane are restricted.

"A developing country that sells a polluting mining concession with low royalties and inadequate environmental regulation may see GDP increase but well-being decrease." (p. xxii). This is a real situation in many developing countries, and the freedom to manage their own natural resources does not always leave them better off.

"For a poor developing country to be told that its GDP has gone up may be of little relevance. It wants to know whether its citizens are better off." (page 29). The report provides data for Ireland, showing that the Irish disposable income declines relative to the country's GDP, as a result of profits that are repatriated by foreign investors. Interestingly, according to an OECD study Ireland is one of the few countries that reduced its expenditures on education during this period.

What is the overall conclusion from the evidence we have provided? If there is evidence that freedom sometimes leads to decrease in happiness, are we to conclude that freedom does not lead to happiness? And hence, if we value the pursuit of happiness as the paramount value, then should freedom be curtailed? The first question can be answered with logical inferences, the second requires value judgment.

On the first question: The evidence shows that expanded freedoms do not *necessarily* lead to happiness. Hence, it is not enough to expand freedoms and then expect a society to

develop up on Maslow's hierarchy in pursuit of happiness. Something more seems to be needed.

On the second question: If we subscribe to Bentham's opinion that liberty is a good that is not of fundamental value itself, but that its value is that it reflects the greatest-happiness principle, and if our evidence has shown that freedom does not always reflect the greatest happiness principle, then we should be ready to make freedoms subordinate to happiness. This route is pursued by regimes that suppress democratic liberties until such times that the economic development of the country could afford it. However, if we value freedom as something of fundamental value --- which is the evaluative part of Sen's arguments, contrary to Bentham's statement --- then we are faced with the difficult question of what to do when the expansion of freedom and the pursuit of happiness are at odds with each other. Recognizing that conflict is unavoidable part of human affairs, we turn in the next section to a search for ways to minimize the conflict.

Recognizing that the proof by example we have given so far is not a rigorous one, we provide a final argument to strengthen this section:

*Exhibit 5.* We point out that the exhibits we have presented so far are examples of the dilemma of a "paretian liberal" as analyzed in Sen's impossibility theorem (Sen, 1970). Without going into the technicalities of the weak and strong forms of the impossibility theorems, Sen has shown that it is impossible for a society to make social choices that satisfy simultaneously Pareto efficiency of the final state and conditions of individual liberty. If we consider, in our case, social choices that relate to happiness then Sen's theorem would state that it is impossible to find a state of society where nobody could be happier unless someone else is made less happy, while respecting the liberty of individuals. We would have to accept suboptimal happiness conditions if we guarantee the individual liberties for some. Interestingly, in his definition of "some" Sen requires that at least two people should have their liberties guaranteed, for if only one person is left in this set then we would have a dictatorship. Even with this definition of minimal liberalism --- which is an oligarchy --- we have an impossibility. Obviously the impossibility theorem holds true in the more general case discussed here, where we do not guarantee the freedoms of only a chosen few.

### **What needs to be done?**

Are there any solutions to resolving the conflict between freedom and happiness we have outlined in the previous section?

*Education.* One answer can be obtained from Sen's own conclusion on what to do with the impossibility of the Paretian liberal: "The ultimate guarantee for individual liberty may rest not on rules for social choice but on developing individual values that respect each other's personal choices" (Sen, 1970:155). Hence, education has to play an important role. But education should not be restricted in developing values that respect each other's personal



choices, following Sen's conclusion. In addition, we argue that education should be board enough so that individuals are capable of judging the impact of their choices on their happiness. We do not expand here upon the kind of education that is needed but two concrete points can be made:

The analysis of Blanchflower and Oswald shows that education enters with a positive coefficient in the happiness equations. What is even more important though is that this positive effect is independent of the earnings effect. That is, while education contributes positively to one's earnings, and wealthy individuals are happier than not-so-wealthy individuals, the positive effect of education on happiness remains even when we control for increased earnings. Education is playing a role independently of income. We surmise that the role it plays is in guiding people to use their expanded freedoms in ways that improves their happiness -for instance, by deciding to use any bonus free time they may receive to spend it socializing with family and friends or relaxing with a good book, rather than watching more television.

Education must be broad, as narrow focus on specialized skills that assist one in improving their income are not sufficient to increase happiness. Thus the arguments that people of the humanities have been making for their disciplines over the years gain renewed gravity (see Nussbaum, 2010). To participate efficiently in the production-consumption cycle, it is not sufficient merely to have an educated population. The population must be in a position to reflect effectively on "producing" those things worth "consuming", such as a functioning, efficient and compassionate democracy, critical thinking, and a creative imagination for the arts and literature.

*Well-being Audits.* A second answer can be obtained by looking at the way society has been dealing with the environmental consequences of our economic activity. Once it was recognized that our free-will choices had an inadvertent impact on the environment, regulations were enacted, and procedures were put in place to carry out environmental audits for major new projects.

A similar approach is needed in dealing with a society's well-being and happiness. Regulatory discussions on specific activities should take into account the effect of these activities on happiness. To this effect, standards must be developed for well-being audits, in the same way the professions gave us standards for environmental audits. It is only through proactive audits that we can discover the inadvertent effects of some free-will choices we make in instituting major projects.

Susan George uses the term "boomerang" to describe how the third world debt is harming the developed nations (George, 1992). Policies that we thought were positive for us had a negative effect on others and eventually worked as a boomerang. In a globalized world we cannot expect to dump our waste on our neighbor's back yard and expect that the filth will

not touch us. Happiness audits should search in advance for such boomerang effects so that informed decisions can be made.

*Well-being Metrics.* The third answer comes from the report of the Stiglitz Commission: the need to develop the appropriate metrics for measuring our lives. The metrics we use dictate our actions. The commission makes four recommendations that, if adopted, will give a more balanced view of what we measure when we seek to measure material well-being. But, most importantly, it makes a fifth recommendation that income measures should be broadened to include nonmarket activities.

It is through the realization that well-being is multidimensional, coupled with metrics and regulations to monitor these dimensions, and improved knowledge on the multiple dimensions and their interactions, that we can exercise the capabilities freedom gives us in the pursuit of happiness. For as long as we fail to do this effectively, the tension between freedom and happiness we have described will remain a paradox.

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**THE REALIZATION OF THE IMPACT OF STRUCTURAL DESIGN ON EXPORTS.****Afxentiou, Georgios<sup>1</sup>**<sup>1</sup>DBA student, University of Gloucestershire. Email: gafxentiou@gmail.com**Abstract**

The research concentrates on the functionality of the organization, departments, managers, employees and their working areas. Also there will be an investigation and match of the employees' skills and experiences with their performed duties. An attempt to identify the customer needs and their financial capabilities will also be key factors to understand the impact of a well designed structure to exports. An analysis of these factors along with the evaluation of business cases will form the outcomes of this research. This project also aims to exploit the validity and adaptability of the factors to cater management to promote products overseas.

The industry includes many small, medium and large size entities. The investigation is expected to yield a diversity of results and side effects of problematic organizational structures. Most of the businesses especially the small and medium size are family oriented. The factors that affect the structure are the way of thinking of these families and their management skills and experiences in the local market.

The outcomes of this research will provide new approaches to a more dynamic and creative way to export local products to the international market. It is a study of organizational structures that influence management and their decisions about exportation based on the new international economic environment.

**Keywords:** Business Structure, Innovation, Exports, Management, International Trade, International economic environment

## CAN LOCAL AUTHORITIES INCREASE THE COMPETITIVENESS OF SOCIALLY RESPONSIBLE SMEs? EVIDENCES FROM TUSCANY REGION

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### Abstract

The decision made by the European Union to promote CSR - Corporate Social Responsibility principles among firms has two main drivers: on one hand the necessity to safeguard local communities and workers from social and environmental point of views; on the other hand the will to revive the European industrial system through a differentiation of services and goods offered toeing the sustainability line, in other words a new possible way to be competitive. The enterprises could indeed decide to invest in CSR for different reasons: philanthropy and moral obligation, safeguard of local communities, but also advantage to operate, good market reputation, saving and optimization of resources, development of human resources, effective management of stakeholders. Moreover, lately and increasingly, European markets encounter an extension beyond local supply chain boundaries in favor of an international scenario. In this sense, the opportunity given by CSR, through co-operation among firms, fair competition, equal treatment of labor force, and safeguard of local community and environment, represents one of the main motive which lead the European Union in the promotion of CSR. Spreading ethics among companies has relevant consequences both for the competitiveness of single firms and for the competitiveness of regions of productions and local communities. For these reasons, the European Union has arisen activities to promoting and supporting CSR at a multi-stakeholder level, and its action represented the stimulus to promotion of CSR by different Local Authorities.

In particular, the role of Local Authorities becomes relevant when the promotion is addressed to Small and Medium Enterprises. SMEs are characterized by lack of human, technical and organizational resources. This condition makes the implementation of formalized CSR policies very difficult, both because of the perceived costs and the complexity of the operation. An investment in CSR is often considered hard and uncertain.

That being stated, what kind of CSR strategies can Local Authorities promote in favor of SMEs? Can these initiatives increase the competitiveness of SMEs? Which

initiatives can be promoted by Local Authorities to increase the competitiveness of socially responsible SMEs?

The present contribution shows some evidences referred to two co-financed EU projects carried out in the Tuscany Region since 2005.

The first project was COOPERATE Project, co-financed within the Mainstreaming CSR among SMEs EU Programme. The aim of the research was to promote and to spread CSR concepts, practices, and tools among SMEs operating in industrial clusters in the Tuscany region (Italy). The research involved three Tuscan industrial clusters. Within the project more than 100 SMEs were interviewed and a lot of local intermediary institutions (representing Local Authorities, local trade associations, local trade unions, agencies for environmental protection, and so on) were involved in the project.

The second project is the Responsible MED project (in progress), co-financed within the MED 2007-2013 Programme. The aim is the evaluation of the connection existing between CSR and levels of innovation and competitiveness in the MED SMEs. This is achieved evaluating the concrete impacts of CSR actions and policies on competitiveness, with a focus on the role that can be played by Local Authorities. Within this project 22 SMEs and 6 Local Authorities were interviewed.

Our analysis aimed at summarizing the results emerged from interviews addressed to SMEs and Local Authorities with respect to:

- the perception of usefulness of CSR practices and strategies adoption in a competitive perspective
- the role of Local Authorities into the improvement of competitiveness of responsible SMEs

Main common results can be summarized:

- general perception (both from enterprises and intermediary institutions) of usefulness of CSR strategies also in terms of competitiveness, but low capability in measuring the real advantages associated to these CSR practices adoption
- large diffusion of informal CSR practices (in particular amongst SMEs operating in industrial clusters) based on existence of social and relational capital that characterizes these productive systems
- identification of Local Authorities as important partner in the start up processes of implementation of CSR practices
- insufficient evaluation (from SMEs) of actions carried out by Local Authorities in order to reward (with positive effects on competitiveness) the

socially responsible SMEs (in particular referring to actions of simplification into administrative and control fulfillments, or to promotion amongst customers and big retailers of socially responsible enterprises).

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## TRUST, THE LUBRICANT FOR INTERCULTURAL KNOWLEDGE TRANSFER AND KNOWLEDGE SHARING

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### Abstract

The incalculable value of knowledge is identified by many companies and, therefore, treasured and protected by them to a great extent. This knowledge protection attitude often represents a considerable obstacle for international business co-operations. For knowledge to be smoothly transferred across cultures, an open and trustful knowledge sharing attitude is required.

It is becoming very prominent in the social capital theory (SCT) the importance of relationship and trust as facilitators for knowledge sharing. Trust, is regarded as the cornerstone when developing a learning culture, a key element in an individual's decision to share, disseminate and enlarged upon knowledge, a guarantor for achieving successful knowledge transfer objectives and for influencing relationships' commitment, Morgan and Hunt (1994) Dirk and Ferrin (2001); Gardener (2003); Fiol (2003); Sharkie (2005); Leyland (2005) Dignum and Eijk (2007), Michailova and Sidorova (2010). On the other hand, they perceived that in low trust environments, co-operation partners are gripped by worries and uncertainties, conversation and knowledge sharing suffers, levels of competitive individual behaviour increases and personal energies are used for protectionism limiting the personal and the co-operation growth. Additionally, the increase on misunderstandings, disagreement and suspicious behaviour might be triggered, an additional proof of lack trustworthiness (Schneider and Barsoux 2003).

In cross cultural environments, trust perceptions are affected by different societal rules, norms and values which are not commonly shared. These different perceptions have an impact on the trust level turning them on a more vulnerable and uncertain. Ideally, the development of a trustful business relationship might lead to create a newly common identity. This new identity and meaningfulness are regarded as the wellspring of creativity and fertile ground where knowledge sharing occurs in a natural way as a result of belonging (Denham, 2005). In practical terms, the climaxes of this trustful environment are: the quick exchange and absorption of knowledge leading to higher innovation rates, flexibility, customer satisfaction and finally to profitability.



## Methodology

The paper aims to present part of the empirical research findings focusing on the importance of trust in knowledge transfer and sharing between Eastern and Western European co-operation partners.

The qualitative research has been conducted using a phenomenological approach to better understand social realities. The grounded theory method of constant comparative analysis based on Glasser and Strauss (1967) and Strauss and Corbin (1998) was used to analyze the gathered data. The research was designed in three stages. In the first stage, prior to the data collection, secondary research was conducted by an extensive literature review. This research was intended to increase the researchers' familiarity with the research setting rather than to develop any theoretical framework. The second stage was dedicated to the empirical research and the third part, was dedicated to the findings' analysis and conclusions. Two case studies were explored, Russia and German speaking countries, using focus groups and 23 in depth interviews for data gathering. The findings contributed to elicit the positive and negative attitudes and behaviours influencing trust development. Additionally, the creation of a model highlighting the positive consequences of developing trust and commitment between Eastern and Western European co-operation partner was introduced.

## Key findings

Due to its importance and positive implications for intercultural co-operations, trust must be taking care for and nurture. Ignoring this care or abusing from it represents a high risk and an immediate detriment of both business relationship and profitability.

For Eastern European respondents, to develop trust among the international partners is a pre-condition to listen and to believe on them. This trust will be the basis to solve problems or to overcome difficulties in adverse times. Furthermore, Westerners regarded trust on a person as well as, on a company level, as facilitator for knowledge flows. It was underlined that this trust development will take time to reach its full potential. Therefore, in order to develop trust companies must be committed to provide the ground in terms of having opportunities for people to meet and interact. Emotional intelligence was especially mentioned to be in place at the beginning of the relationship, otherwise, irreversible damages e.g. being suspicious, having fear of the partners' hidden agendas will finish with a relationship that may be concludes before it really starts. On the other hand, Westerns European respondents claimed to be cautious in terms of providing lots of trust and being abuse regarding stealing knowledge. For this reason, keeping a balance between knowledge provided and

outcomes received should be strictly observed, striving for a balance of giving and receiving policy.

**Keywords:** Trust, knowledge transfer, Knowledge sharing, Eastern/Western Europe

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## MANAGING INTERCULTURAL RESEARCH PROJECTS: THE INTERWEAVING OF LANGUAGE, CONTENT, AND METHODOLOGY

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### Abstract

The conduct of intercultural, multi-lingual large-scale research projects (e.g. EU grants) puts particular demands on their process management and decision-making. Despite the big variety of project types, in all cases, project managers need to direct their attention to cultural and language issues consistently as it can be assumed that they relate to all phases of a research process and affect content, methodology as well as project management.

The authors are involved in two intercultural business research projects on the European and international level; taking on different roles as partners or project leaders. The projects' topics range from "career concepts in different cultures" via "diversity in organizations" to "European consumption behavior". Despite the cases' heterogeneity, the authors' experiences unanimously indicate that language does not only impact on the decision about the data collection method (e.g. qualitative interviews versus questionnaire) and the related quality of the collected data, but also touches on the selection of useful literature (national and international), the definition of the research question, the discussion of methodological issues; the collection, the analysis, and the interpretation of data as well as patterns of documentation and reporting.

Based on a typical procedure of a research project this contribution discusses different decision fields, decision making processes and consequences for resources and vice versa. Furthermore the authors focus on content-related and empirical opportunities for and restrictions of data interpretation. The discussion is illustrated with selected experiences from the case studies along the following questions:

- What are the characteristics of the development of research designs in the intercultural context?
- How can the decision-making process in intercultural research projects be characterized?
- Which are possible organizational structures in international, intercultural projects and how do they influence the decision-making?

- What are the consequences of multilingualism for the decision about data collection methods?
- How do multilingualism and interculturality influence the project management?
- Which characteristics result from multilingualism and interculturality of team members and respondents for the data analysis and data interpretation?

The aim of this discussion is to offer insights into the interplay and consequences of decisions about the content and methodology as well as the management of intercultural large-scale research projects.

The contribution is organized as follows: At the beginning, the characteristics of large-scale intercultural research projects are introduced. In particular, application frames and procedures, rules for the composition of project consortiums and partners, unique patterns of team formation, etc. are outlined.

Subsequently, a theoretical examination of the embedding of project management principles in intercultural research processes and the particular role of multilingualism in terms of team formation and content-related questions lays the cornerstone for a deeper discussion of the impact of multilingualism on decisions within the different phases of a multicultural research process.

First, along with research phases “application and start of the project”, “development of the research question”, “design”, “methodology”, “data collection”, “data analysis and interpretation”, and “reporting”, the procedure of an intercultural project is outlined theoretically.

Second, the discussion of particular impact of language on the particular topics within the different phases is based on the experiences from the case studies and illustrated with selected examples.

Finally, the authors conclude based on a reflexive discourse of the case studies for managing intercultural research projects. The data basis for the reflexive discourse consists of individually prepared written memory minutes of typical occurrences in the projects along with theoretical descriptions of the research phases. Additionally, documents like regular minutes from the meetings or preliminary reports were considered. For the summary and résumé of the discourse, the authors strived after concordance of the interpretations. Overarching themes are identified that need to be considered when working in intercultural research project and influence the research process.

## CSR AND PERFORMANCE IN SPANISH SMEs: EXPLORING THE CAUSAL EFFECTS

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### Abstract

**Motivation and background:** The present paper explores the relationship between CSR uptake and performance in SMEs. It builds on and extends the goals and activities carried out in the Responsible Med project, a European project involving 9 institutions of 6 different countries in the Mediterranean Area. The goals and components of the project have led us to carry out a parallel research based on the analysis of the visualization of CSR activities made by a statistically-defined sample of SMEs. Learning more about the particular corporate culture and the framework of the relationships that condition the economic and social functioning of SMEs is an important issue, especially if we bear in mind the relevance of SMEs in the Mediterranean economies.

**Research Questions:** The main research questions of this article are: What is the perceived effect of CSR in SMEs performance? And what is the statistical relationship between CSR practices and SMEs financial performance?

**Theoretical Framework:** The usual reasoning to incorporate CSR programs is either to reduce externalized costs or to avoid distributional conflicts (Heal, 2004). Recently, different strands of literature have been concerned with the effects of CSR on firm behaviour. Some authors emphasise that CSR practices divert firm resources, increase agency problems and affect negatively firm performance (Hellwig, 2000; Tirole, 2001). Others, on the contrary, show that CSR improves firm performance and firm value (Freeman, 1984; Small and Graf Zivin, 2005; Cespa and Cestone, 2007). This latter idea implies that markets must have the ability to transmit ethical demands to firms, put it in another way, individuals with ethical concern must take part in the market (Brickley et al. 2002). Provided markets are competitive and can punish inefficient behaviour, firms would be pushed to exercise in a socially responsible way to achieve a competitive advantage (Jones, 1995).

Together with this theoretical debate, existing empirical results are not conclusive either. Some studies find a positive impact on firm performance and valuation (Mahoney and Roberts, 2002; Chen, 2004) and others the opposite relationship (Wright

and Ferris, 1997). However, many of these results address CSR in large businesses rather than in small- and medium-sized enterprises (SMEs), because it is too often considered a prerogative of large businesses only (Perrini et al., 2007). Yet, the idiosyncrasies of large firms and SMEs could explain the different observed approaches to CSR (Russo and Perrini, 2010). In particular, Murillo and Lozano (2006) suggest taking a deeper look at: (i) the specific practices carried out in these companies; (ii) these companies' own views and conception of CSR; (iii) their ability to communicate both internally and externally, both with regard to the practices and to the results. This paper focuses mainly on the third point.

**Methodology:** To answer to the former research questions we studied a sample of 100 SMEs in the province of Girona, in the North East of Spain, chosen from the SABI database prepared by Bureau Van Dijk, which gathers descriptive, financial and legal information on companies in Spain and Portugal. We draw a random sample of SMEs, stratified by the number of workers, following the exact distribution of SMEs in the province. The SME is characterized using the number of workers to be below 250 as the operational European definition of SMEs.

We use a double methodological approach using a qualitative and a quantitative approach with the same number of companies, which is not frequent in academic research.

To answer to the first research question, we analyze the discourse of SMEs in their website, and how they connect CSR to performance. For the second question, we will rely on panel data analysis to test the possible causal relationships between CSR and performance.

**Results:** The qualitative analysis reveals the perceived performance effects of CSR actions on key success factors, such as quality, innovation and productivity. We find a differential association of the main types of CSR (namely, workplace, marketplace, environment and society) with the three former mentioned key success factors. This analysis helps to understand how companies perceive that CSR is enhancing their competitiveness, or at least how they decide to communicate these effects.

The quantitative analysis is still under construction and we cannot anticipate the results.

**Contribution / Highlights of the paper:** Combination of qualitative and quantitative research methods. Analysis of effects that SMEs perceive that are associated to their CSR practices. Longitudinal analysis of the causal relationship between CSR and performance, which allows for a better understanding of the direction of causality.

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**RESTORE TUNISIAN TOURISM POST REVOLUTION****Chemli, Samiha<sup>1</sup>**<sup>1</sup>Tourism Lecturer at the 'Ecole Supérieure de Commerce de Tunis', University of La Manouba.

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**Abstract**

**Purpose** – The actual research study aims to identify the negative impact of the Tunisian revolution on tourism to the country and the strategies implemented to overcome the crisis.

**Design/methodology/approach** – The empirical research consists of the use of qualitative methods. The first stage was based on observation, and the second on interviews carried out with tourism professional bodies during the crisis.

**Findings** – The findings suggest that the revolution has both, a negative and a positive impact on the image of Tunisia and on the tourism products. Besides, diverse strategies were implemented by the Tunisian Tourism Ministry, the Tunisian Tourism Board and the private sector to restore the destination, most of which are based on the country's new positioning as 'the place to be now'.

**Originality/value** – This study was undertaken by the time of the crisis, and the qualitative data collected was based on real facts, which could be used as a starting point for future research on the post-crisis stage.



## GREEK BANKS' ENTRY INTO THE CENTRAL AND SOUTH EASTERN EUROPE

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### Abstract

The last two decades banks all over the world have started to expand their activities into the challenging markets of the developing countries. The transitions countries, specifically, present, nearly, the largest level of banking internationalization in the world. The Greek banking industry has adopted this tendency. This study attempts to find the determinants that influence the Greek banks in their decision to engage in international activities. The interest of the study is centered in the countries of the south eastern and central Europe. We selected a group of thirteen countries of this area and explore the presence and activity if any of Greek banks there. Our investigation revealed that FDI is a strong factor that pushes Greek banks to operate in a foreign country. We, also, found that the distance plays an important role in the same process while trade activity between the countries involved does not matter at all.

**Keywords:** expand Greek banks, south eastern and central Europe mergers and acquisitions, globalization, financial markets

## FINANCIAL REPORTING AND PERFORMANCE MEASUREMENT OF ITALIAN UNIVERSITIES

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### Abstract:

**Purpose:** There is an increasing trend and pressure on public sector entities (PSE) to broaden the scope of their financial responsibilities from accounting to accountability. To demonstrate accountability, PSE must provide clear, understandable and reliable information to citizens and taxpayers, which are entitled to high quality information about the financial performance. In more specific terms, there are two main reasons in order to expect high quality reporting from PSE:

- the first reason is accountability: taxpayers and citizens need information which allow them to hold PSE accountable for use of public resources;
- secondly, PSE, just like private organizations, need timely and accurate financial information to monitor and manage their performance.

The paper examines these aspects focusing on a specific PSE: Italian public universities with the aim to investigate their financial reporting and performance measurement.

The current accounting system of all Italian Universities is largely cash- or commitment-based budgetary accounting. So, the aim of this research is to evaluate the characteristics of the present accounting system, to understand the role of budget and financial reporting in decision-making process, to assess the measure of performance used and to investigate the possibility of the implementation of accrual accounting.

In the literature, the introduction of accruals accounting has been the subject of significant debate: some scholars have emphasized its ability to better meet user needs and its consistency with the general movement from ex-ante constraints to ex-post accountability. Critics have raised both theoretical and practical objections.

The hypothesis of the paper is that universities (as well as other PSE) need a “dual system” (cash-based budgetary accounting and accrual accounting), because neither the budgetary accounting nor the accrual accounting produces all the information that managers and stakeholders require for their decision-making: the problem is not only to decide whether a public university should adopt or not accrual accounting, but also

if an accounting system accrual based could coexist with a cash-based budgetary accounting.

The paper analyzes these different points of view in connection with the specificity of public Universities, highlighting some important differences in respect of other PSE. These aspects will be investigated within the framework of the International Public Sector Accounting Standards, which represent a benchmark.

**Design/methodology/approach:** The paper adopts a quantitative research method. It analyses accounting system, financial reporting and performance measurement methods of all Italian public Universities. The empirical analysis is based on the contents of the “Internal accounting rules” of the Italian public Universities limited to “budget and accounting system”. It tries to identify some significant variables that allow understanding the role of budget and financial reporting in decision-making process and to assess the measurement method of performance used.

**Findings:** The main findings of this research are:

1. The accounting system is largely commitment-based, producing information that concern only the financial aspects of operations; as a consequence, it doesn't produce information about costs of higher education and research.

2. Most Universities adopts the old model of budget suggested by the Decree n. 371/1982; only few universities adopts the structure suggested by the Law n. 94/1997. This means that there haven't been any significant innovations in the last two decades and, also, there is a lack of harmonization.

3. Only few Universities adopts an accounting system accrual-based. Moreover, there is a sort of implicit equivalence between budgetary accounting's establishments of accounts receivable and commitments on the one hand, and accrual accounting's revenues and expenses on the other. In substance, the basic conceptual framework remained unchanged, despite the different objectives assigned to Universities accounting over time.

4. A partial uselessness of the performance results produced by cash or commitment based accounting system currently adopted by Italian Universities. This results need to be integrated with economic results and other indicators, coherently with parameters and criteria to be required from the main stakeholder.

5. If we compare the Italian University accounting system with the approach suggested by the International Public Sector Accounting Standards Board, we can notice a considerable distance and a substantial lack of harmonization.

**Originality/value:** The aim of this research is to evaluate the characteristics of the present accounting system, to understand the role of budget and financial reporting in

decision-making process. It represents a starting point for future investigations about the improvement of performance results produced by accounting system adopted by Italian Universities.

**Keywords:** Public Sector Entities; Universities; Accounting Reforms; Accrual Accounting; financial reporting; Performance measurement.

## **ASSESSING FINANCIAL DISTRESS WHERE BANKRUPTCY IS NOT AN OPTION: AN ALTERNATIVE APPROACH FOR LOCAL MUNICIPALITIES**

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### **Abstract**

The goal of this paper is to identify the key financial distress performance indicators of local governments by using published financial data. Thus, using proper financial ratios the financial performance of municipalities is assessed through a multicriteria methodology that combines simulation analysis approach (stochastic multicriteria acceptability analysis) with a disaggregation technique. In particular, an evaluation model is developed on the basis of accrual financial data from 360 Greek municipalities for 2007. A set of customised to the local government context financial ratios is defined that rate municipalities and distinguish those with good financial condition from those experiencing financial problems. The model is validated by testing its outputs on a subsample of 100 local governments assessed in two time periods, 2007 and 2009. The model succeeded in correctly classifying distressed municipalities according to a benchmark set by the central government in 2010. Such a model and methodology could be particularly useful for performance assessment in the context of several European Union countries that have a similar local government framework to the Greek one and apply accrual accounting techniques.

**Keywords:** Local governments, financial distress, multiple criteria analysis, financial ratios, Greece

### **Acknowledgment**

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**ACCOUNTING AND THE 'DOCTOR - MANAGER RELATIONSHIP'****da Silva, Amélia Cristina Ferreira<sup>1</sup>; Pereira, José Manuel T.<sup>2</sup>;****Ribeiro, Humberto Nuno Rito<sup>3</sup>**

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**Abstract**

Some critics of the traditional hospital's organization argue that hospitals are dominated by doctors, who decide clinical issues often unaware of economic dimension of their actions.

Hospitals have been exposed to great pressure in order to reduce costs. Consequently, hospital administrators have responded by becoming more aware of the need for management control tools.

Accounting systems are implicated in the relationship between professionals and organizations as these systems are designed and implemented to achieve bureaucratic criteria of efficiency and accountability. (Abernethy and Stoelwinder, 1995)

**Methods**

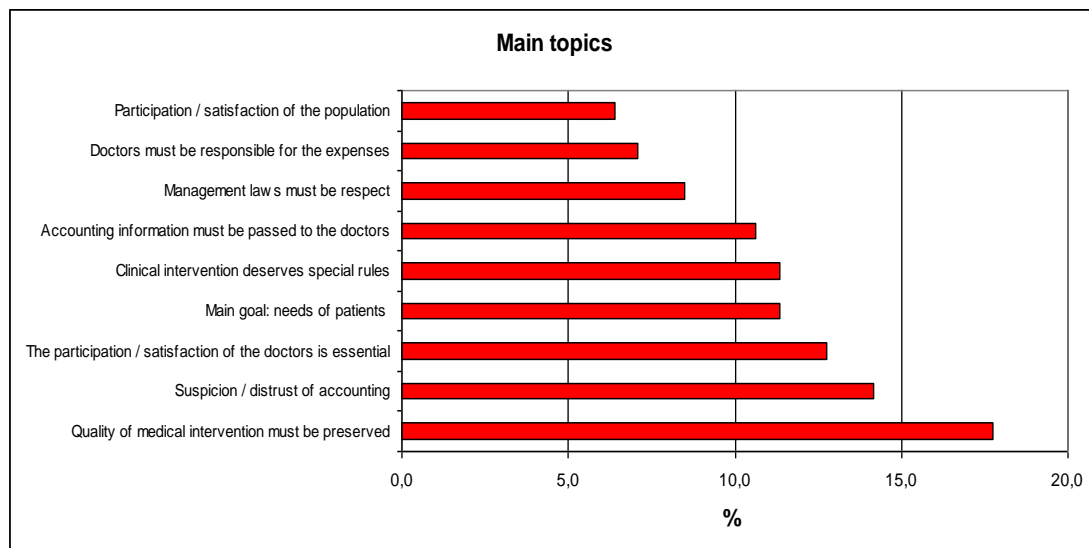
In order to understand how and why management accounting systems is involved on this process, we present an exploratory case study. Case study is the appropriated research method for studying contemporary and complex phenomena (Yin, 1994).

We collected data from: (i) informal meetings with key informants; (ii) documental support; (iii) questionnaire to clinical staff; (iv) "open-ended" interviews to 21 physicians of the health unit.

Data analysis of the interviews corresponds, essentially, to what is known as a "content analysis" The objective was to convert the original texts into significant units, by reading several times the original text and using a software program, whenever indicated.

**Results**

In the next figure, the main topics which resulted from the qualitative analysis are presented graphically, according to their frequency.



## Discussion

This work demonstrates that the medical speech frequently recaptures the underlying conflict in current medicine, a result from the confrontation between the physicians' personal, high and old expectations and management practices. Doctors, probably strengthened by previous competitive training experience and great personal demands (Foster and Anderson, 1978), tend to disagree with practices that transform clinical acts into simple numbers, uniform procedures using low standards and convert “noble art” into a repetitive and monotonous task.

It seems reasonable to think that the aversion to Accounting only appears when it is associated to a “third person” that is easily seen as an uninformed intruder on the contours of clinical situations and that powerfully withstands between “doctor-patient”. Generally, doctors seem to be clearly available and open to develop strategies for the appropriation of the basic accounting knowledge and techniques so they could interpret and use the accounting information.

**Keywords:** doctor-manager relationship, hospital management, accounting information

## **CROSS-GENERATIONAL ORGANIZATIONAL COMMITMENT: EVIDENCE FROM A FIELD STUDY IN GREECE**

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### **Abstract**

We are in the midst of a well-documented world-wise shortage of young employees. This shortage is expected to worsen in coming years. Efforts to recruit employees at a young age, while retaining older employees, have resulted in, at least, three generations in the workforce. As recruiting and retention efforts continue, the concept of organizational commitment across generations is important to consider – since research has demonstrated that enhanced organizational commitment leads to positive outcomes both at the individual and organizational level of analysis. The current study investigated whether generational differences impact the level of organizational commitment experienced by younger vis-à-vis older Greek employees.

In line with expectations, and previous findings, results demonstrate that significant differences do exist between generations regarding exchange-based commitment – particularly, continuance commitment and the social obligation aspect of normative commitment. Yet, contrary to previous findings, no differences were identified with respect to affective commitment – highlighting, perhaps, the particularities of the Greek cultural context.

Recommendations for practice are discussed, along with suggestions for further research.

**Keywords:** Diversity management; aging; organizational commitment; Greece



**THE IMPACT OF OIL PRICE INNOVATIONS ON THE RELATIONSHIP BETWEEN  
TOURISM AND ECONOMIC GROWTH: A STRUCTURAL VECTOR AUTO-  
REGRESSIVE APPROACH FOR EUROMED COUNTRIES**

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**Abstract**

There is a wealth of literature on the interrelationship between tourism income and economic growth. This relationship, however, is rarely examined under the prism of an exogenous shock. As such, the current study is focused on the effects of oil price innovations on the tourism-led-economic-growth hypothesis (economic growth is approximated by industrial production). Furthermore, these effects are filtered through inflation and stock market volatility. The latter is used as an approximation of economic uncertainty which is caused by oil price turbulence.

To this end, we develop a Structural Vector Auto-Regressive (SVAR) model using monthly data from 1995 until 2010 for five Mediterranean countries, namely, France, Greece, Italy, Portugal and Spain.

Our results indicate that tourism income is having a significant effect on industrial production; although, the reverse is not true. Finally, both tourism income and industrial production are affected by oil price innovations and economic uncertainty.

**Keywords:** Oil price innovations, SVAR, tourism-led-economic-growth hypothesis

## PRIVATE BANKING CONSUMER PERCEPTION AND THE INFLUENCE OF AN ACQUISITION

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### Abstract

The aim of this paper is to present the methods and methodology used to gather empirical data about private banking consumer perception and the influence of acquisition on this perception. This is a very important topic in today's economy as the numbers of mergers and acquisition increases due to the ongoing globalization.

At the first stage of the research process, a systematic literature review of qualitative and quantitative literature on private banking consumer perception was conducted. Determinants of client consumer perceptions based on the literature were elicited. These determinants were transferred to the model of determinants of perceived service quality developed by Parasuraman, Zeithaml & Berry (1985). Limitations of this model in terms of private banking consumer perceptions are discussed. Further, the research paper highlights the reasonable assumption that acquisition might have an impact on the private banking consumer perceptions. The gathered data has been used to create a hypothesized model of private banking consumer perception which will be validated by empirical research.

In the next step, the researcher used a case study method to gather primary data. One aim of the case study is to explore phenomena and to understand them within a particular context (Yin, 1984). The researcher analyzes changes of private banking consumer perception in context of an acquisition. Bryman and Bell (2007) described a case study as a vehicle in which several qualitative methods can be combined and by doing so it avoids too great reliance on a single approach. The researcher's case study vehicle consists of observations and semi structured interviews.

Perception is defined as a process by which an individual receives, selects, organizes and interprets information to create a meaningful picture of the world (Creamer, 2007). It depends on internal factors such as beliefs, experiences, needs, moods and expectations and is influenced by the context in which it is seen or heard (Belch & Belch, 2009). There are many parties involved in the process of an acquisition and these parties have an influence on the perceptions of the private banking consumers as they form the context and influence the internal factors. Thus, all parties which have an influence on the topic under investigation like private banking consumers and client advisors as well as consulting companies will be observed and interviewed. Due to the consideration of relevant groups of actors and discovering interactions and relations between them, case studies are a multi-perspective analysis and allow the researcher to

understand the perception from the viewpoint of the “elite” (Feagin, Orum, & Sojberg, 1991) who have the biggest influence on the topic at hand. This offers the researcher a holistic view (Patton, 1990) on the present subject. The holistic case study is shaped by the principles of qualitative research and serves for the evaluation of complex procedures that were not treated effectively with quantitative designs (Scholz & Tietje, 2002). Hence, the researcher is collecting qualitative data which captures the richness of details and nuances of the phenomena being studied (Collis & Hussey, 2003) and as well uses small samples (Varkevisser, Pathmanathan, & Brownlee, 2003). Due to discretion and banking secrecy, the author will not be able to address or contact a high number of private banking clients and, thus, the sample number will be compared to quantitative approaches, small. Snowball sampling is used to locate interviewees. The researcher asked individuals to provide the information needed to locate other members of that population (Babbie, 2008). This method is useful when access or to locate appropriate subjects for interviewing is difficult (Gray, Williamson, & Karp, 2007; Babbie, 2008). In the present research clients are difficult to locate due to discretion and the banking secrecy.

The researcher will use the philosophical standpoint of a critical realist who has the skills to construct theory about mechanisms and to discover their effects. These mechanisms are real but not directly accessible and produce social phenomena (Bryman & Bell, 2007). This allows the researcher to discover the mechanisms (determinants and factors) that form and influence private banking consumer perception.

It is assumed that further determinants will be found by collecting primary data in addition to the ones gathered by the systematic literature review and that the empirical data proves that acquisition has an influence on perception. Further, the initial conceptual model of private banking consumer perception will be validated, too. With the knowledge gained by this research private banks are able to recognize bank consumers’ expectations and perceptions. This increases the competitiveness of banks as customers needs can be fulfilled and client movements during an acquisition process will be reduced.

**Keywords:** Private Banking Perception, Expectation, Acquisition, Internal and External Marketing

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## ARE FUTURES HEDGE RATIOS STATIONARY?

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### Abstract

There are techniques available for reducing and managing financial risk; the most widely used is hedging with futures contracts. A considerable amount of research has focused on modelling the distribution of spot and futures prices and applies the results to estimate the optimal hedge ratio (HR) using OLS, GARCH, ECM and VECM (Floros and Vougas, 2004; Degiannakis and Floros, 2010). Several studies have investigated the optimal HR using stock index futures estimating a constant and a time-varying HR. According to Sutcliffe (2003), stock index futures can be used to hedge market risk caused by spot price fluctuations. Optimal HRs are estimated by modelling the distribution of stock index and futures price changes within the GARCH methodology which allows for time-dependent conditional variances in the unconditional distribution of price changes (Park and Switzer, 1995). Estimation of optimal HRs has also been approached with time-dependent conditional variance models. To estimate a HR, early works used the slope of an OLS regression of stock on futures prices, while an improvement has been made by adopting a bivariate GARCH framework (see Floros and Vougas, 2004). Although these studies are successful in capturing the time-varying covariance-variances, almost all of them focus on the HR estimation only. The main purpose of this paper is to examine if HR is stationary over time, as we know little about the stationarity of HRs. Previous studies such as Ederington (1979) and Anderson and Dathine (1981) assume that optimal HR is constant when it can be obtained as a slope coefficient of an OLS regression. When optimal HRs depend on the conditional distributions of stock index futures price movements, then HRs vary over time as this distribution changes. Previous studies show the variability of hedge returns over time, and support the hypothesis that optimal HRs of commodities are time-varying and nonstationary, see Baillie and Myers (1991). They report that the HR for each of the six commodities contains a unit root and therefore behaves much like a random walk. Grammatikos and Saunders (1983) were the first to examine HR stability. They considered three different tests and found that the null hypothesis of HR stability in five currencies could not be rejected. Furthermore, Malliaris and Urrutia (1991) examined the random walk hypothesis and concluded that futures HRs follow a random walk. However, Ferguson and Leistikow (1998) prove that regression approach futures HRs are stationary. Furthermore, Lien et al. (2002) use the ADF test and show that the null hypothesis that the optimal GARCH HRs have a unit root is rejected. The result is in contrast with Baillie and Myers (1991) who reported that the

GARCH HRs are nonstationary. The main purpose of this paper is to examine if daily HR in DAX futures market is stationary over time. Our work employs stationarity methods to test if German HR, as well as the covariance and variances of spot-futures prices, are stationary. We apply a bivariate GARCH(1,1) approach to estimate HR and six unit root tests (ADF, PP, DF-GLS, ERS, KK, NG) to examine its stationarity. The results show that the HR is integrated of order zero, i.e. it is stationary (even though the logarithmic values of DAX futures and spot prices are non-stationary). These findings are recommended to financial managers dealing with stock index futures.

**Keywords:** hedge ratio; BGARCH; stationarity; futures; DAX

## CREDIT RATING ANNOUNCEMENTS AND STOCK MARKET RETURNS: THE CASE OF GREECE

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### Abstract

Credit rating announcements or rating news may have significant impact on the stock market returns (Azerki et al., 2011; Ferreira and Gama, 2007; Norden and Weber, 2004). The present paper examines the impact of rating news on the Greek General index of the Athens Stock Exchange (ASE) using GARCH-family models under several distributional assumptions (Normal, Student's-t and GED) for the errors. We focus on the three major credit rating agencies, i.e. Fitch, Moody's and S&P; our analysis considers announcements over the period 2009-2011. In particular, there are 15 rating announcements for Greece between January 2009 and May 2011, as follows Fitch (5 announcements) – Moody's (5 announcements) – S&P (5 announcements), all of which are downgrades. Our results show that negative rating news does seem to have an economically and statistically significant (negative) impact on the Greek stock market only at the day of the announcement (event). We find that the dummy coefficients for pre- and after- the credit rating announcements are insignificant, which suggests that rating history does not matter (Ferreira and Gama, 2007); hence, the stock market in Greece understands downgrades as surprises. Further, market participants recognize downgrades as a wake-up call, especially during bad times of Greek economy or financial crises (Ferreira and Gama, 2007). Further research should examine the spillover effects of rating news on International financial markets using a GARCH methodology.

**Keywords:** credit rating, stock market returns, GARCH, Greece.

**THE PUBLIC CHOICE THEORY AS A TOOL FOR CMO WINE ANALYSIS****Gaeta, Davide<sup>1</sup>; Begalli, Diego<sup>2</sup>; Corsinovi, Paola<sup>3</sup>**

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**Abstract**

The objective of this work is to reconstruct the role of agricultural lobbyist and the national alliances, in determining the outcome of the process of the latest wine common market (CMO) regulations entered into force on 1st August 2009 (Reg. 479/2008), and how these have changed the Commission's initial proposals. Four example of public decisions have been discussed: grubbing up vineyards and liberalization of replanting rights; the abolition of market measures (the case of distillation measures); quality policies (designations of origin) and new rules of wine labels. The approach to the models of Public Choice, included for the first time in a specific context such as the wine sector, has served to focus attention on the processes and the interactions between the politicians and the agricultural associations. The most important innovation in this work is the inclusion of different organizational forms of political interests and wine business representation. It covers not only traditional collective action but also individual action and third party representation. This is fundamentally different from the usual focus on collective action in isolation from other organizational form (Coen, 1997). Public Choice theory has identified as pressure groups or lobby stakeholders, of different size, who participating in the political process. This is often referred to in the honorific terms as doing "public service," which is contrary to widespread impression, because they are motivated by self-interest the same as the people in the market place (Buchanan, 2003; Downs, 1957; Rausser, et al., 2009). Politicians find themselves in front of a trade off in choosing a policy in the general interest of the community that would lose the support of the lobby or encourage the latter and unleash the electorate: they choose the policy that best maximizes their objective function and generated the condition of win set between pressure groups and public decisions (Olson, 1965; Putman, 1988). This positive sum game view of governmental intervention also presumes a political economy which improves the allocation of resources.

The focus of the paper is characterizes by two steps. The first one has studied the structure and behavior of the main actors involved in the genesis of the policy of regulation (from "white papers in 2006"). Then have been identified several sources of



pressure groups working at different levels: European actors (Agriculture Commission; European Parliament; Producer Organizations as COPA, COGECA, Comité Vins CEEV; CEJA; and the relationship of political position between the agricultural Ministers of Italy, France, Spanish and Portugal); Italian actors (Agriculture – Distillation unions; Regions; Italian Agriculture Minister and Young farmers unions); each with a range of different interests. In the second step, are analyzed the effects that individual lobbyist actions have generated on the main themes of the Regulation: the Commission proposal, the activities of lobbyists and political agreement reached in December 2007. The wine sector reform, riding on two key moments (Fischler 2003, and Health Check 2007), determined the configuration of a CMO more conservative than the original proposal from the EU Commission (EUC), despite the many new features and some important items that break with the past (Gaeta, 2009). The great and true expectation was based on the budget that the OCM would have generated: this was to be the main turning point, also gives the right signal to the role that the wine sector has acquired in recent years. In front of this objective it can be said that CMO has failed. The impact of government support on the income of the vigneron is not only most limited, but highly unbalanced in respect to other sectors (such as cereals with more than 70%). Looking at the debates of the Member States (MS) with the EUC, the position taken by MS within the negotiations is determined by the win set adopted by government representatives of each country. The Commission has taken the direction of moving the orientation of the win set, depending on the willingness to “meet “ the interests of the MS and Producers organizations. The EU Commission geared towards promoting common EU interests, as well as promoting its own position. According to the theory of Olson and Downs, the reasons for this lobbyist action are partly attributable to the fragmented action that the agriculture and lobbying system has always expressed its inability to act with appropriate means of pressure, if not for individual corporate battles aimed more to justify the existence of different organization (small or large), rather than worrying about the overall effects of the new economic policy and the future wine sector post 2013.

**Keywords:** CMO wine, Public Choice theory, lobby.

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## TERROR IN THE WORKPLACE: DOES ORGANIZATIONAL CULTURE FOSTER WORKPLACE BULLYING?

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### Abstract

This paper focuses on workplace bullying and the relation of its occurrence with the organisational culture and values. Although a significant amount and level of research has been realised on workplace bullying, it mostly focuses on the incidence and implications of the phenomenon for the individual experiencing it (victim), or the one exercising it (bully). Based on a 300- respondents survey, we explore the relation of the incidence of workplace bullying with the 9 dimensions of organisational culture, as developed for the Globe research project.

The terms “workplace bullying” or “workplace mobbing”, which are used interchangeably, were introduced in the early 1990's, to represent a rather common, with very serious repercussions, yet overlooked phenomenon.

To give a definition, “*Bullying takes place when one or more persons systematically and over time feel that they have been subjected to negative treatment on the part of one or more persons, in a situation which the person(s) exposed to the treatment have difficulty in defending themselves against them. It is not bullying when two equally strong opponents are in conflict with each other*” (Einarsen et al., 1994; Nielsen et al., 2009).

Many studies have indicated that workplace bullying is a reality and its incidence has been repeatedly documented in the past. Indicatively, a recently presented study in Greece has indicated that workplace bullying in 800 white-collar workers occurs at 13% of the sample, with the use of a very conservative measurement technique of the phenomenon (Galanaki & Papalexandris, 2011).

Workplace bullying has multiple implications, obviously to the victim- target (ex. anxiety, irritability, feelings of depression, paranoia, mood swings, feelings of helplessness, lowered self-esteem, physical symptoms, social isolation and maladjustment, psychosomatic illnesses, depressions, helplessness, anger, anxiety, despair, burnout, lowered job satisfaction and wellbeing), but also to the organisation in which it takes effect. Organizations are seen as both responsible for the incidence of bullying (Coleman Gallagher et al., 2008; Hauge et al., 2007; Hoel & Cooper, 2000; Salin, 2003) and the key to reducing the frequency of the phenomenon or the severity of its impact (Bulutlar & Oz, 2009; Coyne et al., 2003; Hodson et al., 2006; Namie, 2007; Salin, 2009). So, organisations, being responsible for a safe working environment for their employees, have an interest in reducing to the minimum the incidence of bullying

phenomena. This does not simply emanate from a social responsibility and ethical stance of the employer. It is a pragmatic requirement, in order to provide the necessary conditions for good performance and excellence to occur.

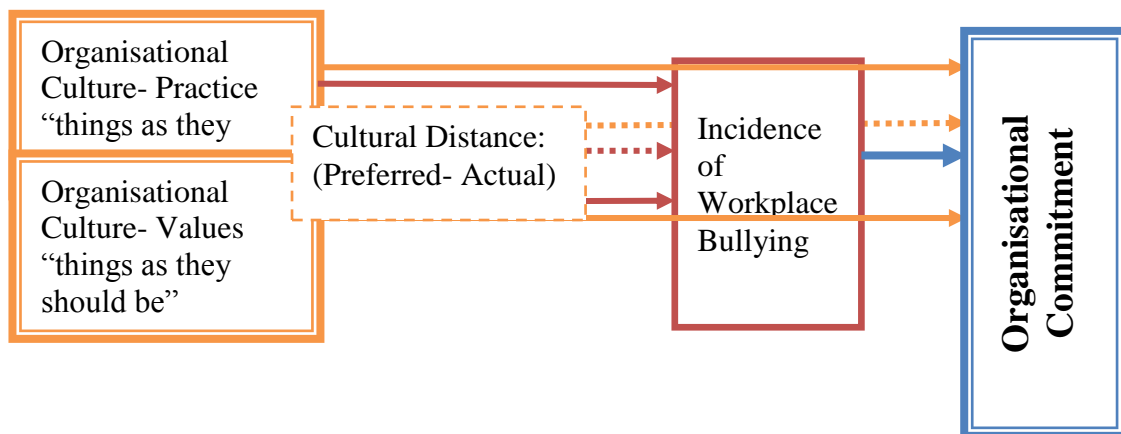
The current research tackles with two questions:

Does organisational culture and values have an impact on the frequency of occurrence or intensity of workplace bullying? Which culture dimensions are mostly related with the incidence of bullying and how organisations could shield themselves from its occurrence?

How does workplace bullying affect the overall organisational commitment?

The relations that we will test can be graphically depicted, in Graph 1:

*Graph 1: Research relations to be tested*



Methodologically wise, the authors have conducted a survey in spring 2011 to 350 white-collar workers from different companies of diverse sectors.

Organisational culture was measured and assessed with the use of the Globe questionnaire on Organisational culture. This instrument has been used extensively as a way to evaluate 9 major cultural dimensions of an organisation and is considered as one of the most reliable scales for the measurement of organisational culture, globally (Chhokar et al., 2007; House et al., 2003).

The researchers also measured the occurrence of bullying with the Negative Acts Questionnaire (NAQ), with 21 types of Negative Acts, which may arise within the working environment. This instrument is one of the most widely recognised and accepted ways of measuring workplace bullying (Einarsen et al., 2009).

Organisational Commitment was measured with the Meyer and Allen commitment questionnaire (Allen & Meyer, 1990). This questionnaire measures 3 dimensions of organisational commitment, i.e. affective, normative and continuance commitment

through 27 questions (9 for each dimension) and is most probably the most well-known instrument for the measurement of organisational commitment.

The study will be useful to a varied audience of academics, researchers and practitioners, mostly in the field of organisational behaviour and psychology, as it tackles with an issue that can have deep and severe implications for organisations, if left unattended. The identification of the roots of workplace bullying at the organisational culture or value system is a first step towards tackling with the phenomenon at the organisational level.

**Keywords:** Workplace bullying, mobbing, organisational culture, Greece, negative acts questionnaire, GLOBE

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## INFLUENCE OF THE SAMPLING METHOD ON BUSINESS FAILURE PREDICTION MODELS

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### Abstract

Since Beaver's and Altman's work, business failure prediction has become an important topic in corporate finance literature and numerous studies have been developed, using a variety of statistical methodologies for predictive purposes.

Most previous models have used a paired sample with the same number of failed and non-failed firms, achieving good prediction results. Nevertheless, this kind of sample has the drawback of not being representative of the population from which it is chosen, since this sampling method does not respect the population proportions on the sample.

In order to prove if the predictive power of the previously developed models is due to the kind of sample they have used, we develop a failure prediction model on the small and medium-sized firms with head offices located in the region of Castilla y León (Spain), using both a paired sample and a random sample based on the population size and composition. Applying a logistic regression analysis, we try to identify the financial ratios, used as independent variables in the respective models, which best explain and predict failure in the two samples.

The obtained results show that there are differences in the variables which become significant in each sample, as well as in the classification results. They are not as high in the random sample as those achieved in the paired one, especially with regard to failed firms, due to its low proportion compared to the non-failed ones.

### Business Failure: Definition and Explanatory Variables

Due to the variety of situations with a negative influence on firms' activity, as well as the diversity of parties involved in a firm, different definitions of failure have been used in the previously developed models, depending on the aim of each one. Nevertheless, the most used definition of failure has been a juridical or legal one (Balcaen and Ooghe, 2006), as it has the advantage of being a highly visible event that can be objectively dated.

These are also the reasons why we consider failure as the firm's formal declaration of one of the three possible proceedings in the Spanish law, which are included under the general terminology of bankruptcy.

Secondly, it is necessary to choose a set of variables to explain and predict business failure. As information extracted from financial statements reflects the firm's activity, most models have included a lot of financial ratios selected on the basis of their popularity in literature and their predictive success in previous research as independent variables to predict failure, as Beaver (1966) did.

Taking into account these criteria, as well as the information availability for the firms in our sample, we finally selected a total of 27 financial ratios classified in the categories of liquidity, profitability, leverage and solvency, turnover and activity, cash-flow, and economic structure.

### **Sample Selection**

The next step forward in the development of prediction models is sample selection.

The most common sampling method has been to derive the sample of failed firms and next to select the same number of non-failed firms by matching them to the failed ones devoted to the same industry and being of the same size.

However, this state-based sample leads to an overstatement of the model's ability to predict, since parameter estimates are inconsistent and biased (Palepu, 1986). In order to prove this statement, we decided to compare both sampling methods regarding prediction results.

First of all, we identified the failed firms in the database SABI, used to collect the information, with the requirement of availability of financial statements for three consecutive economic years. Taking into account our criterion for business failure, there were 59 failed firms, which were chosen to derive the failed sample.

Regarding the non-failed firms, the database included a total of 41,525 companies, and using the formulae appropriate to calculate the size for this group, it resulted in a sample size of 396 firms, which were selected from the same industry in which failed companies developed its activity, attending each industry population size, so as to respect characteristics and peculiarities of different industries. Moreover, each failed firm was matched with a non-failed one randomly selected from the same industry, in order to derive the paired sample.



## Empirical Results

The first step in our empirical study consisted of the application of a Principal Components Analysis (PCA) on the initial list of 27 financial ratios, to reduce the number of variables chosen as potentially explanatory of business failure.

In both samples, six factors were extracted, which were correlated to 15 ratios in the random sample and to 20 ratios in the paired one. Some factors were common to both samples: liquidity, liability structure, cash-flow, economic profitability and current position. However, there were some differences: a specific factor describing turnover, in the first sample, and two important factors measuring equity and working capital issues in the paired one.

The ratios correlated to the factors extracted by PCA referred to the three-year period were considered as independent variables in the models estimated by logistic regression, where some differences were observed.

In the random sample, seven variables became significant, which basically measured different liquidity and current issues, as well as the ability of the firm to generate resources internally. In the paired sample, however, the most important issues in order to avoid failure are some related to equity.

The classification results achieved in both samples are shown in table 1, where it can be observed that the total hit rate is quite similar, although slightly higher in the random one. Nevertheless, the most outstanding difference is observed regarding the classification in each group, since the increase in the proportion of failed firms in the paired sample has involved a large improvement in the correct classification percentage for these firms, while the corresponding to non-failed firms remains quite high. Therefore, the percentage of correctly classified failed firms seems to be higher when a paired sample is used, as the proportion of this group of firms in the sample increases in comparison with a random sample based on the population size.

*Table 1. Classification results.*

<i>Firms</i>	<i>Sample</i>	
	<i>Random</i>	<i>Paired</i>
<i>Failed</i>	43.48%	91.11%
<i>Non-failed</i>	99.59%	75%
<i>Total</i>	90.69%	83.95%

**Keywords:** business failure, financial ratios, sampling, logistic regression, prediction

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## DEFINING CORPORATE REPUTATION

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### Abstract

Corporate reputation is a relatively new construct in management research. While in the past businesses were almost exclusively driven by what is referred to as the 'marketing model', in recent years, also due to the emergence of knowledge-intensive products and to the rise of the knowledge economy, a 30-second advert cannot easily communicate the inherent value of such products – hence, reputation has become more important in creating value for a business (Scott and Walsham, 2005). Moreover, due to the spread of social media, improved geographical connectivity has made it easier for events happening in one part of the world to be almost instantly known all around the globe, thus making the reputational risk more difficult to manage for corporations (Qualman, 2009). Although it can be suspected that people tend to sacrifice values for price when in a situation of economic depression and so things like corporate social responsibility issues might seem to get ignored, according to Page and Fearn (2005) it has become commonly accepted that consumers' buying decisions are affected by organisations' reputation.

It is not just the literature that provides evidence of the fact that, although an intangible, reputation has value. A big business in reputation analysis is emerging. Reputation surveys have multiplied - from *Fortune Magazine's Global Most Admired Companies* to the annual *Delahaye Best US Corporate Reputations Index*. And reputation has become a major buzz word within corporate publications – not just in corporate responsibility and sustainability reports, but in mainstream corporate annual reviews. There can be little doubt that corporate reputation is in the spotlight. But despite all this attention, reputation is a term too often loosely applied and too often confused solely with media relations or CSR.

Although being quite recent as a concept, 'The study of corporate reputation has intensified over the last few years' also resulting in a multitude of definitions (Barnett et al., 2006). Or, as MacMillan et al. (2005) say: 'Reputation is about how a company is perceived by key stakeholders. These perceptions are not built on spin... rather they depend upon stakeholder experiences of a business'. These stakeholders are both internal and external to the organization and include employees, customers, suppliers, even the media and government bodies, although, understandably, customers are the most important group of stakeholders. However, if a corporation's reputation consists of perceptions held by others, who owns that reputation? It seems clear that reputation cannot be 'owned' by the corporation if it consists of perceptions held by others. And if organisations do not own their reputation, how can they manage it?

However, when considering how to manage your reputation – as an individual or as a corporation – one first needs to understand the concept of reputation as distinct from other related concepts.

This paper will set out to answer the above questions. It will start by defining reputation. However, this definition would not be complete without a distinction being made between reputation and other related constructs such as image, identity, brand and legitimacy, too often mistaken for reputation (Brown et al., 2006).

The paper will then discuss the challenges in measuring reputation, the role played by high status reputation intermediaries such as the media and present a case in support of the idea that companies in fact have multiple different reputations and that addressing this concept is a key task for leaders.

The paper will conclude with some implications for management.

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## ORGANIZATIONAL CULTURE, HOSPITALITY AND SUSTAINABILITY: THE DILEMMA OF THE MOUNTAIN HUT

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### Abstract

In alpine regions, mountain huts have been built and managed since late 19th century to offer hospitality to people that want to experience wilderness. These huts have provided during all this time a simple form of accommodation in the most remote places, offering all year round some comfort and security to mountaineers, hikers and skiers.

Traditionally, mountains huts have been operated by institutions such as alpine clubs or tourist associations and are, depending on the season and the type of hut, guarded or non-guarded.

This study explores the organizational culture of two of these membership-based organizations: the Swiss Alpine Club (CAS) regrouping 153 huts located in the Swiss Alps and the Swedish Tourist Association (STF) regrouping 53 huts located in North Sweden.

The analysis explores a dilemma that these two institutions are facing: preserving as much as possible mountain wilderness while operating an infrastructure, the mountain hut, which could potentially threaten all the efforts they both make in terms of preservation. Embracing this dilemma, both CAS and STF have developed a unique organizational culture that attempt to achieve a balance between protecting nature from people's abuse and offering it for people's pleasure.

Reviewing the public discourse of the CAS and STF reveals a culture where not only the organization but also their members and all other users of their mountain huts are together represented as a community sharing a set of assumptions, norms and values that have for main purpose to protect the mountains and regulate their "usage". Using Schein's 3 levels of culture (Schein, 2010), these two organizations are compared, revealing a very similar approach towards hospitality, wilderness as well as a unique sustainable management of these two assets once combined.

The study shows that the approach elaborated by CAS and STF corresponds closely to the concept of "servicescape" developed by Arnould, Price and Tierney (Arnould, Price, & Tierney, 1988). Indeed, and each in their own way, they consciously promote limited managerial control over the staging of the site, they privilege a preservation of the site over customer needs and wants, and they support the idea that providers and

customers enter the “servicescape” together, rather than the customer enters an environment controlled by the provider.

Moreover, both CAS and STF’s emphasize a cult of nature in which the host and the guest should together embrace the same organizational culture in order to preserve it and respect its fragility. The way the mountains are represented through this communion of culture is also discussed using the concepts of “pleasure ground” and “amenity landscape” as proposed by Nepal and Chipeniuk in their work on Mountain Tourism (Nepal & Chipeniuk, 2005). As well, Nyaupan’s discussion on the relationship between ecotourism and nature-based tourism is adopted as a foundation to review CAS and STF’s criteria in defining their core activities (Nyaupan, 2007).

The main conclusions of the study are that CAS and STF have progressively developed a very similar organizational culture that is centered on the respect and preservation of the unique geographical environment they operate into and that paradoxically attempt to take advantage of its fragility, its relative isolation and difficult access to promote their own existence as organizations. In doing so, the culture they propose is in itself fragile as it seeks to maintain a delicate balance between protecting the pristine nature of the mountains and at the same time promoting activities and operating infrastructures that constantly threaten it. The study also shows that these two organizations created a culture of sustainable management long before it became a field of study, a role of pioneer that they both still claim to play today.

**Keywords:** organizational culture, corporate social responsibility, sustainable management, mountain tourism.

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## INTERNATIONAL HUMAN RESOURCE MANAGEMENT: GENERATION Y, RETENTION AND COMMUNICATION

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### Abstract

Human Resource experts working in international settings have to overcome the lack of loyalty in the workplace for young managers. These belong to the so-called generation Y.

It is especially in the hospitality industry that the problem of retention is significant. Increased employment availability in the global marketplace, redefined work life balance and biggest generational shift from the baby boomers to generation Y are the main workforce trends today.

Our work aims to define a plan of action for our client, HotelCo., a Hotel Industry operating with 60 properties around the globe which is being expanding in the next four years causing the workforce to grow by 50%. This requires an intense recruitment activity focused on hiring young people, approximately 22,500 managers.

According to the "Employee Satisfaction Survey" (2010) of HotelCo 55% of managers based in all the Hotel properties are younger than 30 years. 64% of the interviewees declare that they would consider an offer from a competitor and 75% assume that they would accept an offer from another property of HotelCo.

It is necessary to understand the reasons why generation Y does not develop a sense of belonging to the work environment and desire to commit. What are the main work values and expectations of generation Y in comparison to the past generations? What are the HR actions to be taken in order to create loyalty? Answering these questions is useful to understand how to improve retention in international work environments and motivate the new hired staff.

The value of work is a concept that changes in time and space. For example, in the 60's there has been a refusal of the concept of work and political conflicts took to an important student revolution based on the denial of the values of industrial society. In the 80' the youth were called "yuppies", whose work values were oriented on career, earning and promotion. Today, the so-called "generation Y" or the "Millenials" are born between 1980 and 2000 in rich countries. These young people grew up in small families and in a social environment that helped them build a strong self-esteem. They lived an extremely busy childhood full of educational and recreational activities.

Millennials are global citizens with a sense of tolerance towards diversity and skilled users of all kinds of telecommunication devices such as cell phones, iPods, iPads or laptops, they are multi-tasking, e-communicators and bloggers. They are also aware of the risks of technology and of environmental issues. Finally, generation Y expects to keep a balance between work and personal life.

It is clear that it is hard work for the employer to motivate such skilled communicators and confident global citizens. They are fresh thinkers and quick learners, exceptional technological savvy and effective team workers especially in multicultural environments. It is here suggested to improve communication strategies to deal with generation Y. In order to develop a sense of commitment in the long term generation Y need constant constructive feedback and development of its full potential through trainings and a clearly defined career path.

We have elaborated a development program based on communication strategies to be applied according to individual needs and expectations. Standardized applications do not work well with high skilled communicators as is the case of generation Y. Consequently their mentors and trainers have to be good listeners and practice an “open door” policy. HR managers and top managers can take advantage of this program in order to improve retention of the young workforce. Our communication plan aims to facilitate constant interaction with the new hired managers. Firstly, an induction phase has to provide in-depth information of the corporate core values in order to implement a sense of belonging to the organisational culture. Secondly, the assignment of a mentor would help them to be accustomed with the basic work practices and norms. In general mentors are responsible of controlling that accurate feedback and performance appraisal are regularly communicated. Finally, trainings and informative seminars have to be organised both collectively for general issues and planned according to individual needs.

The challenge of motivating young managers to commit and stay in their workplace can be faced with the application of a rigorous communication plan that is institutionalized in the everyday practice of managerial activities.

**Keywords:** International Human Resource Management, Hospitality Industry, Communication, Retention, Generation Y.



## **A VISION FOR ESTABLISHING THE GLOBAL PARTNERSHIP FOR SHARING KNOWLEDGE AND EXPERIENCE IN MANAGEMENT OF SCIENCE, TECHNOLOGY, INNOVATION, QUALITY AND CONFORMITY ASSESSMENT BUSINESS**

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### **Abstract**

To earn competitive edge as well as for ensuring the sustainable market access in the global trade regime under WTO, due to three major Agreements: TBT, SPS and TRIPS, the economies as well as the industries are facing severe challenges to have access to the technical services from science, technology, innovation, quality and conformity assessment infrastructure of any economies. The key institutions responsible for providing these services are: national-regional-international standards bodies, technical regulation organizations, market surveillance operators, metrology organizations, testing-calibration service providers, certification-inspection bodies, quality and environmental management system certifiers, accreditation bodies, scientific-innovation and R&D organizations. These organizations both in public and private are to be operated under certain legal and regulatory regime to cater the needs of the economy as well as to ensure the level play ground for all in the market. Historically in may cases, especially within the technical organizations operating under public sector have been mandated by laws to perform a number of competing functions: both technical as well as regulatory policing, leaving these bodies with a number potential conflict of interests. In most cases, these are the origins of non-transparency and corruption as such leading these organizations to be ultimately dysfunctional ones facing constraints in delivering the reliable and acceptable services to the clients. These have been identified as the major challenges especially in the developing economies not having sufficient and efficient capacity, competency and competitiveness to take part to the global trade effectively. This technical infrastructure are absolutely critical for sustainable industrial-economic growth facilitating trade, protecting the consumer's rights and environment, ensuring the quality and safety of the products, meeting the

customers as well as compliance requirements and underpinning scientific-innovation-technological and industrial advancement.

Identifying the needs and demand, formulating the suitable strategy, developing these national, regional and international technical infrastructure, devising the business plan for efficient-transparent management of these kind of organization through leadership, earning technical competency, developing human capital, evaluating, monitoring and controlling these technical businesses are major challenges not only for developed economies also for developing, least developed and transition economies. Various tools and techniques are to be developed, applied, verified and disseminated. The global views, options and knowledge realms are to be built, shared, and applied through continuous research and communications among the communities.

Unlike all other scientific and technical fields this rapidly expanding field of knowledge has not been built, shared and communicated in a systematic manner globally. Being an interdisciplinary nature, this subject in business management indeed should be fashioned and shared by the people from almost all disciplines. It has been envisioned that practitioners and visionaries in Standards, Metrology, Testing, Calibration, Quality and Conformity Assessment and Accreditation bodies, Scientific-Industrial QAQC-Technology- R&D Organizations, academia, the policy makers, regulators, legal practitioners, standards users/consumer and market surveillance operators would be the main contributors in developing the global views in this field. People involved in analyzing the impact of these technical services on the national, regional and global economy would also be participating in this process in augmenting further these knowledge realms. Scientific, empirical as well as all other methodologies commonly practiced in search of knowledge in the other fields are also to be applied and shared in search of the knowledge in this field to build better understanding for the further advancement of the civilization. This networking through knowledge management will in turn build the knowledge as the commonwealth for the benefit of all human being.

**Keywords:** Business Management, Conformity Assessment, Knowledge Management, Market Access, National Quality Infrastructure, Science & Innovation Management

## A STRATEGIC ANALYSIS FOR DEVELOPING THE CHEMICAL METROLOGY INFRASTRUCTURE OF BANGLADESH

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### Abstract

The “valid, acceptable and reliable measurement” is the fundamental to science, innovation and technological development for sustainable industrialization, protection of consumers’ rights and protection of safety of human being as well as plant, animal and environment. “Chemical measurements” for certification underpinning the trade in this era of fierce competition under WTO trade regime are indeed essential tools to overcome the major barriers due to WTO Agreements on TBT and SPS.

Thousands of Bangladeshi laboratories are providing chemical measurement services with out acceptable, reliable, valid, traceable and internationally recognized quality. It is impossible to attain the confidence and reliability in chemical measurements without having access to traceable chemical calibration system as well as without practicing the “Science of Chemical Measurement” within a national framework for chemical metrology. The “science of chemical measurement” is known as the “Chemical Metrology”. The study has indeed identified this huge “gap” in Bangladeshi chemical measurement system as this essential element is absent.

Assessing the needs and demands in chemical measurements the study has came up with the national strategy and implementation roadmap for establishing the chemical metrology infrastructure of Bangladesh for the year 2009-2021 meeting essential international technical requirements. This ‘national chemical metrology strategy’, endorsed on 12 January 2011 by the Ministry of Science & Information & Communication Technology, Government of Bangladesh is the outcome of an exploratory research consists of thorough investigations, brainstorming, working group consultations, inter-ministerial meetings, and extensive process of strategic thinking. Standards, testing, metrology, quality and conformity assessment practices of many other countries/economies have been investigated. Numerous reports, laws and regulations, literature, publications, opinions, national-international experts' views,

communications with export promotion authorities, chamber and trade associations have been consulted. The recommendations from industry-civil-consumers societies, development partners, UN agencies and private-public stakeholders' active in developing the quality and conformity assessment infrastructure have been incorporated during the consultation process. Internal and external (SWOT) analysis has been done. The strategic options, goals, objectives, mission, visions and activities and implementation pathway for setting up the national chemical metrology services in Bangladesh have been elaborated.

It has identified 07 most important and priority fields in Bangladesh in which more than 90% of the chemical analysis are required. This exercise identified the most suitable option for Bangladesh would be to establishing a Decentralized Partnership Based National Chemical Metrology Infrastructure consists of a number of designated national reference laboratories having required expertise in the selected fields and would be lead by a coordinating designated national reference laboratory, namely, the National Reference Institute for Chemical Metrology (NRICM). This strategic analysis has identified 04 Key Success Factors (KSF) and 25 Key Performance Indicators (KPIs) to evaluate/monitor and control the implementation of this strategy as well as to oversee the performance of the designated national reference laboratories embodying the network of the reference laboratory services.

The strategy has clearly defined 08 packages of services from this national system. Through building partnership with other regional and international reference laboratories in chemistry, the designated reference laboratories would be producing, qualifying, quantifying, storing and disseminating Standard Reference Materials, Certified Matrix Matched Reference Materials (CRMs), would be assigning reference values to the candidate reference materials as well as the working calibration standards, would be running periodic inter-laboratory comparison or proficiency testing programs nationwide to check the national testing status as well as competency. These designated national reference laboratories would be participating to the key, pilot and supplementary comparisons hosted by the regional or international metrology communities under the aegis of APMP, BIPM CCQM and other. This infrastructure will also ensure and promote the training and education in analytical sciences as well would be providing the national think tank for laboratory quality management system establishing effective interactions among academia, industries and scientific communities. To ensure the metrological traceability in chemistry up to international system of measurements (SI) hosted by BIPM globally as well as to earn international recognition, these designated reference laboratories must be accredited by the ILAC MRA signatories as per applicable international standards. Within the partnership based decentralized system the coordinating designated National Reference Institute for Chemical Metrology (NRICM) would ultimately be representing

Bangladesh to BIPM via entering into CIPM MRA for Chemistry (MiC) as such would be participating to the regional and international activities hosted by Asia Pacific Metrology Programme (APMP) and BIPM. To reach these goals, Bangladesh should go through a number of political decisions, legal and institutional reforms, technical and financial challenges. This strategy has clearly identified the key challenges and the way forward to overcome them.

**Keywords:** Accreditation, Key Performance Indicators (KPI), Key Success Factors (KSF), Metrology in Chemistry (MiC), Mutual Recognition Arrangement (MRA), Metrological Traceability

## THE NON ECONOMICAL CRITICAL SUCCESS FACTORS THAT INFLUENCE THE SUCCESS OF A SPORT EVENT

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### Abstract

Traditional management systems that evaluate and measure performance entirely on financial measures, are insufficient in modern performance measurement systems, where one has to evaluate more specific tangible and intangible factors that influence the success of an organisation. Through this study we try to investigate how the different sport organisations perceive the importance of the NON ECONOMICAL CRITICAL SUCCESS FACTORS (NECSFs). The objective is to identify how NECSFs are implemented in the various organisations' sport events and also to recognise the similarities and differences in characteristics and dimensions according to how they perceive and implement the NECSFs.

### Literature Review

Allen et al. (2005) address the positive and negative aspects of events via measurable outcomes that assign a high importance on financial impacts. In contradiction they provide little exploration of impacts -that are less clearly measurable- and the non economical factors. However, the need to assess the contribution that events make in this less tangible area is recognised (Hall, 1997; Allen et al., 2005) but to develop such an analysis requires a narrative as opposed to a statistical approach (Allen et al., 2005). It is accepted that sport event successful organisation involves more than economical parameters. As Ittner et al (1998) and Hemmer (1996) also suggest, non-financial measures of performance are useful to help refocus managers on the long-term aspects of their actions.

### Methodology (Research Design and Data analysis)

Semi-structured interviews (Yin 2009) with key personnel at each sport organisation were conducted as a fundamental part of data collection. The research took place in 2009 in the six sport organizations: FIBA, FINA, UEFA, Lausanne Triathlon, Vardinoyannia International Track Field Meeting, and Cyprus Aphrodite Semi Marathon. Five members from each organisation committee have participated in the study. The interviews were recorded, transcribed and then imported into the software NVivo 8 which was then used to structure and manage the data. Taking into account

the responses, a guide of key indicators was developed. With the help of the NVivo 8, these indicators were encoded, transcribed and analysed.

## Results

Part of the research analysis, identified as NECSFs the factors that affect the effective organisation performance plan to ensure harmonious relationships with all stakeholders in the framework of the event organisation. The interviewees also consider factors of organisational structure that support collaboration between different departments and promote good working relationships while ensuring the participation of knowledgeable staff at all levels. Amongst these factors one may find the sport event evaluation through surveys, feedback from the various stakeholders, the comparison with previous events and the evaluation of the strategic alignment according to the goals set at the beginning. A remarkable importance has been assigned to factors that support safety and security. In addition, a special category of factors involve volunteerism along with responsibilities and actions that are essential for the successful completion of the event. Last, data analysis at the grassroots level showed the importance of factors that help the organisation develop sport and in parallel promote its values while educating the population. In this category, plans, goals and tasks set by the organisers for the specific event are included.

## Conclusion

In order to support the sport organisations to shift towards including also the non economical critical success factors in their organisational plans, a clear and coherent framework is needed which will support the identification, monitoring and the evaluation of their promoting learning and performance assessment.

The framework of the non economical critical success factors must be simple and sufficiently user friendly for a sport event. However, because it is very difficult to organise and plan a universal framework for action and an instrument for evaluation for all types of sport events and all stakeholders, it might be useful to organise a general framework. This framework could follow a personalised process based on the characteristics and dimensions of each sport event so as to use it in a flexible way that ultimately enhances the development effectiveness of the sport event organisation as a whole.

**Keywords:** sport event, non-economical, critical success factors.

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## THE KNOWLEDGE EFFECTS OF PRIOR ALLIANCES ON ACQUISITION PERFORMANCE: AN EMPIRICAL STUDY

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### Abstract

**Motivation:** This paper provides further empirical evidence that prior strategic alliances made with firms similar to or in the same industry as the acquisition target positively affect the focal acquisition's performance. In doing so, the paper aims to fill a gap in the literature on how prior strategic alliances affect acquisition performance.

**Earlier research:** Earlier empirical studies such as Porrini (2004a) show that a prior partner-specific alliance, between a US manufacturing acquirer and target, positively relates to post-acquisition performance. Porrini (2004b), using the same dataset of US manufacturing acquirers and targets, shows that prior general alliance experience is able to positively explain differences in low-tech and high-tech acquisitions. Zollo & Reuer (2010) do an empirical study of US commercial bank mergers and show that prior general alliance experience of the acquirer with any other partner can positively explain acquisition performance provided that there is a lower requirement for post-merger integration and the quality of the acquirer-target relationship is good.

These three published papers are the only ones known to this researcher that study the relationship between prior strategic alliances and post-acquisition performance. This is surprising given the immensity of literature in both these areas. Taking a closer look at the nature of the prior alliance experience studied in these three papers, there seems to be neglect of a middle ground between prior partner-specific alliance experience and prior general alliance experience, namely similar technology or industry alliance experience. This paper tries to fill this gap in the literature by providing empirical evidence that shows how prior industry alliance experience can also positively explain post-acquisition performance.

**Theoretical basis:** Drawing from the concepts of organizational learning theory (Levitt and March, 1988) and learning transfer theory in acquisitions (Haleblian and Finkelstein, 1999), firms that engage in alliance activity will have a stronger propensity to transfer their alliance learning to acquisition activity rather than vice versa (Wang and Zajac, 2007). Also drawing on the concept of absorptive capacity (Cohen & Levinthal, 1990), firms unfamiliar with new technology or new markets engage in strategic alliances to learn from their partners and from the environment that the alliance is exposed to. As they do so, they become more sensitive to this environment and develop a deeper sense of what is important. The more they repeat or engage in this activity, the more they develop absorptive capacity for this new market or

environment. If the timing and opportunity is right, one partner firm may exercise its (real) option invested in the alliance and buy out the other alliance partner (Kogut, 1991). However, as this paper argues, the choice to exercise or not its option to acquire its partner is not the only one firms have. They can also use their newly gained absorptive capacity from their alliance to search for other more suitable targets within the same industry or with a similar technology base and acquire them instead. The value of this alternative option may often far exceed the option value of acquiring an existing partner. Taken together, this paper hypothesizes that the extent to which a firm has engaged in prior strategic alliances that are similar to the target will be positively related to the performance of the acquisition.

**Results:** The results of this paper provide further empirical evidence that strategic alliances can increase performance of a future acquisition (intended or not), and hence increase firm value. It also has consequences for how firms can use flexible strategic alliances relationships to learn and then cross from their traditional markets and industry into new markets and technological environments before making much longer commitments such as market entry by acquisition.

**Limitations:** One of the limitations of the paper is its use of a US manufacturing dataset which has a wide range of industries as the conclusions drawn from this paper may not be the same as those from a dataset of firms that come from a more restricted range of industries. This study also uses the same dataset as Porrini (2004a and 2004b), which is beneficial for the sake of comparison between the results, however for the sake of extending the literature, it may be even more interesting to try the hypothesis testing on another set of data.

**Keywords:** Prior alliance experience; Industry-based alliances; Strategic alliances; Joint ventures; Valuation

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## A HABITUS OF EARLY RETIREMENT IN THE AGE OF AUSTERITY: LESSONS FOR HUMAN RESOURCE MANAGEMENT

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### Abstract

Early retirement must be distinguished from retirement. The former may be defined as the situation at which people do not work, do not seek work and also consider themselves retired, although their age is below the official (depending on the situation and the country) retirement age. OECD (2005) has defined early retirement (*retraite anticipée*) as “*a situation when an individual decides to retire earlier and draw the pension benefits earlier than their normal retirement age*”.

Economic as well as health reasons frequently make people decide to go on early retirement (Bazzoli, 1985). Bould (1980) and Strandh (2000) found that unemployment encourages people to proceed to early retirement - as an exit strategy from unemployment.

However, it is frequently the case that the employers – or the labour legal framework of some countries – may accidentally encourage people to retire early. Fasang (2010) suggested that there are a number of institutional early retirement pathways which people can follow in order to retire early. Higgs et al. (2003) suggested that organizational restructuring, financial offers, opportunities for leisure and self-fulfillment are some of the factors affecting people's decision for early retirement. Blekesaune and Solem (2005) suggested that men may find it easier to obtain an early-retirement disability pension because men usually have more physically demanding jobs.

It has been frequently argued that people in the age group of 55-64 should be encouraged to stay in employment for longer. For example, Euwals et al. (2009) explained that the goal of the Dutch government is to retain 60% of the people of this age group in employment by 2020. The EU has been investing for years on research projects to retain people in the labour market for longer (Ketsetzopoulou, 2007).

An important report by OECD (2006) suggests that the percentage of people in employment in the age range of 50-64 varies significantly between countries and between men and women (also see Phillipson and Smith, 2005).

Human Resource managers do not, normally, want their most talented or experienced personnel to retire early. Experienced personnel at the age of 54 or 60, are still very young and able to work productively. Business needs them in order to train younger personnel and pass the organizational culture to the younger generations. For

example, Brooke (2003) suggested that *"findings refute the proposition that older workers are more expensive to employ than younger employees ..."* (p. 279).

### **The aims of the study**

We principally aim to investigate the factors that make people retire early. Secondly, we aim to suggest initiatives to reduce the burden of early retirement on the modern societies and on business.

### **The data**

Data from all 28 participating countries of the 4<sup>th</sup> round (third edition of the dataset) of the 2008 European Social Survey were used. Only the respondents in the age group 55-64 (including ages 55 and 64) were selected for the analyses. Overall, there were 7011 respondents in this age group. From those, 3940 respondents were classified as active (employment-wise) whereas 3071 were classified as early retired, with an average sample size of 250 persons per country.

### **Results**

Multilevel logistic regressions were used in order to identify the factors that explain the decision of people to go on early retirement. Financial, demographic and other personal reasons can explain the decision of employees to go on early retirement. Education and well as attitudes towards society and political issues are also reasons to take into account. Big differences were also identified between countries but also between regions within the same country.

### **Discussion**

It is important to know which are the employees who are more likely to decide to go to early retirement. Such a knowledge can help governments as well as Human Resource managers to prepare the succession of important employees, or to give to other employees the appropriate motives to stay in employment for longer.

**Keywords:** early retirement, employment

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## INTERNAL AUDIT CONTROL IN THE HOTEL INDUSTRY IN GREECE

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### Abstract

**Purpose:** The Internal Audit Department provides management with sufficient information to determine whether operations are functioning efficiently, effectively and in accordance with management's intent. The study intends to investigate how a well organized Internal Audit Department in the hotel industry will result in lower operating costs and higher quality of services offered.

**Design/Methodology/approach:** The research is based on qualitative data derived through questionnaires addressed towards 28 large luxury hotels in Greece. Each questionnaire contains 24 questions covering the main areas of internal audit measured on a 1-5 rating Likert scale. The sample, although small, represents almost 67% of the total population for this type of hotels in Greece. The data were treated with the SPSS package. Besides descriptive statistics, the Pearson correlation coefficients were used to investigate the major factors contributing to the efficient operation of a hotel internal audit department.

**Findings:** The findings suggest that there is a significant relationship between hotel size and size and efficiency of the audit department. Large hotels with well organized Internal Audit, are found to face lower risks in terms of false information and non-compliance with the rules and legislation. This results in a decrease of operational risks in large hotels vs. the smaller ones. The size of the internal audit department is found to correlate with lower operating costs and risks.

**Practical implications:** The results of the study can be used by hotel management in establishing a well organized Internal Audit Department, or in improving an already existing one, thus providing management with constructive criticism and positive recommendations designed to strengthen and improve performance results and cost effectiveness. This way they can achieve lower operating costs and higher level of services, upgrading the image of the hotel

**Originality/Value:** To the best of our knowledge, no such research has been done so far for Greek hotel industry. Most of the studies focus on economic analysis and profitability aspects. The internal control is a crucial function in the firm and especially in the hotel industry contributing to both the good reputation and the effectiveness of the hotel.

## HOW DO REVERSE LOGISTICS REACT TO A GREEN SUPPLY CHAIN? A CASE STUDY

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### Abstract

Following changes brought on by globalization, the establishment of regulatory bodies (such as WEEE, RoHS) in the EU economic market has had a dramatic influence on the supply chain of entire information technology industry. This has driven the development of Green Supply Chain. From the perspective of green operations, Srivastava (2007) believes that a product can generate significant added value, or be used again for other useful purposes, after it is recovered at the end of its life cycle, and taken through re-manufacturing, updating, re-use, or other processes. Carter and Ellram (1998) believe that green supply chains go through this reverse logistics process to reach their final objective of reducing their use of resources. In view of the important role reverse logistics system plays in the management of green supply chains, this study has chosen reverse logistics as its main focus of research.

This study aims to learn how reverse logistics systems can extend product life cycle and how increased added value can be generated, through the process of reconditioning. The research problem is stated as: "What factors drive the construction of reverse logistics system under the wave of Green Supply Chain? How does the system react to these factors in terms of its players and activities?"

In order to answer this question, a well-known computer manufacturing company in Taiwan is used as the subject for research into reverse logistics systems, as an extension of the back-end operation of that company. We firstly examine the potential drivers from both internal and external as suggested by Carter and Ellram (1998). The resource dependency theory (RDT) is then adopted as a starting point for an investigation into the impact of how these motivational factors have had on the system. The "As-Is" and "To-Be" models of the system are observed, focusing particularly on the "players" of and their "activities" in the system. The overall concept of this study is depicted as below.



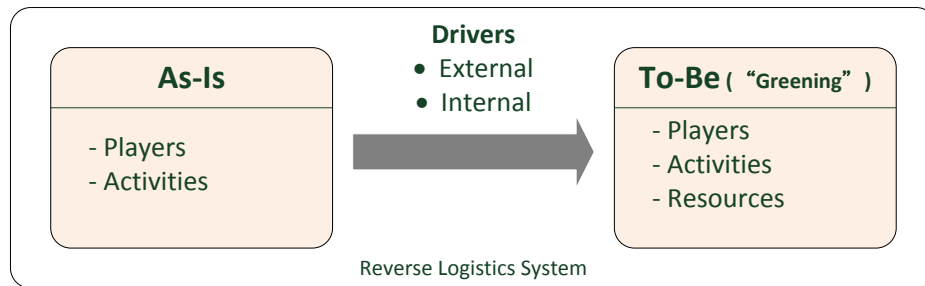


Figure 1. Overall concept for the study

This study uses a case study method to approach the collection and validation of qualitative data. Focusing on the selected case company, we adopted the multiple data collection method as the way to collect our data. These methods include in-depth interviews, plant tours, documentation, and archival records.

Regarding the forces that compel businesses to transform their original reverse logistics systems into one based on green supply chain management, we found that external pressure was due mainly to outside regulations and pressure from competition, as a tactical shift in their strategic dimension. Internally, the main driving force came from support and policy implementation of top management, forcing the business, (within the scope of its operational dimension), to establish communication and procedures internally from the top down.

Product recovery supply chains include four major players: consumers, distributors, manufacturers, and suppliers. The roles of these players are repositioned or renewed following the transformation. Manufacturers move from the original system of disposing recycled products as scrap to extract precious metal from the recycled products that can no longer be repaired. By increasing the exchange of information, manufacturers can gain valuable information regarding the amount of precious metal available for extraction from recycled products or the proportion of original raw materials that could be recovered. This information can then be fed back to the front-end of the product design stage. Where once there was no role for distributors to play, the roles of third party logistics operators and volunteer groups have opened up during the overall implementation of product recovery systems.

The activities involved in the implementation of reverse logistics include five stages: collection, transportation, sorting / inspection, remanufacture, redistribution and sales. After the original recycled products from the internal departments of the business are recovered, they are handled all at once in accordance with the follow-up procedures of processing operators in dealing with recycled products. During the subsequent product recovery process, recycled products are recovered externally from government agencies and general business. The goal of recycling products is to convert them into regenerated products such as computers that are destined for donation in remote areas.

This is accomplished through a two-stage process of additional inspection and disassembly, with redistribution sales. Product recovery activities in shipping and re-processing vary, according to different recovery sources, the quality of the recycled products, and the objectives involved. With regard to the effects they have on the delivery process, third-party logistics operators are commissioned for outsourcing the delivery of recycled products, with assistance provided for the planning of shipping routes. The quality of recycled products for external recycling can only be determined by repair and maintenance operators, while recycled products that cannot be repaired will be handled by third party logistics operators. Products from within the business that are unsuitable for repair are taken away by the processing operator. After passing through repair or maintenance, they have regenerated value and are donated to others for use, rather than having the original recycled products disposed of as scrap by the processing operators. This is accomplished through reprocessing procedures progressing from original product recovery, to added repair and maintenance, to added re-manufacturing.

The take-back method was employed in the research background. Based on this conceptual structure, further development could be made in the reverse logistics system of product buy back. Further, an increase in the sample size could more comprehensively encapsulate the operational criteria of the reverse logistics model.

This study investigates how the reverse logistics system reacts to the internal and external drivers for the “Greening” purpose. It discusses both the “players” and “activities” in the relevant process, and proposes a realistic To-Be model. This model is expected to serve as the basis of a general reference for the computer-related industry.

This study collects practical evidence to investigate the relationship among drivers, players, and activities of a reverse logistics system. By analyzing the As-Is and To-Be models, the roles of “players” and “activities” are re-defines. This study further extends the application of Resource Dependency Theory in the supply chain management area.

**Keywords:** Green Supply Chain, Product Recycle, Reverse Logistics, Computer Industry, Taiwan

## EVALUATING THE TENDENCY FOR ENTREPRENEURSHIP AMONG UNIVERSITY GRADUATING STUDENTS IN CYPRUS

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### Abstract

This study was carried out for the purpose of understanding the tendency for entrepreneurship among university graduating students in Cyprus. Specifically, this study expects to identify the factors that tend be more influential on entrepreneurship as well as the extent to which those factors influence this tendency.

The primary purpose of this study is to understand the tendency for entrepreneurship among university students in Cyprus. Specifically, this study is sought to identify the factors that tend be more influential on entrepreneurship as well as the extent to which those factors influence this tendency. It is crucial to investigate the importance of those certain factors and the extent to which they influence the tendency for entrepreneurship of those who finish their university degrees since these are the type of entrepreneurs that could be more able to generate high value entrepreneurship. A secondary purpose is to compare the results of this study with the study results from other populations.

The data used in this study was gathered from graduating students in the University of Cyprus, University of Nicosia Cyprus, and the Technological University of Cyprus. A self-fulfillment questionnaire will be administered on a personal basis, that is, data will be collected through use of a written questionnaire hand-delivered to participants. In-office research was employed, which allowed high flexibility of data collection. Administering the questionnaire on a personal basis, allows the researcher to explain and clarify questions that were complex in nature (e.g. lengthy and complex scales).

A number of statistical techniques were utilized for analyzing the data. These were ranging from simple descriptive tests such as frequencies, descriptives, crosstabs and multiple response analysis, to more complex tests such as chi-square tests, a one-way Analysis of Variance (ANOVA) tests, and correlation analysis.

This study tested whether the tendency for new ventures among university graduating students depends on socio-demographic, contextual, and psychological features, using a survey questionnaire administered on a personal basis. It identified that the tendency for entrepreneurship depends on such factors as, age, gender, nationality, family background, income level (social-demographical characteristics); university attended, undergraduate program, number of disciplines on

entrepreneurship, oriented incentives programs (contextual characteristics); and associativism, team sports, fortune games, openness (psychological characteristics).

This study was carried out for the purpose of identifying the main factors that influence the tendency toward entrepreneurship.

The first objective of the study was to assess the factors that influence the tendency for entrepreneurship among university students. The current study identified that students tend to assign high importance to motives such as seize the opportunities, to develop the region/country, self-fulfillment, security in terms of income, and be innovative. The current study also identified the most important discouraging factors which are, lack of financing, lack of information, economic instability, lack of knowledge in entrepreneurship issues, and lack of experience.

The second objective was to identify the factors that tend be more influential on entrepreneurship. It was verified that age, university attended, university program, gender, student's nationality, father's education, household income, father's professional activity, mother's professional activity, sports, sports preference, student belonging to sports association, student belonging to social solidarity association, gambling, risk taking, and traveling abroad, are the main variables that influence the tendency toward entrepreneurship.

The third objective was to test whether the tendency for new ventures among university graduating students depends on socio-demographic aspects. The fifth one was to test whether the tendency for new ventures among university graduating students depends on contextual features. Finally, the sixth objective was to test whether the tendency for new ventures among university graduating students depends on psychological features. The analysis of students' responses showed that the tendency for entrepreneurship depends on such factors as, age, gender, nationality, family background, income level (social-demographical characteristics); university attended, undergraduate program, number of disciplines on entrepreneurship, oriented incentives programs (contextual characteristics); and associativism, team sports, fortune games, openness (psychological characteristics).

**Keywords:** entrepreneurship, universities, new ventures, students.

## Tables

Table 1: Conceptual Model

<i>Social-Demographic Characteristics</i>	<i>Contextual Characteristics</i>	<i>Psychological Characteristics</i>
<i>Age\gender</i> <i>Nationality</i> <i>Family Background</i> <i>Income Level</i>	<i>University attended</i> <i>Undergraduate Program</i> <i>Number Disciplines on</i> <i>Entrepreneurship</i> <i>Oriented Incentives Programs</i>	<i>Associativism</i> <i>Team Sports</i> <i>Fortune Games</i> <i>Openness</i>

Source: João Pedro Couto and Maria José Camilo (2007)

Table 5.1: Motivating Factors Classification

<i>Rank</i>	<i>Motivating Factors</i>
1	<i>Seize the opportunities</i>
2	<i>To develop the region/country</i>
3	<i>Self-fulfillment</i>
4	<i>Security in terms of income</i>
5	<i>Be Innovative</i>
6	<i>Aim for profit</i>
7	<i>Freedom to organize his/her work</i>
8	<i>Assume risks and overcome challenges</i>
9	<i>Follow the example of people I admire</i>

Table 5.2: Discouraging Factors Classification

<i>Rank</i>	<i>Discouraging Factors</i>
1	<i>Lack of financing</i>
2	<i>Lack of information</i>
3	<i>Economic instability</i>
4	<i>Lack of knowledge in entrepreneurship issues</i>
5	<i>Lack of experience</i>
6	<i>Risk Perception</i>
7	<i>Lack motivation to creation of companies</i>
8	<i>Lack of education in entrepreneurship issues</i>
9	<i>Lack of support from the institutions</i>
10	<i>Lack of consulting support</i>
11	<i>Lack of mechanism to publicize incentives</i>
12	<i>Political instability</i>

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**VOCATIONAL EDUCATIONAL TRAINING (VET) IN EMERGING MARKETS:  
THE MARKET-ORIENTED AND INNOVATIVE APPROACH TO  
INTERNATIONALIZATION OF EDUCATION SERVICES**

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**Abstract**

In Europe, the theme “Export of educational services” is rather new, but currently politically and economically en vogue. It finds interest in industries, as well as in SMEs, and in the scientific sector.

With view to globalization industries and their suppliers need to invest in emerging markets like Central and Eastern Europe, Russia, South Africa, China or India. There, they face a tremendous lack of well-trained workers below the management level, mainly in technical or commercial vocations.

Internationally unique is that in the German speaking countries (Austria, Switzerland and Germany) the vocational training is provided by the public-private co-management of employers and public training institutions (Dual System).

Abroad, the quality of this co-management system is highly acknowledged, but often the local situations differ so much that the Dual System cannot be installed in the same manner as in the home market.

On top, education in emerging markets is the profit-making and non-profit making good at the same time. Without contributing to the population education on the whole the export of education is politically less accepted, neither in the home country, nor in the emerging markets.

The German educational system is very heterogeneous due to the fact, that the education is ruled by the 16 Federal States and it makes defining common standards and a joint marketing in target markets very difficult. As we can see by the newest studies the export of German education services is underdeveloped compared to the Anglo-Saxon educational systems.

In 2009 the Federal Ministry of Education and Research in Bonn / Berlin announced the strategic goal that Germany should become world champion in the field of education export until 2015. For common marketing and quality standard supervision the label “EDVANCE” (education advanced) as an international brand for German export of education was launched, but it is not executed, yet.

The main focus of this research is to explore the best practice for the export of education services with regard to vocational education training (VET). Based on the

requirements of strategic management, export management, international marketing, business development and other related knowledge fields requirements for the export of education will be compiled to the comprehensive strategic model for the export of education. The market-oriented and innovative model will consist of three stages: Strategic planning, market entry and market penetration.

The research follows the method of “Market-Oriented Innovation Management” based on Kellner (2007: 41). This research method consists of seven steps:

(1) Definition of the specific kind of innovation: the innovative prototype model for the export of VET services to emerging markets is presented; (2) Enquiry about the requirements of the respective users regarding the innovation with the contribution from the literature review including market studies and pilot projects’ reports from Germany, Austria, Russia and Vietnam. And, in the following research stages with the knowledge input from five case studies conducted for the export of VET services in Central and Eastern Europe, Russia, South Africa, China and the Middle East; (3) Description of the characteristics gained from various fields of knowledge co-operation between with Germany and the outcome of the reflected experiences; (4) Development of the innovation: the combination of suitable characteristics to meet the requirements, and to create new features is developed; (5) Innovation’s application and test with view to the required features; (6) Critical reflection of the innovation to improve future operations; (7) Critical reflection of the innovation application to improve the innovation itself. In a shorter form the steps 5 and 7 may be left out and offered to further research.

In this first paper the three stages of the innovative prototype models for the export of VET services are presented. There are based on researcher’s field experience and the described requirements and characteristics drawn from the literature review.

**Keywords:** Globalization, strategic management, export, vocational educational training (VET)

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## EXPLORING LOCUS OF CONTROL IN THE REPUBLIC OF CYPRUS

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### Abstract

**Purpose:** The proposed study is concerned with the cognitive-based construct locus of control. It aims to determine whether citizens in the Republic of Cyprus tend to be more internal or external while also investigating potential differences across gender, age, race and ethnicity. A secondary objective is to determine if college students' locus of control is related to their academic achievement. Although this particular study is cross-sectional in nature, this research is also part of a wider, longitudinal study that aims to determine if an individual's locus of control significantly changes over time.

**Theoretical background and selected relevant literature :** Locus of control refers to people's beliefs about how much control they have over their lives (Lefcourt, 1966; Rotter, 1966). Individuals with a more internal locus of control, called internals, believe that they are in control of their lives. Externals, believe that they have less direct control of what happens to them, attributing their life experiences to external factors or luck that are beyond their control.

Locus of control is a psychological construct derived from social learning theory (Rotter, 1954). It is theoretically linked to the notion of control beliefs (Averill, 1973; Skinner, 1996) which has been associated with various affective, behavioral, cognitive and physiological outcomes (NG et al., 2006). Although control beliefs may be dispositional in nature, unaffected by external reinforcements (Lefcourt, 1976; Phares, 1976), they may also be affected by social experiences (Langer, 1983; Lefcourt, 1976). Locus of control has been studied considerably due to its theoretical importance and practical implications.

Studies conducted on locus of control extend the work on the role that personality has on work behavior. Empirical evidence has shown internal locus of control to be positively related to desirable outcomes such as better academic achievement, mental well-being, life satisfaction, job satisfaction, intrinsic task motivation, job involvement, organizational commitment, higher earnings, transformational leadership, and job performance (Findley & Cooper, 1983; Judge & Bono, 2001; NG et al., 2006; Njus & Brockway, 1999; Spector, 1982; van Praag et al., 2004); and negatively related to job stress, turnover intentions, work-family conflict, overall burnout and depression (Benassi et al., 1988; Howell & Avolio, 1993; HG et al., 2006).

Other studies have investigated whether there are gender differences with respect to locus of control. Parson and Schneider (1974) found female university students to be

less internals than males. Similarly, Khanna, Molinari and Khanna (1977) also found liberal arts college female students to be more externals than males. However, Lee and Dengerink (1992) did not find any statistically significant differences in gender among state university students, both sexes being internals. This finding was similar to those of three other studies in which college students tended to report an internal locus of control (Knoop, 1981; Pascarella et al., 1996; Rotter, 1966).

**Originality/value :** Although numerous studies have been conducted on locus of control in other countries, research on this construct in the Republic of Cyprus seems to be very limited. This research aims to fill this gap by contributing to the paucity of studies carried out on the construct in Cyprus. The findings may provide empirical evidence on whether Cypriots in general are internals or externals, and whether locus of control differs across age and gender. Moreover, due to the racial and ethnic diversity of the residents of the Republic of Cyprus, subject responses may help to identify statistically significant differences with respect to race and ethnicity thus further contributing to our theoretical understanding of the construct while permitting comparisons with studies carried out in other countries.

**Design/methodology/approach :** A quantitative research approach involving a random sample of adults and a non-probabilistic convenience sample of undergraduate students will be used for the purposes of this study. Rotter's I-E Scale (1966) will be used to measure individuals' locus of control. This scale has repeatedly shown high validity and reliability. Statistical tests will be used to determine any significant differences in locus of control across age, gender, race and ethnicity thus permitting for comparisons with the extant literature. Bivariate correlations will also be estimated to determine any statistically significant relations between undergraduate students' locus of control and their overall Grade Point Average (GPA) as a proxy for academic achievement.

**Findings :** Similar to other studies, the results obtained so far suggest that undergraduate college students tend to have an internal locus of control. The complete findings will be presented at the conference after the collection of all questionnaire responses and their analysis.

**Managerial implications/Research limitations :** The findings of this study along with conclusions of the planned longitudinal research should be of practical use to managers. Given the desirable attitudinal and behavioral outcomes associated with an internal locus of control, managers may be able to improve the performance of their organization through better selection and retention of workers that may be achieved by using an appropriate instrument to measure job applicants' locus of control. Additionally, if a statistically significant relationship between internality and GPAs is found, organizations may benefit from management selection practices that seriously

consider job applicants' academic achievement. However, if an individual's locus of control changes over time becoming less internal (more external) with age, then the appropriateness of using locus of control measures to improve selection decisions will need to be reconsidered. One of the limitations of this study is the inherent bias in the non-probabilistic sampling procedure used to obtain responses from undergraduate college students.

**Keywords:** Locus of control, Selection, Cyprus

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## WASTE MANAGEMENT AND SUSTAINABILITY: A NEW BUSINESS MODEL

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### Abstract

We are entering an era of renewed environmental consciousness. Innovative waste management practices are becoming more and more important in socially responsible enterprises. The trend towards corporate responsible behaviours is increasing and the issue about ecological awareness is absolutely relevant today. Producers and retailers are concerned with implementing their environmental efficiencies to act for the good and to improve their image upon their stakeholders. It is necessary to rethink the way that enterprises reduce the production of waste material to achieve sustainability and the way that technological advances can help collect, recycle and reuse waste. Many stakeholders are involved in this process; producers, retailers, citizens and municipalities.

The theoretical framework of systems thinking will be applied to understand the crucial stakeholders' linkages. In practice, there is the necessity to raise awareness on the shared goal of acting in a sustainable way. Producers and retailers need to reduce energy and packaging, citizens have to separate waste and municipalities should organize and control the collection and recycling of dry/wet waste and guarantee their separation.

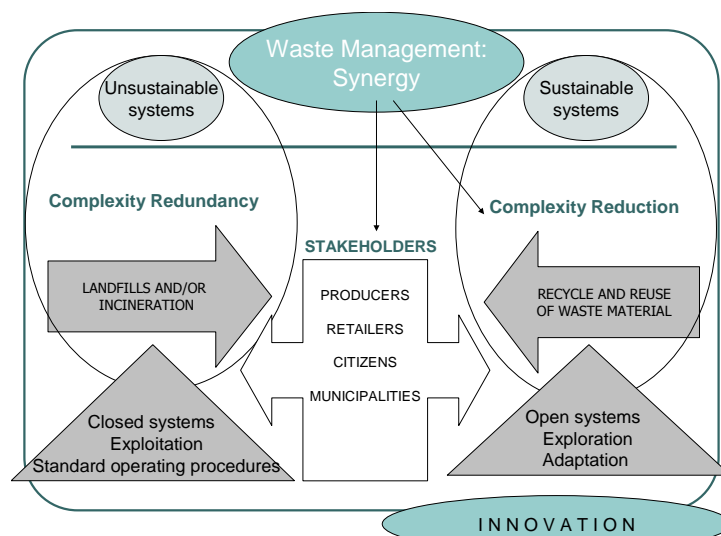
The most influential European and American supporters of the systems theory are Niklas Luhmann, Daniel Katz, Robert Kahn, Russell L. Ackoff, Peter Senge John Seddon and Peter Checkland. A systems theory approach applied to practice helps understand how to solve complex problems by seeing how actions and events influence one another as a whole. Using the language of systems thinking exploration of new forms of waste management or adaptation to environmental threats is the best practice to reduce complexity. Open systems, as opposed to closed systems, have the capability to anticipate change and gain competitive advantage. Indeed, systems thinking competence is needed to manage the complexity of new events and forms of interactions. All independent parts of a whole have to collaborate to reach the common goal of the long lasting survival of our planet. For example, producers, retailers, citizens and municipalities are both independent parts of the same system and connected to one another to accomplish the duty of respecting the environment and anticipating a predictable crisis. The complexity of today's globalizing world combined with the rapid changes must be challenged through new ways of thinking to explore

both innovative technological advances and organizational practices or to adapt to environmental threats.

The new model proposes to collect, recycle and reuse the dry waste that has not yet being recycled. This is crucial to avoid that solid waste will still lie in landfill sites or will be burnt out causing significant damage to the environment. Wet waste refers to organic wastes such as vegetable peels and left-over food. Dry waste is in general mixed waste that does not contain food or other organics. Specifically, contaminated recyclables such as waste paper, metal cans, plastic bottles, floppy disks, batteries, glass bottles, old clothes, baskets, pens and shoes are at present materials for recycling. What remains is still a significant amount of total waste – even in countries with the highest level of recycling, this could be around 15-30%. Right now the solutions are landfill and/or incineration. A potential alternative is to develop an industrial process that could clean and sterilize the waste and to make new raw material for low grade industrial use, like plastic pellets. This innovative industrial process cannot be put into action without the synergy of stakeholders who have to collaborate to fit into a mechanism of coordinated action. Producers and retailers should support this initiative by promoting environmentally friendly behaviours in their advertising campaigns, slogans and packaging. Citizens should separate dry/wet waste and conduct an adequate separate waste collection. Finally, municipalities and even governments should fund new forms of collection to allow innovative ways of managing waste.

This new business model based on the theoretical framework of systems thinking is an important contribution to sustainability because the synergy between stakeholders with diverse needs and expectations is crucial to the long-term survival of our societies.

**Keywords:** Waste management, Systems thinking, Business model, Sustainability.



*Source: own elaboration.*

## WINE TOURISM MODEL IN ALENTEJO, PORTUGAL – TOWARDS A CONCEPTUAL FRAMEWORK

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### Abstract

Alentejo has a long tradition in wine production. However, it's only in the past decade that investors, tourism industry professionals and other regional strategic players began recognising the link between the tourism industry and wine as a relevant factor of regional development and sustainability of its economy. In fact, at global level, wine tourism is an economic activity of rising importance with several potential positive impacts and this explains why countries and regions with a strategic vision of the future integrate it in their tourism strategies. On the other hand, the fierce competition among international destinations, unthinkable until very recently, highlights the need for their differentiation and strategic (re) positioning, based on their endogenous and really distinctive resources. In this context, it is essential to understand the structural dimensions of wine tourism, its dynamics and interactions, in order to develop an appropriate model for the Alentejo region. The literature review on this field of research has revealed gaps in what regards the possible approaches to the development of this tourism product. This paper aims to develop and discuss a wine tourism framework appropriate to the specificities of the Alentejo, a south region of Portugal.

The methodological approach to be followed is based on the following steps: (1) review of the literature on wine tourism, on regional development, on governance and on marketing of tourism products; (2) secondary data collection based on existing studies, reports and statistics on the region's economy, tourism and wine tourism; (3) inventory and assessment of Alentejo's existing wine tourism resources as well as other tourism resources which contribute to increasing the value of wine tourism; (4) primary data collection and analysis, to develop a qualitative study. This should be achieved through interviews with various players somehow involved in wine tourism, public (Municipalities, Tourism regional and Tourism promotion agency and the Alentejo Regional Wine Producers Association - CVRA) and private (owners/managers of wine tourism facilities, wine producers, restaurants and hotels in the region and people in charge of other tourism facilities); and (5) development of a benchmark study about other wine tourism destinations. With these results it is possible to present and

discuss a conceptual framework for an adequate wine tourism model in Alentejo, mainly supported on seven structural pillars: Core wine product, Core destinations appeal, Cultural product, Tourist motivations, Governance, Branding and Distribution.

The wine tourism model identified in this study gives many relevant clues to the owners of tourism facilities and tourism professionals as well as to the destinations managers on the appropriate ways to develop the wine tourism product in this particular region, on levels of accountability among players and on ways to market the product. Specifically, we must take into account the current trend of international tourism demand motivated by “things” related to wine and its degree of knowledge and expertise. The governance model to be adopted is critical to this product success. In terms of requirements linked to its distribution, the importance of focusing on specialized channels should be stressed although mass channels should not be overlooked since we need to take into account the increasing demand by visitors and tourists whose primary motivation is not wine.

**Keywords:** Wine Tourism, Tourism Product Development, Tourist Experiences, Regional Players Dynamics, Wine Tourists, Wine Tourism Models.

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## THE NEGOTIATING CULTURE IN FRANCE: A QUALITATIVE STUDY

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### **Abstract**

We are making four contributions. First, a mix of academic as well as practitioner approaches. Second, our study builds on previous studies about French culture by using an in-depth qualitative approach. Third, our study aims to contribute to the academic debate on methodologies used for qualitative research. Our study uses both ethnographic primary materials (interviews) and secondary data (historical accounts). Fourth, our paper contributes to advance the field of cross-cultural management studies.

The predominant negotiating culture in France is characterized by the effective achievement of objectives through confrontation and logical debate to obtain an advantageous position over the other party. Highly competitive and untrusting, this culture tends to see negotiation as a win/lose situation. It is a formal culture that follows protocol. Extreme and carefully justified opening demands are common. Negotiation is a slow bargaining process in which sometimes threats and rudeness are mixed with charm to pressure the other party. The negotiator is the most senior person in charge, with a supportive team. It is expected that the chief negotiator will take few risks, will manage his time well and will leave the agreements in writing. We found differences between commercial and political negotiations and personal conflict resolution. We used a qualitative research methodology based on 251 structured interviews with open questions on specific experiences with intercultural negotiations. This report includes three studies carried out independently but using the same methodology.

**Keywords:** Intercultural negotiation, France, qualitative methods, French culture.

## EMERGING ISSUES IN HUMAN RESOURCE ACCOUNTING: A CASE STUDY OF INFOSYS TECHNOLOGIES LIMITED

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### Abstract

Now the day's businesses have reached at its developed stage. In any type of business two types of resources are used; active resources and inactive resources. A business cannot be operated unless there is human resource. There are different compositions of the human resource. Human resource is called as active resource as it uses the other non active resource and makes it possible to the best utilization of that inactive resource. We also know that in modern manufacturing environment the quantity of human resource has been reduced up to a great extent but still without a minimum quantity and quality of human resource, a business cannot be operated. Hence, the human resource will always have an upper hand over the other inactive resources.

As the HRA is compulsory neither under the Companies Act, 1956 nor under the Accounting Standards, this paper is an attempt to explore prevailing practices of HRA in Infosys Technology Ltd by applying Lev & Schwartz model.

**Keywords:** HRA, Active Resources, Inactive Resources, Infosys, Human Capital.

### OBJECTIVES OF THE STUDY

The present study has been taken up with the following objectives:

- (i). To investigate current practices in Infosys Technology Ltd.
- (ii). To analyze the current human resource valuation practices.
- (iii). To highlight the challenges confronted by the organization in adopting human resources accounting.
- (iv). To provide information regarding costs and benefits associated with investment in human assets.
- (v). To ascertain whether human resources valuation is worthwhile for internal management purposes as well as for decision making by investors, financiers and creditors.

- (vi). To ascertain the viewpoint of executives professional accountants and shareholders about the desirability of public disclosure of human resource data by corporate enterprises.
- (vii). To suggest effective human resources accounting model for Indian corporate companies.

## RESEARCH METHODOLOGY

1. Sample Area: The present study is a resource approach to manpower. To make the study more concrete and meaningful, the researcher has selected Infosys Technology Ltd
2. Period of the Study: 2003-2004 to 2007-2008
3. Methods of Data Collection
  - a) Primary Sources: The primary data for the purposes of the study have been collected from the corporate office, zonal office and divisional office and branches of Infosys Technology Ltd. Personal interviews were held at various levels of the enterprises viz. managers, executives, supervisors, technical staff, clerical and office staff, etc. to collect primary data.
  - b) Secondary Sources: These include annual reports, journal and magazines, standard books, newspapers and other literature.
4. Sampling Technique: Sampling technique used in the study is deliberate sampling technique.
5. Statistical Tools: To test the given hypothesis and presentation survey findings, the appropriate statistical tools, wherever necessary, have been used.

## IMPACT OF TORISUM IN OMAN ECONOMY

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### Abstract

Oman economy is one of the fast growing economies in the world. The contribution of the tourism sector in the economy is also note worthy. So the government must give more focus on the promotion for this sector this will lead to increase its contribution towards Omani economy.

The Main objective of this research was to find out the impact of tourism sector towards the GDP of the country Oman, along with how can we increase this impact and generate more income from the tourism sector. The study reflects some insight on how to work further in the direction of making tourism sector a backbone of the economic system of Oman.

I use statistical package for social science (SPSS) software to analysis the data. Two variables have taken, number of tourists visit Oman and real GDP, where number of tourists has considered as independent variable and real GDP as dependant variable. Regression analysis will be used to test relation between tourism sector and GDP in Oman.

**Keywords:** Economy, Tourism, GDP, Oman, Variables.

### Introduction;-

Tourism has become a flourishing business around the world. Oman has considered both politically stable and physically safe for tourists, for that it has a medium-term plan, Vision 2020, to develop areas of its economy away from their present dependency on oil and gas production. Information related to contribution of tourism sector on the economy of other countries is introduced in the research scenery data from ministry of tourism are used to study the effect of tourism sector on Oman economy.

### Research Questions and Objectives;-

#### Research questions

- a. Will the tourism industry contribute to Oman economy?
- b. What are the policies that can be used to how increase the revenue from the Tourism industry?
- c. How we can make tourism industry more effective?

### **The objective**

This research is value addition to researches conducted in this area. So, how can we increase impacts and generate more income from the tourism sector .In Oman there is a few research study this area especially the relationship between GDP and tourism. For that we expect to have positive relation between GDP and Tourism in Oman.

### **Research Methods Adopted**

The research includes secondary data for the period (1998-2007), collected from ministry of tourism, chamber of commerce in Salalah and have referred many books like -National accounts bulletin book/ ninth issue 2009, Statistical year book / thirty second issue 2004, Statistical year book / thirty fifth issue 2007, Book the sixth development plan (2001-2005)/ third book in 2001, Book the seven development plan (2006-2010)/ the first document and analyze collected data with the help of statistical package for social science (SPSS) software.

### **Concluding observation**

Research indicates the positive relation between GDP and Tourism sector .Oman on an average has earned around 0.6% to 0.7 % from the tourism sector. This contribution is praiseworthy and worth noticing.

**MARKETING AND COMMUNICATIONS IN ITALIAN UNIVERSITY HOSPITAL:  
THE CASE OF PIEDMONT REGION**

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**Abstract**

Italian university hospitals are a kind of “teaching hospital” that are covered by specific agreements between health institutions and universities, contained in Legislative Decree no. 571/1999 and Decree of the President of the Council of Minister May 24, 2001.

University hospitals are custodian of a triple mission:

- a) delivering specialized and innovative medical care to patients (health care function);
- b) providing clinical education and training to future and current doctors, nurses, and other health professionals (teaching function);
- c) carrying forward scientific research (research function).

This paper aims to contribute to the literature about communication’ methods of services provided and their relevance to users’ needs of Italian university hospital – through the instrument of case studies.

The structure of our paper is as follows:

- a) introduction: the concepts of marketing and communications in health care;
- b) selection of the Italian university hospital located in Piedmont Region, as the sample of the research;
- c) analysis of the characteristics and methods of marketing and communication adopted.

**Introduction: the concepts of marketing and communications in health care**

In the case of marketing for health care, you make a mistake to associate the concept of target marketing to “sell” the image of the company or the services it provides. In healthcare, marketing aims (Caldesi, 2008) not to increase demand, but to increase the relevance of the service provided to citizens’ demands with the ultimate aim of:

- maintaining and strengthening the relationship of trust between the company and the patient, and

- improving the quality of performance from a technical point of view.

Marketing in healthcare (Achard, 1999) assumes, therefore, particular connotations that arise:

- the performance characteristics, and
- the specific rules of law and ethical conduct of providers as protection of (i) health, (ii) process of choice for users, (iii) principles of customization and confidence which is based on the doctor-patient relationship.

Marketing appears to be strictly related to the role of communication in healthcare. Therefore, the latter plays an important role in three major areas of the healthcare setting: prevention, health care services provided and access to them.

### **Selection of the Italian university hospital located in Piedmont Region, as the sample of the research**

In Piedmont Region, three university hospital (AOU – “Aziende Ospedaliere-Universitarie”) has been established. They constitute the sample to be examined as described in section c).

### **Analysis of characteristics and methods of marketing and communication adopted**

The analysis was conducted through observation of the marketing mix variables, listed below and briefly discussed.

1. Services provided: they have four distinctive characteristics (Kotler et al., 2010), which influence marketing programs: intangibility (unlike physical goods cannot be seen, touched, heard, etc. before to be bought), inseparability (services are produced and consumed simultaneously), variable (depending on the person providing them, where and when) and perishability (cannot be stored); in particular, the analysis focuses on the marketing methods adopted on the following services:

- prevention service: as the realization of information campaigns on issues of health with the goal of educating citizens;
- care services: not only as the type of care services offered, but also as formality of access to care;
- teaching activities.

2. Payment of services:

- care service: the Legislative Decree 502/1992 has introduced the system of charging of the National Health Service. The rates are fixed according to the type of performance and they are uniform throughout the country. The health agencies are therefore

considered price-taker for the limited autonomy in the determination of prices of services (except for those provided under professional services). Following measures: DM 15/04/1994 sets out criteria for determining tariffs; DM 14/12/1994 defines the maximum rates for types of services. In this context, Regions must adopt its own tariff in accordance with the guidelines above and DM 1/1995 of the Ministry of Health. Rates are updated and supplemented with DM 30/06/1997. Finally, DM 31/07/1997 containing guidelines for the signing of Memoranda of Understanding ("Protocolli d'Intesa") University-Region, as stated in art. 6, law no. 502/92, provides for Regions recognizing the higher costs induced in the care services of the functions of teaching and research and paying university hospital concerned an integration from 5 to 8% of the value of care;

- educational activities.

3. Promotion: what about advertising techniques for the above mentioned services?

**Keywords:** Marketing of health care, health care services, university hospital, teaching activities, research, promotion, advertising techniques.

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## CROSS-CULTURAL TOURIST BEHAVIOR IN CULTURAL EVENT TOURISM

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### Abstract

**Purpose** – The aim of this study was focussed on an investigation of the tourist behavior who make a cultural journey for the purpose of attending an event, both at the stage of taking decisions about the journey, that is, before undertaking it, and once at the destination, as a function of the dimensions of national culture proposed by Hofstede et al. (2010). From a review of the literature it is possible to observe growing interest in analysing culture within the tourism sector (Reisinger and Turner, 2003). Culture is seen as an effective tool allowing a better understanding of tourists and the identification of similarities and differences among them, this permitting the development of products more suited to their needs and more appropriate and efficacious communication campaigns. There are various theories on culture, but Hofstede's cross-cultural investigation (1980) is one of the most widely accepted and tested of these.

**Design/methodology/approach** – In carrying out this investigation, use was made of data from the international survey performed by the Association for Tourism and Leisure Education (ATLAS). Discriminant analysis was applied to identify the cultural tourist behavior patterns that most strongly distinguished between the cultures that developed, with countries being classified in accordance with Hofstede's cultural dimensions.

**Findings** - On these lines, the study demonstrated that certain tourist behavior patterns are more often by given cultures than by others, with significant differences existing between them.

**Research limitations** – This study was limited to the analysis of a relatively small sample, concentrating on just four European countries (France, Germany, Spain and United Kingdom) and the United States. An investigation including a larger number of countries would permit more interesting and complete results on cultural differences to be obtained.

**Practical implications** – The ultimate objective was to provide information relevant to the development of products and communication strategies by destination managers, tourism enterprises and public institutions that are being aimed at the various markets from which cultural tourists come.

**Originality / value** – In a review of the literature, few references are found to research into the influence of cultural dimensions upon the tourist behavior, and these, moreover, refer to travel in general, not specifically to cultural tourism. This makes it necessary for more exhaustive work to be done on the topic.

**Keywords** - National Culture, Hofstede, Cross-cultural behavior, Cultural Tourist, Information search, Tourist behavior pattern

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**BRANDING FAMILY BUSINESSES IN THE TOURISM SECTOR****Presas, Pilar<sup>1</sup>; Guia, Jaume<sup>2</sup>; Muñoz, Maria Dolors<sup>3</sup>**<sup>1</sup>Universitat de Girona, pilar.presas@udg.edu<sup>2</sup>Universitat de Girona, jaume.guia@udg.edu<sup>3</sup>Universitat de Girona, dolors.munoz@udg.edu**Abstract**

**Motivation and background:** We are in front of a society where there is a hard competition between companies to get a higher market share. It is a race against time through different sorts of strategies to avoid running out of the market place. The strategies of the businesses have to be oriented to the differentiation of the business itself, not just a product differentiation, because that one is easily imitable for competitors.

This paper takes a closer look at how family businesses, which mostly are small or medium companies, can build and manage a brand. We argue that family firms have unique resources and capabilities, called familiness, which affect their competitive position. This supports recent research that has shown the importance for family businesses of developing their own brand. The aim of the present paper is focused on finding out which brand strategy a family business should opt for building a strong and differentiating brand.

**Research Questions:** The main research questions of this article are:

- How a SMEs family business can build a differentiating brand?
- Which brand strategy should they follow?

**Theoretical framework :**The brand is the main mechanism for companies to gain competitive advantage through differentiation on competition through intangible elements of the business, since there are increasingly more products and services to market with the same characteristics (Velilla, 2010). So the key of success is not to be the best, but in fact be different. Building and managing strong brands guarantee a series of benefits to firms, for example customer loyalty, higher profit margins, market value (O'Neil and Xio, 2006), acceptable price changing, brand extension opportunities (Keller, 2001), and lower risk perception by customers (Yesawich, 1996).

Although all companies since their beginning have an innate brand, there is a lack of knowledge about the use of differentiation strategies because of the lack of resources and knowledge. In addition, there is a preconceived idea that the development of a brand is only available to large companies. SMEs have an advantage over large companies which is the proximity between the company and the customer, especially those in service sector where there is direct contact between both parts.

A family business can use the brand as a strategy to communicate the soul of the company to the customers and connect with them emotionally (Berry, 2000), taking advantage of the inseparability of production and consumption. The distinctiveness is achieved through building and communicating a brand well defined, through both internal and external communication (Berry, 2000). The results of the internal communication are the motivation of employees to offer a better service to consumers, which will be a distinctive element. The external brand communication is the information that customer receives about the company and its service, which is not fully controlled by the company, as it is disseminated by the same consumers through for example word-of mouth communication (Berry, 2000).

The traditional communication strategy for family businesses is the use of stories drawn from the history of the family and family business and stress the family business origin, their culture, traditions and other unique characteristics. Storytelling makes an organization more human (Gabriel, 2000). Family businesses should then use storytelling as a management communication tool to create a strong and differentiating corporate brand.

**Methodology:** An empirical study has done using a qualitative research. The sector chosen to perform our analysis is the wine sector which is family-owned in Catalonia, Spain. The data was collected both through interviews with the businesses and from their websites. On one hand we want to characterize the role of the family in the business. And on the other hand, we would like to observe the presence or absence of the family in the brand strategy, and analyse the family business communication strategy.

**Results:** Family firms can uses storytelling as a mechanism for family businesses to develop a differentiating brand. The research is still in process, and we do not have results on the differences between family and non-family firms in this respect.

**Contribution / Research highlights:** The analysis of storytelling as an strategy to build a differentiating brand for SMEs family businesses.

**Keywords:** family businesses, tourism, branding, storytelling

## BRANDING THROUGH CSR: A COMPARISON OF FAMILY VERSUS NON-FAMILY FIRMS

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### Abstract

**Motivation and background:** The present paper explores the relationship between CSR uptake and branding in SMEs. It builds on and extends the goals and activities carried out in the Responsible Med project, a European project involving 9 institutions of 6 different countries in the Mediterranean Area.

One of the effects of CSR on competitiveness has been connected to their marketing effect, which includes its contribution to corporate branding. Although SMEs are in real need of optimizing their processes and investing on differentiation, their lack of scale is a common hindrance to capitalizing on their CSR actions, including its branding possibilities. An additional problem is that many SMEs do not consider the strategic importance of CSR. These circumstances make it relevant to understand better the current state of CSR and its use as part of SMEs branding. A better knowledge can help design policies or support for SMEs to streamline CSR into their competitive strategy.

To tackle this topic, the research questions of this article are: how do firms use CSR as a branding strategy, why do firms engage in CSR, and whether there are differences between family and non-family business in their branding through CSR.

**Theoretical framework:** According to the American Marketing Association (AMA) a brand is a name, term, sign, symbol, or design to identify the goods or services of a seller. But it is something else, a bundle of tangible and intangible elements, which can bring wealth and added value to the business, because it can create a certain amount of awareness, reputation, prominence and others in the marketplace (Keller, 2008). Anisimova (2007) said that the corporate branding represents an opportunity for organizations to enhance and sustain their distinctiveness through linking corporate characteristics to products and services, thereby, allowing unique synergies to be developed.

The strategies of family businesses have to be oriented to the differentiation of the business itself, not just a product differentiation because it is easily imitable for competitors. A brand strategy can serve as an effective way to distinguish a corporate brand from another (Siguaw, et al., 1999), and especially for SMEs family businesses which cannot compete with the same strategies as large businesses.

Some empirical evidence demonstrates that excess levels of CSR investment can be destructive to financial performance (Wang et al. 2008), but that successful brands will be the ones that use CSR activities to provide incremental consumer value matched to product category salience of those values. Yet, CSR has been proved useful as a means of differentiation. For example, Du et al. (2007) find evidence that when a brand positions itself as a “CSR” brand (as opposed to a brand that just engages in CSR activities), consumers’ awareness levels increase, and they further suggest that product-related CSR activities are related to higher levels of awareness.

**Methodology:** To answer to the former research questions of how and why firms use CSR as a branding strategy, a qualitative approach is recommended. In particular, we use a discourse analysis (e.g. Fletcher, 2007) to gauge the nature of CSR branding and the reasons for such branding.

Since branding refers to the visible part of company’s image and culture, we propose an analysis of websites to carry out this research. We study a sample of 100 SMEs in the province of Girona, in the North East of Spain, chosen from the SABI (System for the Analysis of Iberian Balance Sheets) database, which gathers descriptive, financial and legal information on companies in Spain and Portugal. We defined a random sample of SMEs, stratified by the number of workers, following the exact distribution of SMEs in the province, and using the number of workers to be below 250 as the operational definition of SMEs.

We study the website of these SMEs tabulating information on their CSR activities and their connection with company competitiveness and performance, capturing the exact wording of their discourse. To analyse the possible differential branding strategy of family versus non-family firms, we use chi-square analysis/matrix to test the hypothesized different branding strategies of the two groups.

**Results:** Our results up to now point that SMEs make a significant different use of the types of CSR for branding, namely workplace, marketplace, environment and society, focussing more on marketplace and environmental values, as recommended in relevant literature. The differences between family and non-family firms are still under exploration.

**Contribution / Research highlights:**

- Understanding better how and why SMEs use CSR as a branding strategy.
- Measure the nuances between CSR branding in family and non-family firms.

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**FAMILINESS IN TOURISM CONSUMPTION: A CONSUMERS' PERSPECTIVE****Presas, Pilar<sup>1</sup>; Guia, Jaume<sup>2</sup>; Muñoz, Maria Dolors<sup>3</sup>**<sup>1</sup>Universitat de Girona. Email: pilar.presas@udg.edu<sup>2</sup>Universitat de Girona. Email: jaume.guia@udg.edu<sup>3</sup>Universitat de Girona. Email: dolors.munoz@udg.edu**Abstract**

**Motivation and background:** The present paper explores the relationship between familiness and tourism family firms which was initially researched by Getz, Carlsen and Morisson (2004). We take as a reference the concept 'familiness' which has so far only been approached from the perspective of the firm. Our purpose in this paper is to observe and analyze the concept from the standpoint of the consumers, get a better understanding of how familiness is by them perceived and see to what extent the firm and the costumer's interpretation of familiness differ. Then, we explore how this concept can help to better understand tourism consumption and tourist experiences in family firms.

**Research Questions:** The main research questions of this article are:

- What and how familiness is perceived by consumers?
- How does familiness applies to define tourism experiences in family firms?

**Theoretical framework:** Familiness has first been defined as the unique bundle of resources that a family business has (Habbershon and Williams, 1999) because of the interaction between the family, individual members and the business as a whole (Habbershon, Williams, and MacMillan, 2003). A recent definition of the term was provided by Zellweger, Eddleston, and Kellermanns (2010) identifying three relevant dimensions: the implication of the family in the business, the essence of the family conduct, and the relevance of the family in the identity of the firm.

The simultaneous production and consumption of the tourism product make people be a main factor for the successful delivery of the service and to supply a satisfactory experience to the customer (Jones, and Haven-Tang, 2005). Wanhill (1997) suggests that the family may be part of a tourism product, and therefore opens the door to take seriously the analysis of what familiness mean to customers and how they perceive or observe the influence of the family in family businesses.

**Methodology:** To give an answer to the former research questions we have used a qualitative method using the technique of focus group (Catterall and Maclaran, 2006). In particular we conducted 3 focus groups comprising people with different backgrounds and perspectives of travelling. The number of participants in each focus group was 6. The moderator introduced a list of open questions to generate discussion, and additionally during each focus group session was taken notes. The discussions were

then tape-recorded and transcribed for later analyses. The length of the discussions in the focus groups ranged from one hour and thirty minutes to approximately two hours. In the discussions participants talked about multiple stories and narratives depicting how they have experienced what they understand by familiness in multiple situations concerning travel and tourism consumption. The range of experiences explained by the focus group participants included hotels, airports, restaurants, cellars, tourism guides, etc.

**Results:** The results show that customers experience and interpret 'familiness' as a bundle of four dimensions: (1) feeling the hospitality and hospitableness of the firm; (2) perceiving 'authenticity' in the consumption in terms of 'slow' values; (3) experiencing story-telling through narratives that report on the history, traditions and values of the company, the product and/or the owners; and (4) getting to know and having direct interaction with the owners/family or the employees of the firm. In turn, we found that at least some of the dimensions can be found to a higher or lesser extent in both family and non-family businesses. Finally we found that customers value familiness as a distinctive a differentiating element of the products and therefore becomes a relevant element in their buying decision-making behaviour.

**Contribution / Research highlights:** A new perspective of familiness from the consumer point of view.

A better understanding of how firms can incorporate familiness in the tourism consumption experiences of their clientes

**Keywords:** family businesses, tourism, familiness, focus group

## FACILITATING ONLINE COLLABORATION IN ORGANIZATIONS: THE ROLE OF E-MODERATOR SUPPORT IN VIRTUAL TEAMS

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### Abstract

The purpose of this paper is to introduce the concept of e-moderating from online pedagogy to organizational theory and to propose a model that links the role of the e-moderator to the functioning of virtual teams in organizations. The following questions are addressed; how can the concept of e-moderator support be extended to theories on virtual teams and organizational behaviour, and how does online support and facilitation affect outcomes of virtual teams?

### Background and rationale

*Virtual teams* represent a new organizational form that provides firms with new levels of flexibility and responsiveness (Powell et al, 2004: 6). The growing prevalence of virtual teams is being attributed to a combination of technological and organizational developments and several business benefits associated with using such teams (Solomon, 2001). As noted by Martins et al (2004), virtual teams provide “an effective structural mechanism for handling the increased travel, time, coordination, and costs associated with bringing together geographically, temporally and functionally dispersed employees to work on a common task” (Martins et al, 2004: 806). While the issue of *leadership* in virtual environments has received some attention (e.g. Kayworth and Leidner, 2000, 2001-2002, Tyran et al, 2003, Hertel et al, 2005), previous research has mainly focused on self-directed teams, with limited focus on the role of managerial structures (Powell et al, 2004: 15). The existing literature suggests that an effective leader in a virtual team has to lead in ways that are different from established practices designed for the traditional team environment (e.g. Jarvenpaa and Leidner, 1999). Most importantly, according to Kayworth and Leidner (2001-2002) a virtual team leader must be able to “facilitate communication among teammates, create clear structures, foster role clarity, and improve socio-emotional relationships with limited access to FtF meetings” (Powell et al, 2004: 18). According to Powell et al, the lack of attention to virtual team structures is surprising “given the substantial research on team structure in the traditional environment and can probably be ascribed to the relative novelty of virtual team research (Powell et al, 2004: 16). The authors further hold that “investigation of team structure in the virtual environment holds significant promise

for research and practice because it represents perhaps the most controllable and influential aspect of virtual team design” (Powell et al, 2004: 16).

## Purpose

The purpose of this paper is to introduce the concept of *e-moderating* from online pedagogy to organizational theory and to propose a model that links the role of the e-moderator to the functioning of virtual teams. The e-moderator concept is originally used in the context of teaching and learning online, referring to a person that presides over an electronic online meeting or conference (Salmon, 2004). According to Salmon, “the essential role of the e-moderator is promoting human interaction and communication through the modelling, conveying and building of knowledge and skills (...) through using the mediation of online environments designed for interaction and collaboration” (Salmon, 2004: 4). Core research questions in this paper are; how can the concept of e-moderator support be extended to theories on virtual teams and organizational behaviour, and how does online support and facilitation by an e-moderator affect outcomes of virtual teams? In this context, team outcome is understood as the degree to which a team has completed its tasks. Drawing on insights from previous research on virtual teams in general (e.g. Powell et al, 2004, Martins et al, 2004, Dixon and Panteli, 2010) and on global student teams (e.g. Jarvenpaa and Leidner, 1999, Rye and Støkken, 2009), this paper seeks to develop a conceptual framework for investigating the role of leadership in virtual teams.

**Keywords:** Virtual teams, leadership, e-moderator support, facilitation

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## CHALLENGES AND OPPORTUNITIES OF THE NEW GLOBAL FINANCIAL PLAYERS

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### Abstract

**Purpose** – Since the advent of the recent global financial crisis, Sovereign Wealth Funds (SWFs) have emerged as important global financial players. Although the contribution of these funds has been widely recognized, speculation about the motives and objectives of these large funds has remained a source of controversy. While global conditions continue to hinder the availability of capital resources, SWFs continue to increase their role as global sophisticated investors, altering the conventional flow of capital in the global financial market and thus challenging the market model. The purpose of this paper is to evaluate the implications of SWFs in the global economy as well as the opportunities and challenges of these large funds.

**Design/methodology/approach** – This is a research paper based on secondary data analysis. Data is obtained from various official entities. The evaluation incorporates aspects related to investment motivators and the strategic vision of these funds. It also includes an appraisal of the international institutional initiatives in response to the controversy surrounding these funds.

**Findings** – The emergence of SWFs has transformed the traditional flow of capital in the global financial market; there is a significant shift from the dominance of the Western world to the surging importance of the emerging and developing economies. This transformation has also involved public capital financing private investment.

**Originality/value** – Since the phenomenon of the role of SWFs in the global financial system is novel, scholarly research on the topic of SWFs is limited. As the opportunities and challenges associated with SWFs have yet to be finely discerned, this paper addresses some of the current gaps in scholarly research in this area.

**Keywords** – Sovereign Wealth Funds, International Financial System, International Investment, Emerging Economies

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## REDEFINING ORGANIC PRODUCTS

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### Abstract

To define organic products we can identify three ways. The first view is from the scientific perspective, the second is a legislative perspective and the third view is that from commercial perspective, the customer perception. When science, law and the market have different views on an issue, it must be research and propose a solution. After the analyses of that ideas and a research based on some in-depth interviews we put the results in a graphic design: This graphic present different type of organic products. Before this picture we must ask which of these products are truly green.

**Keywords:** green marketing, marketing for organic products, consumer behaviour research.

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### Introduction

To define organic products we can identify three ways.

The first view is from the scientific perspective, the second is a legislative perspective and the third view is that from commercial perspective, the customer perception. The idea behind this article arose during the development of more data analysis research on organic products. Was noticed that what the respondents comprehension on organic products is quite different from what is contained in scientific papers and existing legislation. And as long as science, law and the market have different views on an issue, it must be indicated and resolved in order to better meet the consumption needs as the marketing theory says, to put science in the market service and to legislate what is important for consumers. In view of marketing, organic products are defined focusing on the product life cycle. (Coddington, 1993; Ottman, 1993; Polanski and Mintu-Wimsatt, 1995)

If we talk from scientific point of view should also be mentioned views of some authors who say they can not talk about green product but about greener products (Smith, 1989). From legal point of view the most comprehensive effort in this direction is given by the European legislation (Regulation (EC) NR.834/2007)



Even if the regulations require compliance with established rules there are exceptions that lead to loss of confidence in using eco products.

For example, sustainable production should be made wherever possible using biological and mechanical processes of production through land and related production without using genetically modified organisms.

Food can be labeled as "organic" unless at least 95% of their agricultural ingredients are organic.

For manufactured goods legislation refers only to labeling. Until now, eco-label - "EU flower" was given for 26 product groups, including 3,000 products and services.

The objective is to guide consumers towards products with low environmental impact during the entire life cycle of products.

However, there are important classes of products that speaks as organic market but they are treated from a legal perspective.

Cars and houses are examples with the greatest impact. Regulated pollution rules exist, attempts to refer to types of fuel, but we can not talk about a law to define an ecological car or a house.

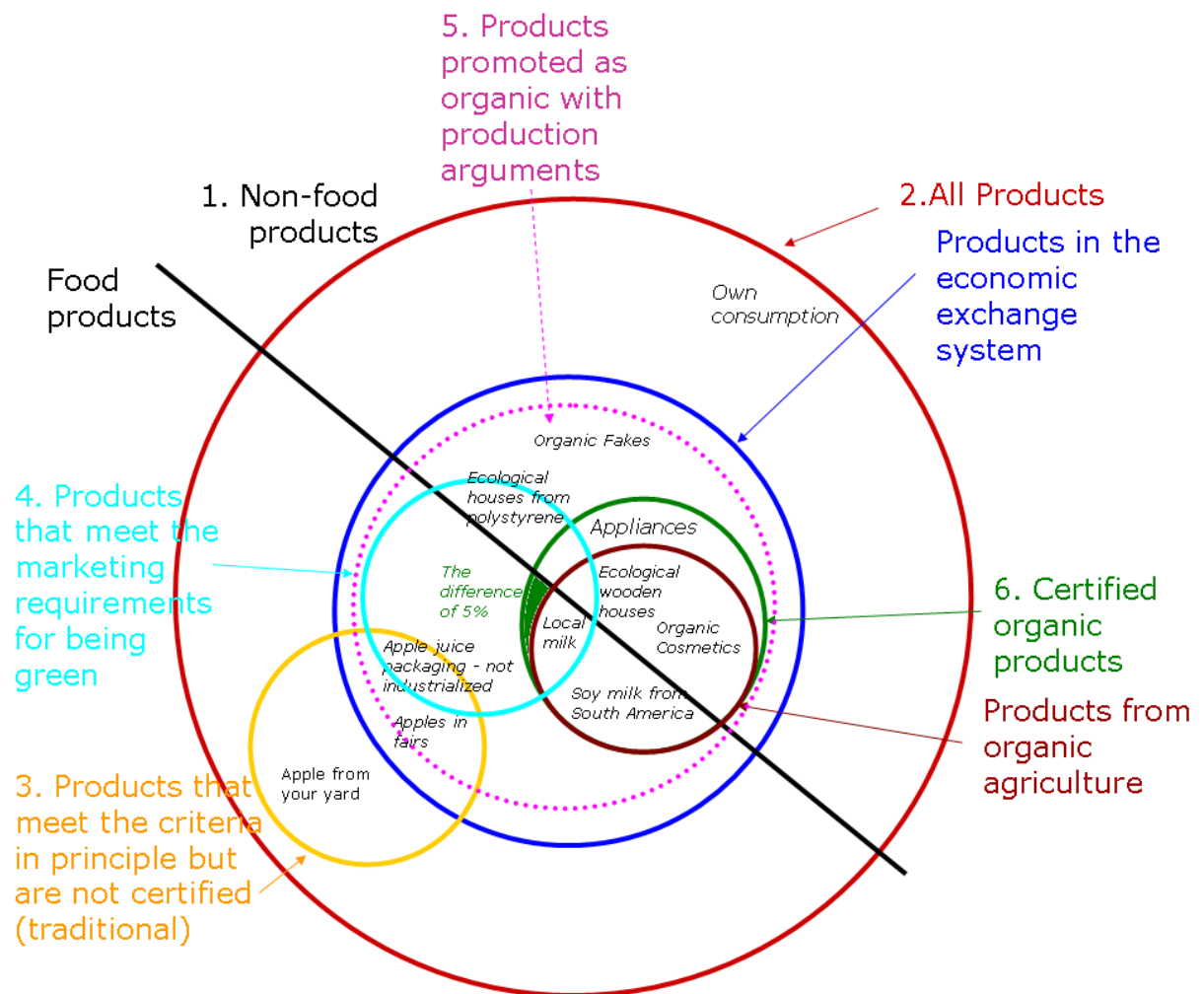
Even so, where legislation exists, there is a control system that certifies whether the product meets all legal requirements and may receive organic certification.

However, some consumers say that these certified organic products are not really green because they are not met other conditions which they consider important.

Such conclusions were drawn after some in-depth interviews about organic products made by people who buy weekly food for their families and who said they buy environmentally friendly products. Following research carried out to see an ignorance of terms like organic products are portrayed in literature or in legislation. Opinion denying the problem exists even for organic products.

After the analyses we put the results in a graphic design:

Fig.1 Different meanings of the term organic



1. The food product are separated from the non food by a line mostly because the respondents often think about ecological products only as food.

2. Considering the fact that not all production enters the economic system but a part own consumption. In many parts of the world there is still a subsistence agriculture due to a large number of population living in rural areas and dealing with agriculture.

3. Some of these products reach the market still having all the qualities of an environmentally friendly product but no one is pointing that out.

4. Some manufacturers realize they can exploit the ecological niche and aim to sell products but not certified organic but with references to natural, no preservatives, traditional, etc..

5. Some of these products do not meet the organic principles but are started on packages such information only to sell more easily, this category I placed it in the organic fakes therein.

6. There are known certified organic products but still have flaws in that it can be declared organic but do not meet a certain criteria or be in an acceptable law.

And since this picture we must ask which of these products are truly green and which ones are you looking for the consumer.

Each of the above cases were identified in the market behind them there are some buyers more or less informed that spend to come into their possession.

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**WOMEN ENTREPRENEURS IN SWITZERLAND: SITUATION,  
CHARACTERISTICS, MOTIVATION AND ENTREPRENEURIAL BEHAVIOR OF  
WOMEN ENTREPRENEURS IN SWITZERLAND**

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## **Abstract**

Entrepreneurs are important for national labour markets and economies in that they contribute significantly to economic growth as well as provide the majority of jobs and create new ones (OECD, 2000; van Praag & Versloot, 2007).

According to the Global Entrepreneurship Monitor's "Report on Women and Entrepreneurship" (Allen, Elam, Langowitz and Dean, 2007), investment in women's entrepreneurship is an important way to exponentially increase the impact of new venture creation. Finding ways to empower women's participation and success in entrepreneurship are critical for more sustainable and successful economic development.

Our results confirm that there are strong differences between men and women entrepreneurs. The reasons for this male preponderance seem to be the lack of specific business skills, the less extensive social network, and the lack of identification patterns among women. Those differences can be explained by the fact that women still have fewer opportunities to make a career. If this is correct, we can predict an increasing proportion of women among entrepreneurs in the next years.

Concerning the development of an favorable environment for developing and enhancing women entrepreneurship activities, our results show the insertion in a network and the role of a model doubtless represent elements determining in the choice to launch an entrepreneurship activity, as well as a precious resource for the success of her company.

**Keywords:** Women entrepreneurship, GEM data, entrepreneurship motivation, entrepreneurial behavior.

## **Introduction**

Entrepreneurs are important for national labour markets and economies in that they contribute significantly to economic growth as well as provide the majority of jobs and create new ones (OECD, 2000; van Praag & Versloot, 2007).

According to the Global Entrepreneurship Monitor's "Report on Women and Entrepreneurship" (Allen, Elam, Langowitz and Dean, 2007), investment in women's entrepreneurship is an important way to exponentially increase the impact of new venture creation. Finding ways to empower women's participation and success in entrepreneurship are critical for more sustainable and successful economic development.

## **Objectives**

Female entrepreneurship is undoubtedly a topic rising in awareness. In the same time, we do not know much about women entrepreneurship in Switzerland, especially concerning entrepreneurship behavior, perception of entrepreneurship, motivation, and growth orientation.

The first objective is therefore to provide an analysis of the key characteristics and context of female entrepreneurial activity and how that may differ from that of their male counterparts.

The second objective of this paper is to provide a comprehensive and up-to-date study of the role played by women involved in entrepreneurial activity in Switzerland.

We also would like to advance the understanding of the needs of aspiring and existing female entrepreneurs, and will help to provide some policy insights useful to develop and enhance a favorable environment for women's entrepreneurship.

Our main hypotheses are that female and male entrepreneurs differ with respect to their personal and business profile: they start and run businesses in different sectors, develop different products, pursue slightly different goals and structure their businesses in a different fashion (Fischer et al., 1993; Brush, 1992).

## **Methodology and data**

For this research, we proceeded to a secondary analysis of the Swiss GEM datasets (Global Entrepreneurship Monitor) of 2005, 2007, 2008, 2009 and 2010.

The GEM project is one of the largest survey-based studies of entrepreneurship in the world. It consists mainly on a phone survey with a representative sample of the population, at least 2000 persons for each edition. It aims to measure annually the entrepreneurship activity in a large number of countries.

## **Definition of entrepreneurship in the present study**

A wide range of definitions of entrepreneurship exists (Davidsson, 2005). For instance, Hebert and Link (1989) describe an entrepreneur as 'someone who specializes

in taking responsibility for and making judgemental decisions that affect the location, form, and the use of goods, resources, or institutions'. In a broader sense, selfemployment and business ownership are understood to be equivalent to entrepreneurship. This occupational definition of entrepreneurship, which is congruent with the Gem's one (Baldegger, Rossi, Schüffel, 2009), i.e., entrepreneurs are people working for their own account and risk, is adopted in the present research.

## Main results

First, we can point out that, regarding women's participation in entrepreneurship, Switzerland reaches an excellent position, compared to neighboring or similar European countries, with 4.5% of women entrepreneurs, just after France.

The men woman ratio is also to be noticed. If in innovation driven economies the ratio is generally of 2 men for 1 woman, in Switzerland this ratio reaches 3 men for 2 women. These results have to be balanced with a relative low level of entrepreneurial activities in Switzerland, under the mean of comparable countries, but regarding our neighbors, still better than Germany and Italy.

Without any surprise regarding our hypothesis, there is a gender effect on women entrepreneurship behavior, activity (sector and industry), perception, motivation and growth orientation.

**Sector and industry, organization:** Women entrepreneurs are widely active in consumer oriented and service (tertiary) activities, for examples, activities related to health, social, or education. These activities take mostly place at the local level and therefore need generally relatively less resources. Women entrepreneurs are therefore under-represented in the transformational industry and in business-to-business activities. Women entrepreneurs can be found in rather smaller (in number of employees) organization than men.

**Motivation, behavior, growth orientation:** The results of the annual GEM report (Bosma, 2009) show that women can enter into entrepreneurship for many of the same reasons as men: to support themselves and their families, to enrich their lives with careers and financial independence and so on. Nevertheless, there are some differences. For the women of our sample, the main motivation is the independence, as their male colleagues, but in a proportion appreciably higher. Women also express less than men their ambition to grow their level of income or to develop their business. As we know (Baldegger, Rossi, Schüffel, 2006), in Switzerland, business growth often requires an internationalization of its activities. It appears that women have much less the intention to internationalize their business than men. Regarding that, it is logical that they are much less numerous than the men (four times less numerous) saying they intend to create 20 jobs or more within their organization.

Finally, companies with high growth potential often find themselves in areas technologically innovative. Women entrepreneurs use relatively less new technologies in their supply, products and services than men.

## Conclusion

Our results confirm that there are strong differences between men and women entrepreneurs. The reasons for this male preponderance seem to be the lack of specific business skills, the less extensive social network, and the lack of identification patterns among women. Those differences can be explained by the fact that women still have fewer opportunities to make a career. If this is correct, we can predict an increasing proportion of women among entrepreneurs in the next years.

Concerning the development of a favorable environment for developing and enhancing women entrepreneurship activities, our results show that the insertion in a network and the role of a model doubtless represent elements determining in the choice to launch an entrepreneurship activity, as well as a precious resource for success.

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## THE NEW INCOTERMS® 2010

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### Significance of INCOTERMS®

Parties to international contracts of sale very often use international commercial terms – so-called INCOTERMS® – in order to define their obligations. INCOTERMS® regulate major obligations of the seller and the buyer for all international contracts of sale, irrespective of the business sector. The terms are characterized by their abbreviations consisting of three letters such as “FOB” (“Free On Board”) and “CIF” (“Costs Insurance and Freight”).

Since 1936 the International Chamber of Commerce (ICC) has published several versions with a set of international rules for the interpretation of trade terms. The present version “INCOTERMS® 2010” names 11 terms and has been in force since 1st January, 2011.

### Application of INCOTERMS®

Although INCOTERMS® have been used for decades, their basis of application has not yet been totally clarified. In order to understand when INCOTERMS® apply, it is necessary to distinguish between the single 11 terms and the rules for the interpretation of these terms as published by the ICC.

The first step is that parties to a contract have expressly to agree on one of the 11 terms. In a second step the single term which the parties agreed on has to be interpreted because the single term does not describe the parties’ obligations. This interpretation is supplied by the ICC’s rules for the interpretation of the terms.

### Structure of INCOTERMS®

The new INCOTERMS® 2010 are grouped in two distinct categories which differ from each other by the fact for which mode of transport the INCOTERMS® are suitable.

#### (i) First category

The first category names the following seven INCOTERMS® which can be used for any mode or modes of transport:

- EXW      Ex Works
- FCA      Free Carrier



- CPT Carriage paid to
- CIP Carriage and Insurance paid to
- DAT Delivered at Terminal
- DAP Delivered at Place
- DDP Delivered Duty paid

These seven terms can be agreed between the parties even when one or more than one mode of transport shall be used for the carriage of the goods. Under the term “EXW” the seller must make the goods available to the buyer at his own premises. When the parties to the contract agree on “FCA”, the seller must deliver the goods free carrier at the named place or at the named port of shipment. However, the seller is not responsible for the main carriage of the goods.

When one of the terms “CPT” or “CIP” applies, the seller must contract for carriage, but without assuming the risk of loss of or damage to the goods or additional costs due to events occurring after shipment and dispatch.

The terms “DAT” and “DAP” are new under the INCOTERMS® 2010. When the parties to the contract agree on “DAT”, the seller must unload the goods from the arriving vehicle and place them at the buyer’s disposal at a named terminal at the named port or place of destination. Under the term “DAP” it is sufficient that the seller places the goods at the buyer’s disposal at the named place of destination on the arriving means of transport in such a way that the goods are ready for unloading.

The term “DDP” establishes the maximum obligations for the seller and thus rules that the seller also has to clear the goods for import, to pay all import duties and to take care of all customs formalities.

#### **(ii) Second category**

The second category lists up the following four INCOTERMS® which can be used for sea and inland waterway transport, only:

- FAS Free alongside Ship
- FOB Free on Board
- CFR Cost and Freight
- CIF Cost, Insurance and Freight

Under these terms the place of delivery and the place to which the goods shall be carried both have to be ports. When the parties agree on the term “FAS” or “FOB”, the seller fulfils his obligation to deliver by placing the goods alongside the ship (“FAS”) or on board the ship (“FOB”) nominated by the buyer at the named port of shipment.

Although under the terms “CFR” and “CIF” the seller must contract for and pay the costs and freight that are necessary to bring the goods to the port of destination, he does not bear the risk of loss of or damage to the goods during the transport.

## Conclusion

INCOTERMS® 2010 have effected relevant changes in comparison to the previous versions and bring the rules in line with current international trade practices.

**Keywords:** INCOTERMS®, ICC, international contracts, transport, shipment, risks

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## DUNDU – THE PHILOSOPHY THAT CHANGES A GROUP

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### Abstract

On the Lotusphere 2011 in Orlando, IBM presented the new strategy for the Lotus Collaboration Software: Get Social, Do Business.

Social Business is the introduction of new Web 2.0 collaboration tools in order to revolutionize the way a company works (IBM, 2011). Especially, the social platform category is an emerging market and is predicted to grow at an annual rate of nearly 40% according to a recent IDC white paper (Traudt and Vancil, 2011). Despite this huge growth potential, a deeper look reveals that the success factors for Social Business and its major goal to transform the company into a more collaborative “Enterprise 2.0” go beyond mere implementation (Pitt, 2011). IDC sees social software as “an enabler to the cultural shift and business process changes that need to take place in order to transform a company into a Social Business.” (Traudt and Vancil, 2011, p.1).

But that also means, in consequence, that the success of the implementation mainly depends on the accomplishment of this cultural shift. It is critical for a social business that the employees start to rethink their patterns of their level of collaboration and communication (Pitt, 2011). Effective communication and collaboration still starts on the personal level, one level below this technological platform, and this will be the critical success factor (Richter, 2010). The employees have to live the change and as early adapters lead by example.

The goal of the paper is to introduce a new concept to communicate and implement Social Software more efficiently in a creative and easy way and to evaluate the results. As stated in the introduction, the level of interaction of the people matters most, and it is not so much about the technology that just indicates where the collaboration takes place (Richter, 2010).

The core part of the paper refers to the adoption of a new team-building instrument called Dundu. Dundu is a puppet that is handled and steered simultaneously by a group of persons (Husemann, 2011). Every member of the group is responsible for handling a part of the body. In consequence, every team member is very important for the team success, and the focus on one common goal leaves personal disputes unconsciously behind.

The main idea of the team-building with Dundu is that social software depends to a great extent on the communication and sharing good will within a company. Dundu

changes groups and individuals through transmitting to them an emotional connectivity. It is exactly this emotional connectivity that makes them collaborate better. Only if this higher level of communication is granted on a personal level, it will be leveraging the positive impacts on the social platform as well and transform a business to a “Social Business”.

Dundu will be used in an activity-based team-building with different scenarios. Every scenario represents a problem or a requirement of a real project in a model environment. The solution of the specific task in the model environment will enable the group to reflect together on the right steps and processes in the real project life.

The research will be designed in stages. In a first step, the theoretical part sums up the development of social software and the importance responding to recent trends towards social networks and an assessment of the key success factors of social software. Furthermore, the literature review will cover the current mainstream approaches for team-building and its importance for change management which is needed for a social business network implementation.

Based on use-cases from current client requirements towards social software, specific scenarios with the puppet Dundu will be developed to accomplish the client requirements. Dundu will represent a simplified model and collaboration platform, and the aim is that Dundu enables the group to solve the problems themselves afterwards. This kind of solution development and gathering from within the group will have higher long-term effects.

The stage three will be the evaluation of the executed implementation workshops both via a quantitative and qualitative methodology. The possible effects of Dundu will be measured with questionnaires. In total, there will be at least three implementation workshops in comparable environments with the client. For the analysis of the quantitative findings, SPSS will be used and through the number of three different implementation workshops with 10 to 15 participants respectively, a reasonable amount of respondents is given as well to underline the positive impact that Dundu has.

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## THE ROLE OF BRAND COMMITMENT IN CUSTOMER-BASED BRAND EQUITY

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### Abstract

This paper discusses the important but neglected role of brand commitment in evaluating customer-based brand equity.

In academic research, there are four different perspectives regarding brand equity . Following Russell and Bick (2005) and Keller and Lehmann (2006) these four perspectives are: (a) *accountancy* – dealing with problems related to the uncertainty and intangible aspects of the future benefits and value of brands, (b) *financial* – the financial worth of a brand based on the brand assets (like plant, equipment and sales) that can be frequently bought and sold, (c) *marketing* - a strong brand facilitates growth of demand; more power and control in the marketing channels; more effective advertising and promotion; and the ability to sell at a higher/premium price (d) *customer* -- representing the total or the sum of the perceptions and feelings toward a brand, including brand loyalty, brand image etc., which are translated into purchasing behavior.

The current paper deals with the customer perspective of brand equity, termed "customer-based brand equity" (CBBE). There are several models or methods that deal with measuring CBBE. The leading models in the academic literature were developed by Aaker (1996) and Keller (1993, 2008).

Aaker's "Brand Equity Ten" model utilizes five categories with a total of ten measures to assess brand equity (Aaker, 1996). The first category, Loyalty is measured by (1) price premium and (2) customer satisfaction or loyalty. The second category perceived quality or leadership is measured by (3) perceived quality and (4) leadership or popularity. The third category other customer-oriented associations or differentiation measured by (5) perceived value, (6) brand personality and (7) organizational associations. The forth category awareness measured (8) brand awareness. The fifth category market behavior measured by (9) market share and (10) market price and distribution coverage.

Keller's CBBE model (Keller 1993, 2008) is built by "sequentially establishing six 'brand building blocks' with customers" (Keller 2008. p. --). These building blocks include: (1) brand *salience*, which relates to the awareness of the brand (category identification and needs satisfied); (2) brand *performance*, concerned with the satisfaction of customer functional needs underlined by the characteristics and features of the product (reliability, durability, service availability, effectiveness, efficiency,

empathy, style, design and price); (3) brand *imagery*, which relates to the satisfaction of the customer's psychological needs (user profiles, purchase and usage situations, personality and value history, heritage and experiences); (4) brand *judgments* focus on customer opinions based on performance and imagery (quality, credibility consideration and superiority); (5) brand *feelings* are customer emotional responses and reactions to the brand (warmth, fun, excitement, security, social approval and self respect); and (6) brand *resonance*, the relationship and level of identification of the customer with a brand (loyalty, attachment, and community engagement).

The current study argues that these two models have complementary dimensions and that *brand commitment* has a major role in evaluating brand equity.

Both models use loyalty, performance and quality, need satisfaction, differentiation etc., factors that are argued to be a part of brand commitment and thus have a major effect on the measurement of CBBE. *Brand commitment* is defined (Shuv-Ami 2010) as *the degree of attachment and readiness consumers have towards a preferred brand that they use and re-buy or re-patronize*. Shuv-Ami (2010) argued that brand commitment has four components: brand satisfaction, brand loyalty, brand involvement and relative brand performance. Based on both Aaker's "Brand Equity Ten model, Keller's CBBE model and others, the current research suggests eight dimensions for measuring CBBE: (1) category, brand knowledge and usage; (2) brand image; (3) brand personality; (4) brand overall attitude; (5) brand commitment; (6) brand recommendation; (7) market share (at the moment of measurement, it is not a variable); and (8) potential or future market share (future intentions to buy the brand). This research shows that brand commitment has a positive impact on the other dimensions of brand equity.

Based on data collected from an Internet panel of 1004 consumers from the financial industry, it was found that brand commitment has a strong relationship with most of the dimensions of brand equity. Commitment was highly correlated with overall attitude, brand image, brand personality (the positive aspects) and brand recommendation. However, low correlations were found in the relationship of commitment and usage and brand knowledge.

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**MOVING ON FROM THE BEACH: MEDITERRANEAN DESTINATION  
DEVELOPMENT FOR TWENTY-FIRST CENTURY MARKETS**

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**Abstract**

This paper contends that significant changes in the values and expectations of northern European leisure markets mean that the nature and characteristics of conventional resort destinations in the Mediterranean region are becoming less well-attuned to tourists' needs and wants. After an assessment of the present situation, consideration of changing twenty-first century market preferences indicates an increasingly apparent product: market divergence, and particularly in relation to the lack of provision for holiday activities and 'soft adventure'. Destination product development needs are identified, and proposals made for the provision of new attractions based around biophysical and cultural resources by Destination Management Organisations and others. Drawing upon experience from central and northern Europe, proposed developments will complement existing products at relatively low cost, offer opportunities for entrepreneurial activity, and address elements of destination sustainability.

## THE DYNAMICS AND PATTERNS OF PARTICIPATION IN TOP MANAGEMENT TEAMS: GENDER PERSPECTIVE

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### Abstract

The proposed research program aims to elucidate the dynamics of involvement and participation of women and men in top management teams (TMT), focusing on conflict management and decision-making processes. Specifically, the investigation attempts to discern the subtle and hidden aspects of gender construction in such senior teams and their effects on power relations between women and men as reflected in decision-making and conflict management processes.

The emphasis of research program is on group dynamics in teams characterized by diverse membership, due to the mounting prevalence of these structures in organizations and the organizational reality of highly heterogeneous workforce. Notwithstanding the burgeoning research on diversity in work teams, studies highlighting this feature in the dynamics of TMTs, especially gender diversity have been scarce. The importance and potential impact of strategic decisions made in such groups and the fact that women are more likely to be involved in these processes warrant in depth examination of the internal dynamics of TMTs, particularly patterns of participation and influence exerted by women in comparison to men.

The research is based on integration of two corpuses of knowledge: the role of conflict and diversity (notably gender) in the processes of decision making and conflict management in teams and gender perspective on management. Based on these bodies of literature, we study women's formative experiences as members of TMTs; namely, how women, in comparison to men, engage in negotiating authority (or legitimacy), value (in recognition and reward), support (developing networks) and commitment (definition of "successful" TMT member).

## MAIN DEMOGRAPHIC CHARACTERISTICS INFLUENCING CONSUMER BEHAVIOR ON EMERGING FINANCIAL MARKETS

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### Abstract

This article aims to provide a picture of the main demographic characteristics influencing consumer behavior on emerging financial markets. Financial products consumer has a different behavior in some ways, both because of financial products and their characteristics and attributes and also because of the individuals' intrinsic influences, most commonly including demographic characteristics. Financial products mean money and money means an extended emotional baggage. The research method is a survey based on a sample chosen with the "snowball" method undertaken in 2010. There were gathered 500 questionnaires and only 478 were analyzed. Research is not a statistical nationwide representative because of the lack of the financial and human capabilities. The research was conducted on the Romanian financial market, which meets the characteristics of an emerging financial market. The study objective was to determine the most important factors that are influencing the decision to invest. From the research resulted that different financial products are preferred by individuals with specific demographic characteristics like income or family structure.

**Keywords:** marketing, consumer behavior research, demographic characteristics, emerging financial markets

### Introduction

Financial products consumer has a different behavior in some ways, both because of financial products and their characteristics and attributes and also because of the individuals' intrinsic influences, most commonly including demographic characteristics. As Erlich and Fanelli say, financial means money and money means an extended emotional baggage (Erlich and Fanelli, 2004). Individual attitude toward money is an extremely emotional one. Unlike consumer goods when taking the decision to purchase a financial product they do not buy one brand but rather rely on the advice of financial intermediaries in the final decision (Lewis, 2008).

Thus, on international financial markets purchase decision models appear being extremely complex may be because of the inviolability of financial products on the one hand, or because of the uncertainty of profit generating and also because of the

financial risk, not insignificantly, which may precede a wrong decision. Marketing literature presents a complex five-step model of decision making (Assael, 1995; Kotler, 2008). The need to model the purchasing behavior based on demographic and psychographic criteria such as gender, age, financial situation, social situation, adaptability, risk, etc. is also very strong. (Tang et al., 2007).

On emerging financial markets, like the one in Romania, such initiatives are limited. For the financial market in Romania, specially, the initiative in this direction are sporadic taking place only in recent years (Olteanu and Vlad, 2007; Dragotă and Șerbănescu 2010). Thus, the need to start a research based on the finding the main demographic characteristics that might influence the consume behavior for different financial products.

## Methodology

Right from the beginning we state that the research is not a conclusive one, but an exploratory research. The questions were introduced in an omnibus-type research carried out in summer 2010. The research carried out in 2010 was based on the results of another research driven in 2009 and the research tool has been improved based on its' results analysis. 500 questionnaires were applied and 478 among of them entered in the analysis.

Sampling was done using the "snowball" method (Cătoi et al, 2009). The research was conducted on the financial market in Romania, which has the characteristics of an emerging financial market. Main purpose of this study is to determine the demographic characteristics of individuals to those with a greater appetite for savings and investment.

## Results

We present here only the main findings. For each financial product investigated a consumer profile emerge, but because is not a conclusive research the emerged profiles are only informative ones. The results are to be tested in a larger research that is taking place this year. Because of the fact that the analyzed questions are part of an omnibus research, which included a series of questions on the ecological conduct, a new idea emerge that the profile of the person with high appetite for investing is the same with the one that also consume ecological products, a modern consumer. This idea is to be further tested.

If we take a description of each type of investment instrument after the socio-demographic characteristics of the main consumer, it would be said that certificates of deposit are chosen mainly by women, over the age of 64, with middle or very advanced studies, being persons either with management responsibilities or

technicians and operational workers, rather high income, married, having children and being rather provincial.

Government bonds in exchange are chosen especially by men, between 36 and 55 years old, highly educated, middle income, married with children, as specialists or technicians, and being rather provincial.

Investment funds are chosen mainly by men, 36-45 years, post-graduate studies, with medium to high incomes, divorced or widowed, childless, specialists with intellectual and scientific occupations, from the province.

Shares and bonds might be preferred rather by male, 18-45 of age, with school or college education, not married or living with a partner, no children, holding management positions or technicians.

Term investments are rather to be chosen by people between 18 and 35 years with secondary or university education, high income, who are single or living with a partner, no children and being rather from the capital.

Alternative investments are chosen rather by women aged between 46 and 65, high school, with medium incomes, officers or operatives workers.

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## INNOVATIVE STRATEGIES OF ELECTRONIC COMMUNICATION IN THE GREEK BANKING SECTOR

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### **Abstract**

In an attempt to remain effective, flexible and competitive in today's rapidly developing technological environment, banks increasingly recognize the benefits of the Internet to meet the needs of the modern consumer. Bank management aim and develop their customer base by implementing strategies that achieves an equilibrium between physical and virtual presence. While online banking (e-banking, mobile banking) has increased immensely in Greece there is insufficient evidence concerning its acceptance by consumers.

The purpose of the present study is to examine the impact of the implementation of innovative electronic communication strategies to attract new customers and to satisfy the existing ones. Another objective of this paper is to investigate the impact on quality of online banking services on customer behavior. Finally, the diagnosis of online risks and whether these risks are associated with the adoption of new technologies or not by customers, is the corner stone of this study.

The research sample consisted of 153 customers of various banks in the region of Central and Eastern Macedonia in Greece. The formulated questionnaire was administered personally and through the Internet between February and April of 2011.

The results of this study, indicate that there is a statistically significant relationship between implementation of innovative technological applications, easy understanding, transaction security, quality of service and the development of online banking. Furthermore the delivery of online services is the key element that leads to increased customer capacity and meets the needs of the existing.

**Keywords:** innovation, strategies, internet banking, customer behavior

## AN ANALYSIS OF STRATEGIC PLANNING ACTIVITIES APPLIED IN FOOTBALL SECTOR

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### Abstract

**Purpose:** One of the most common sets of activities in strategic management is planning. All strategic planning deals with at least one of three key questions (Bradford and Duncan, 2000): 1. What we do? 2. For whom do we do it? 3. How do we excel? As research has pointed out, strategic planning is widely used by organizations in order to confront with a great number of changes, and respond effectively to their new situations (Kriemadis, 1997; Kriemadis & Theakou, 2007; Mintzberg, 1994; Wit & Meyer, 1998). Strategic planning refers to the process of determining the mission, major objectives, strategies, and policies that govern the acquisition and allocation of resources to achieve organizational aims (Johnson & Scholes, 1999). However, strategic planning is not a static product (Stopford, 2001). This study aims at partly contributing to the theoretical discussion concerning the ability of football clubs to integrate and employ strategic planning. The primary purposes of this research were: a) to determine whether strategic planning activities exist in Greek football sector, (b) to identify the extent to which the strategic plan is applied in real terms, (c) to identify the differences in strategic planning activities between under research football clubs.

**Design/methodology/approach:** The study was a quantitative design and the analysis was exploratory in nature. The methodology session includes secondary research as well, meaning literature review in due of collecting theoretical and practical elements relative to the variation of strategic planning activities. Descriptive statistics and one way analysis of variance were used to answer the research questions derived by objectives of this research, using SPSS software. A sample of 48 managers of the upper administrative levels of all 16 Football Clubs in Super League (Greek Championship) during the period 2010-2011 were surveyed using a 17-item management style survey, developed by researchers and selected experts, in order to collect data regarding the following steps of strategic planning process: (a) mission statement and objectives setting, (b) action plans and planning level, and (c) assessment of strategic planning activities. The survey instrument included strategic planning factors as well as demographic characteristics. The questions were answered using a five point scale. Each point of the scale represented different extent level that question items were considered when formulating plans (from “considered to a very little

extent" to "considered to a very great extent") and depicted the respondent's perceptions and behaviour. The reliability of the scale was found to be:  $\alpha = .82$ .

**Findings:** According to the survey findings, 90% of the football clubs managers have developed a vision of the club's future direction and aspirations. 88% have also developed a mission statement that describes the club's purpose and philosophy. The managers considered to a very great or great extent (91%) the factors that are related to the external environment of the football club, such as political trends, economic/tax considerations, social trends, local businesses, media, and sponsors. Managers considered to a very great or great extent (87%) the factors that are related to the internal environment of the football club, such as financial performance, adequacy of facilities, financial resources, There were no factors considered to a "very little" or "little" extent by 66% of the football clubs managers when formulating their plans. Furthermore, the football clubs utilize short-range plans which cover approximately 1 year, and long-range plans which cover approximately 3 years. When managers were asked about the key factors that discourage them from engaging in strategic planning activities, 57% identified to a "very great" or "great" extent insufficient financial resources and lack of time. Interestingly, 60% indicated that insufficient training and experience was a factor that discouraged them to "some" extent from engaging in strategic planning activities. Finally, the results revealed that only 18% of the football clubs have formalized written, long-range plans.

**Research limitations:** Data for this study were collected from all 16 Football Clubs in Super League (Greek Championship) during the period 2010-2011 and there was no attempt to generalize this information to all football clubs during other time periods in Greece. The study was also delimited to a questionnaire designed to collect data regarding strategic planning activities. The following were acknowledged as the limitations of the study: (a) the honesty, accuracy, and objectivity of the respondents when completing the questionnaire, (b) the respondent's level of understanding of the planning vocabulary. A useful research might be undertaken to assess the relationship between the extent of planning activities used by Greek football clubs and performance.

**Originality/value:** This study is useful in extending the concept of strategic planning to football sector and the authors proposed that football clubs should think and act strategically. The study will be useful in helping football managers/administrators to further their understanding of the strategic planning process in their respective football club. Finally, this study will yield information which may serve as the basis for further research in the area of football.

**Keywords:** Strategic planning activities, football clubs



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## BRAND AND HUMAN PERSONALITY CONGRUENCE: DOES CULTURE MATTER?

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### Abstract

The paper explores whether culture influences human and brand personality congruence. It evaluates differences between preference levels of consumers from Norway and Turkey with respect to brand personality dimensions across human personality proxy types. The study finds that consumers with same personality types have statistically significant different brand personality preferences across cultures. Linking these findings with Hofstede's cultural dimensions, the paper concludes with a list of propositions for future larger scale studies. Finally, conclusions are outlined, contributions and limitations acknowledged, and suggestions for further research are provided.

**Keywords:** Personality, Brand Personality, Culture, Consumer Behavior, Brand Preferences

### Extended Abstract

Brand personality is defined by Aaker (1997) as "the set of human characteristics associated with a brand". From a consumer behavior viewpoint, the basic assumption has been that consumers prefer products and brands that possess characteristics consistent with their own personality and self-concept (e.g., Dolich, 1969, Sirgy, 1982, Kassarian, 1971). Moreover, empirical research showed a fit between human and brand personality (e.g., Maehle and Shneor, 2010). However, previous studies overlooked the potential differences across cultures in human and brand personality congruence. Consequently, the objective of this paper is to study and compare brand and human personality relationships in two different cultural contexts, namely Norway and Turkey. To reach this objective, we extended an earlier study from Norway (i.e., Maehle and Shneor, 2010) to the Turkish context.

A two-stage methodology was followed. At the first stage, 50 Turkish university students majoring in business administration studies evaluated chosen brands with respect to Aaker's (1997) framework. The first stage results classified brands in each of the five dimensions. At the second stage, 173 Turkish university students with the same background filled the DI human personality survey and indicated their preference levels for brands in the study. The results from the Norwegian sample was

attained from an existing study (i.e., Maehle and Shneor, 2010). Overall, the samples from two countries were deemed equivalent. We compared the average brand preference scores for each brand personality dimension among each of the three human personality groups (Red DI, Blue DI, and Green DI). The results are presented in table 1.

The findings show statistical significance of the difference between preference scores for each brand personality dimension in the two cultures. More specifically, we observe that Norwegian respondents have a significantly higher preference for sincere, competent and exciting brands, while Turkish respondents have a significantly higher preference for rugged brands. These preferences are consistent across all DI human personality proxy groups. Alternatively put, consumers with same personality in different cultures have different preference levels for particular brand personality dimensions. However, respondents do not seem to differ in their preference levels for sophisticated brands in both cultures. Hence, at least with respect to four of Aaker's (1997) five brand personality dimensions, our findings show that culture indeed influences relationships between brand and human personalities.

		TURKEY			NORWAY			df	t
		N	MEAN	SD	N	MEAN	SD		
<b>RED DI</b>	<i>Preference for Sincerity</i>	76	2.94	0.62	73	3.64	0.84	147	-5.80***
	<i>Preference for Competence</i>	76	3.56	0.79	73	4.19	0.73	147	-5.05***
	<i>Preference for Excitement</i>	76	3.45	0.77	73	4.19	0.73	147	-6.02***
	<i>Preference for Sophistication</i>	76	3.45	0.77	73	3.28	0.65	147	1.45
	<i>Preference for Ruggedness</i>	76	3.46	0.84	73	2.91	0.81	147	4.07***
<b>GREEN DI</b>	<i>Preference for Sincerity</i>	83	2.84	0.70	75	3.45	0.62	156	-5.77***
	<i>Preference for Competence</i>	83	3.60	0.82	75	3.95	0.89	156	-2.57**
	<i>Preference for Excitement</i>	83	3.52	0.78	75	3.95	0.89	156	-3.24***
	<i>Preference for Sophistication</i>	83	3.52	0.78	75	3.40	0.71	156	1.01
	<i>Preference for Ruggedness</i>	83	3.54	0.85	75	2.98	0.86	156	4.11***
<b>BLUE DI</b>	<i>Preference for Sincerity</i>	80	2.98	0.74	69	3.29	0.78	147	-2.49**
	<i>Preference for Competence</i>	80	3.48	0.88	69	3.68	1.07	147	-1.25
	<i>Preference for Excitement</i>	80	3.40	0.83	69	3.68	1.07	147	-1.80*
	<i>Preference for Sophistication</i>	80	3.40	0.83	69	3.24	0.70	147	1.26
	<i>Preference for Ruggedness</i>	80	3.43	0.89	69	3.05	0.88	147	2.61**

**Table 1:** Comparison between Turkey and Norway among different personality types for brand personality dimension preferences. Significance levels (one-tailed): \* $p < 0.05$ , \*\* $p < 0.01$ , \*\*\* $p < 0.001$

Linking our findings to Hofstede's (2001) cultural dimensions' framework, one can outline the following propositions, which may be suitable for future large scale studies, involving multiple cultures.

- P (a): the more individualistic the culture the greater the preference for competent brands across different human personality types.
- P (b): the more feminine the culture the greater the preference for sincere brands across different human personality types.
- P (c): the more uncertainty avoiding the culture the lower the preference for exciting brands across different human personality types.
- P (d): the more masculine the culture the greater the preference for rugged brands across different human personality types.
- P (e): the more individualistic the culture the greater the preference for sophisticated brands across different human personality types.
- P (f): the more power distance tolerant the culture the greater the preference for sophisticated brands across different human personality types.
- P (g): the more masculine the culture the greater the preference for sophisticated brands across different human personality types.

The findings of the current study allow us to map potential influences culture may have in consumer behavior, while particularly suggesting that it affects brand and human personality congruence. Accordingly, the study shows that regardless of human personality types, consumers from different cultural contexts exhibit significantly different preferences for certain brand personality dimensions. Future studies should incorporate multiple cultures. Alternative brand personality frameworks emerging in different cultural contexts may also be relevant for testing and challenging the propositions suggested in the current study.

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[7]

**THE PRIVATE-SECTOR INVESTOR'S PERSPECTIVE IN THE FRAME OF PPP****Turhani, Ali<sup>1</sup>**

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**Abstract**

The main objective of this paper is to help the investors of the private-sectors to understand the procedures they must go through to take a decision for taking part in a PPP. The actors of the private sector can be different investors, financial lending institutions, as well as companies that offer the construction and the operational service. The actors of the public sector are the public authorities that design and implement the policies of a PPP, as well as those authorities that procure the funds for the financing of the PPP agreement, while not forgetting the general public who uses the assets that are offered by the PPP.

Each of these parties should have a base good understanding for the policy and financial problems, and each of those parties should have clear the role that it should play in the PPP project, as well as the benefits that they will have from this project.

Considering that the Public Authority goes through the process of developing and signing up to a PPP Contract, this paper considers the parallel process on the part of the private-sector investors, i.e.:

- The investment pool for PPP projects
- The financial basis for the investment decision
- Bidding and project development
- Joint-venture issues
- Formation and management of the Project Company
- The use of external advisers

**Keyword** : Cost of Capital, Project Company, External Advisers, Equity IRR

**FLEXIBILITY IN HOSPITAL BED CAPACITY PLANNING****Tütüncü, G. Yazgi<sup>1</sup>; Vasilaki, Athina<sup>2</sup>**

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**Abstract**

One of the major concerns of health care management (HCM) is to optimise the health care operations processes while working within imposed constraints of the management system. One of the major operations is bed capacity planning and control that aims to satisfy patients' needs, optimise ward efficiency and increase the utilisation of the provided service. Often, bed capacity planning is considered as a long-term strategic decision due to the lack of flexibility in managing the capacity. However, in realistic settings such as seasonal demand fluctuations, staff absences, emergency requirements for resources and beds, short-term and temporary maintenance, repair or renewal works, capacity decisions have to be made to improve the flexibility in management. To satisfy the need for flexibility in HCM decision makers need quantitative tools to organise short-term changes in operations and to review periodically tactical and strategic plans for anticipated bed capacity to reorganise department resources.

Several methods such as the ratio method, discrete event simulation, queuing models and stochastic simulation have been suggested to solve the bed capacity planning problem in the literature (Kokangul, 2008) for long-term strategic decisions. The ratio-based method which uses the average length of stays has been applied extensively to determine the size of the required bed capacity (Nguyen et al, 2005). The size of the required bed capacity is determined using the length of stay (LOS) ratio (Nguyen et al, 2005). Capacity decisions have also been made based on target occupancy levels. However, these methods do not take into account the variation of requested admissions over time. These variations arise due to the unpredictable nature of hospital admission rates and patients length of stays. Stochastic simulation models used to determine the size of the required bed capacity based on the number of patients in the hospital (El- Darzi et al, 1998). A combination of simulation, queuing theory, statistical analysis and mathematical modelling are used to determine the bed requirements and to predict the probability that patients needing admission will be turned away (Hershley et al, 1981). Stochastic methodologies that combined queuing network analysis with integer programming model and discrete event simulation are

used to balancing bed utilisation with associated benefits of reduced waiting, reduced patient blocking and reduced poor bed assignment (Cochrant and Bharti, 2006). A network flow model, that incorporates facility performance and budget constraints, is developed to determine the optimum size of bed capacity (Akcali et al, 2006). But most of the studies mentioned above are quite theoretical and hard to apply in a real life cases for a hospital manager and they do not provide solutions for short-term tactical decisions. In this study, our motivation is to propose a simple decision making tool that can be used easily without an expertise to the decision makers (hospital managers). The proposed decision making tool implements a modified network model and Dijkstra algorithm is used in order to solve the short-term tactical bed capacity problem raised in an oncology department of a hospital.

The results show that the department can increase their bed capacity using its own resources. This leads to an increase in the service quality and a decrease in expected waiting time of the patients which is very vital for this department since the patients who come to this department have to be treated urgently. Moreover, the proposed decision tool enables the health care decision makers to have an applicable solution for bed capacity planning within the context of flexibility. The impact of implementing the proposed quantitative tools to the flexibility in health care operations management has been discussed. As further work, the study can be continued for different departments of the same hospital or other hospitals which have larger bed capacity and more constraints for the planning.

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## IT IN HELTHCARE (DENTISTRY) AS ONE OF MAIN FACTORS IN IMPROVING QUALITY OF LIFE: BALANCED SCORECARD APPROACH

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### Abstract

The main purpose of this article is to investigate non-evident relationship between IT penetration in medical clinics and patients' quality of life (QOL) improvement. The research was done for private dentistry field of health care industry of Russia, as one of the most saturated with IT and fast growing.

By IT penetration we understand the degree of using the most popular IT in dental clinics: practice management systems (PMS), imaging systems, diagnostic equipment, connected to LANs and WANs, mobile applications, Internet.

Cause-and-effect relations between quality of treatment and IT penetration were first revealed for practice management software, diagnostic equipment and imaging software. The metrics of balanced scorecard (BSC) for dentistry was used to show, how IT helps to manage clinic, and, as a consequence, improve patients' treatment results, their overall satisfaction, oral health indicators.

Clinic's status assessment was accomplished regarding traditional 4 BSC perspectives: financial, patients care, personnel improvement, and business processes justification (Kaplan and Norton, 1996). Statistical data of key performance indicators (KPI), construed in accordance with BSC approach, were obtained from practice management software system "Dental for Windows" (Australian company "Centaur Software" made, and localized for Russian market since 1997) ([www.centaursoftware.com](http://www.centaursoftware.com), [www.d4w.ru](http://www.d4w.ru)).

These data show, that patients quality of life indicators (objective ones) were steadily growing during observed period (2005 – 2010) in Russian clinics. Quality of life of particular patient (as opposed to traditional approach with subjective measures based on questionnaires (McGrath and Rogers, 2010)) can be implicitly assessed by following objective criteria: frequency of repeating appointments, time to wait in queues at the clinic, time to wait an appointment, types of services rendered (caries treatment, dentures, etc.), age of patients distribution.

Relationship between some traditional subjective measures and objective ones, derived from statistical data of PMS, was revealed. Subjective measures vary regarding



set of indicators and scales, appropriating specific domains, for example, the most widely used:

- Oral Health Impact Profile (OHIP) (Slade and Spencer, 1994) - functional limitation, pain, psychological discomfort, physical disability, psychological disability, social disability, and handicap.
- General Oral Health Assessment Index: (GOHAI) (Atchison and Dolan, 1990) – assessment of psychosocial impact associated with oral diseases in older populations
- And others (McGrath and Rogers, 2010).

PMS is very effective in preventive and hygienic measures promotion. It is achieved by using Internet and mobile communications with patients. Recalls (through SMS, or Internet) help to cut the risk of interrupting treatment because of patients' forgetfulness, when treatment has to be fulfilled in a few stages.

Our hypothesis, that the more often patient visits the dental clinic the worse is his/her QOL indicators, was proved by statistically significant experimental study and expert judgments.

BSC approach is supposed to provide step-by-step transition from strategic goals, which in our case is QOL improvement, to concrete metrics, which characterize every of 4 BSC perspectives.

So, we included in BSC metrics new KPI, which are responsible for objective assessment of patients' QOL (patients' perspective). We also included new KPI, which characterize IT penetration, in business processes perspective. This allowed us to modify BSC of dental clinic so that relationship between QOL indicators and IT penetration became clear and transparent, when assessing clinic stance regarding BSC.

The next step (future implication) in our investigation is to extend set of subjective and objective indicators of QOL, which relationship should be established, in order to add more KPI to BSC with purpose to get more comprehensive picture of dental clinic status assessment. Then it is supposed to use new BSC, which includes IT penetration metrics, and QOL metrics. As a result, it is will be possible to formulate strategic initiatives in terms of IT initiatives, and assess the consequences quantitatively.

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**LEAN THINKING IN THE EUROPEAN HOTEL INDUSTRY****Vlachos, Ilias<sup>1</sup>**

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**Abstract**

The aim of this study was to assess whether lean practices are applied in European hotel industry practices and whether or not their implementation contribute to efficiency and effectiveness of hotel management. Removing all types of waste can prove itself a survival strategy during recessionary times for many small and medium hotels across Europe.

We surveyed small and medium hotels across 19 European member states by sending questionnaires to hotel managers. We evaluated 7 value stream mapping techniques: Process activity mapping, Supply chain response matrix, Production variety funnel, Quality filter mapping, Demand amplification mapping, Decision point analysis, and Physical structure. Initially, we identified two value streams: (a) Reservation value stream: reservation – transportation – check in – housekeeping – check out – transportation; and (b) Procurement value stream: establishment of a need – placing an internal order – order / purchase – delivery to the hotel – delivery to the hotel segment.

Data analysis showed that hotels apply value stream mapping techniques to a varying degree. Results show high level of similarity in hotel operations regardless of the country a hotel is located in. We offer managerial implications and suggestions for further research.

**Keywords:** Lean thinking, Value Stream Mapping Tools, hotel industry, Europe.

## A METHODOICAL APPROACH FOR LEAN TRANSFORMATION FOR FOOD COMPANIES

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### Abstract

In today's competition, for businesses to survive or supply chains to succeed, they must be sufficiently capable of continuously meeting or exceeding the needs and wants of their customers and also cope with the constant changes in the marketplace. In other words, it is all about staying or converting to lean, the aim of which is to meet customer demand instantaneously, with perfect quality and no waste. By reviewing literature and looking to situation of many businesses, we developed a methodical approach for lean transformation (MALT) having the following characteristics: holistic (inclusive, by addressing all the necessary factors for change and encompasses all relevant aspects of an organization), adaptive to several industries and business scenarios, and also systematic with sufficiently clear and explicit steps for the execution of lean transformation.

The MALT model proposes a way how businesses or supply chains can effectively and efficiently be transformed to lean states in relatively shorter time, with minimum cost and people resistance, better and sustainable change in culture and maximum participation.

A case research was adopted with multiple sources of data: reports, questionnaires, and in-depth interviews as well as participant observation.

The Key Findings of the Research include (a) the HAS features (holistic, adaptive and systematic) of the suggested MALT Model are obviously useful for achieving comprehensive and successful lean transformation. (b) The eight key factors showed significant contributions to lean transformation in a way or another. These can be described as following: (1) Business Strategy (BS): It contributes to ensure a holistic lean transformation while it also used to define value. (2) Cultural Change (CC): The lean transformation involves a remarkable cultural change which is behind the success of the LT. (3) Leadership (L): Leadership was the main influential factor behind the achieved cultural change and also contributed to a holistic transformation. (4) Lean Education (LE): There is evidence of a high impact of LE to the success of LT although results are inconclusive. (5) People Involvement (PI): It was not a critical success factor due to automation of the value stream process. However, its impact was similar to that of Leadership. (6) Marketing Plan: It contributes significantly to define value as a cornerstone of managing value stream. (7) Value Stream Mapping: The application of

Value Stream Mapping was very effective for LT. (8) Performance Measurement and Assessment (PMA): Reports indicate a possible high effect of PMA to the success of LT which is similar to that from Leadership, People Involvement, and Execution of Lean Tools.

Suggestions for future research include the examination of the MALT Model in a wider business case that facilitates a thorough application of whole concepts of the model.

**Keywords:** MALT Model, Lean Transformation, Value Stream Mapping, case research

## SIZE, CAPITAL STRUCTURE, FIRM PERFORMANCE AND INDUSTRY SECTOR: EMPIRICAL EVIDENCE BEFORE AND AFTER THE ECONOMIC CRISIS

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### Abstract

**Purpose:** The main purpose of this paper is to investigate whether the capital structure of Greek firms is influenced by their size, different variables and the sector they are in. The study includes the period before and after the economic crisis, investigating the effect of the crisis on capital structure. The analysis tries to identify also differences in the behavior of small and medium sized firms vs. large firms in the most important exporting industrial sectors in Greece with respect to their capital structure and performance.

**Design/Methodology/Approach:** Multivariate regression models will be used, along with descriptive statistics, on panel data, to investigate the significant factors affecting capital structure and performance of Greek firms, with size and industry sectors acting as control variables. Data are collected from the data base of ICAP Hellas, a private research and data base firm, based on published financial statements of firms. The random sample will include 200 publicly listed and non listed, small and medium size and large sized firms from major export oriented industry sectors, based on their population distribution, for the time period 2000-2010, in order to include before and after economic crises data.

The models will include as explanatory variables capital structure and relative performance and as independent variables, size, capital expenditures, sales growth, ROA and relative to industry ROA and volatility.

The analysis will be based on different groupings of firms, according to size (SMEs and Large firms) and industry sectors and the OLS models will be applied in order to detect differences in the factors affecting the dependent variables, i.e. long term debt leverage and relative performance (product-market). The stability of factors before and after the crisis, will be also examined.

**Findings:** Since this is still an undergoing research, a significant effect of leverage is expected on the relative to industry sales growth, but a significant decrease is expected in relative to industry ROA, based on theory and literature. The size and industry sectors are expected to play a significant role in the capital structure of firms and the factors affecting it.

**Practical implication:** The results of the research will be valuable for both industry and academia, since they will help them develop policies and strategies to make Greek exporting firms more competitive and assure their viability and growth. Investors and managers will be able also to forecast the performance of a firm and act accordingly.

**Originality/ value:** The issue has not been researched in such depth for the Greek market for the last ten years in Greece, including the after crisis period. The relative to industry variables used in the models will give the dimension of competitiveness in the export oriented firms in Greece, as well as the differences among of SMEs and Large firms.

**EXTENDED PERFORMANCE SATISFACTION INDEX - STANDARDIZED  
MEASURE OF COMPANY SUCCESS OR PROSPERITY OF NATIONAL  
ECONOMY?**

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**Abstract**

For more than 15 years, in a certain countries exists a several procedure of calculating the satisfaction index so that their comparison is possible – of course, depend on fact of standardized procedure and level of confidence. The national satisfaction index is composed results of the satisfaction indexes of individual industries within the economy, while the indexes of individual industries of the economy are result of the indexes of individual companies (primarily companies that have a significant market share). Of course the indexes of each individual company have a different impact (“ponder”) on the index of the individual branch of the economy. In the same way, the influence of the index of every branch of the economy on the national satisfaction index is different. This fact have to be take in account when considering national satisfaction index.

Well known national satisfaction indexes exist in the USA (ACSI – American Customer Satisfaction Index; established in 1994) and in Sweden (SCSI – Swedish Customer Satisfaction Index or SKI – Svenskt Kund Index, established 1989). The SKI results point to the understandable relationship between the customer satisfaction index and profitability (in which profitability is observed as a return on assets (ROA). A clear and positive relation between customer satisfaction and company profitability was also determined (according to the same source) by using ACSI results in USA. (Eklof et al., 1999). Today, the most popular and recognized model in Europe is EPSI – Extended Performance Satisfaction Index. A European feasibility study for coordinated national studies was conducted in 1997 – 98. In this, a model for customer satisfaction measurement and analysis, based on the Swedish SKI-approach, was proposed. During 1999-2010 EPSI has become a recognized international system of non-financial measurements. The coverage of various countries and common sectors has successively been extended. The basic reasons for the establishment of this index as a new, added indicator of the change in the national economy should be searched for in the desire to stimulate economic growth and higher competition of national economies in general. The main idea of EPSI is to develop a common European standard for measuring stakeholder satisfaction and identifying stakeholder priorities. EPSI is characterized by independence and a scientific background. The network of EPSI national (sub-regional)



platforms (entities) and clients are active in around 25 European countries (including Croatia since 2010).

Currently, EPSI is running multi-national surveys in the following industries/sectors: Banking (consumer and corporate segment), General Insurance (consumer and corporate segment), Life/pension insurance, Retail Trade, Mobile Telecoms and Broadband (consumer and corporate segment) as well as a few other ICT-segments like digital TV and mobile Internet, Utilities (electricity etc.), Health services, Education, Police and public safety, Public transport, Public administration, Logistics (corporate segment), Postal Services, Business Services (IT, auditing, legal) ([www.epsi-rating.com](http://www.epsi-rating.com)).

It worth to point out the relation between market share and customer satisfaction as the performance indicator but it is also possible to pose the question of the relation between customer satisfaction and productivity – what can we expect if the intention exists to simultaneously increase productivity and customer satisfaction? Is it possible to realize their simultaneous growth and till when and up to what point is it possible to increase both performance dimensions or is there an “internal conflict” which suggests that it is necessary to find a strategy which will keep them in balance? Customer satisfaction can simultaneously be observed as a goal, a means and a measurement of the marketing management performance and that as such it is the basic precondition of customer orientation culture.

Economic growth and the competition of the national economy are in the end the result of the good business performance of the companies that act within the framework of this economy. One of the goals of business performance according to the traditionally understood business marketing philosophy was in the beginning the fulfillment of needs and desires of consumers but also achieving their satisfaction. According to this – it is very interest to consider similarities and differences during a time on different national economies in different circumstances and developments. But in general we found and we can expect clear evidence of the positively caused relationship between satisfaction and other measurements of performance.

**Keywords:** ASCI, EPSI, performance, satisfaction index, national economy

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## THE ENCOUNTER BETWEEN SERVICES PROVIDERS AND POOR CUSTOMERS

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### Abstract

“Services for the poor are poor services” (Richard Titmuss)

The twenty-first century has been labeled The Service Age. It seems that the traditional role of family and community in meeting human’s needs, has been supplanted by other social structures, mainly service organizations.

The present study aims to describe the encounters of services providers of basic-needs (transportation, food, school, health and banking) with customers who live in poverty. It also aspires to raise a number of ethical questions pertaining to the attitude of service organizations toward their poor customers as a reflection on us as a society.

### The “transparent customers”

At the start of the twenty-first century there are, in Israel, approximately 1,774,800 people living in poverty. They constitute close to a quarter of the Israeli population.

Impoverished customers are perceived as people who are not equal participants in the economic-social systems (Doron, 2008). The attitude to people living in poverty as “others” in general and as “customers of a different kind” in particular, originates in age-old images and in the modern-day capitalist economy that glorifies financial success and accelerated consumerism (Doron, 2008; Krumer-Nevo, 2006; Lister, 2004). This is a population whose needs are in effect ignored by society and its agents, such as businesses and service organizations (Andreasen, 1993; Hill, 2008).

They could be called “transparent customers”, since most organizations do not have a policy for dealing with them, and in studies addressing service relations they gain little mention.

### Methodology

The present study was conducted in the qualitative tradition (grounded theory) and it is based on half-structured in-depth interviews with fifty services providers: Ten bus drivers, ten supermarket cashiers, ten elementary school teachers, ten family doctors and ten bank tellers. All the participants in this study share two common characteristics – they all have a direct interaction with service recipients, and they all provide services that meet basic needs. It is noteworthy that although service

providers share many skills, the heterogeneity of the services sector means that service providers often come from different backgrounds and possess a variety of different skills (Yagil, 2008).

Two main themes that stood up from the interviews outline the discussion of this study: 1- The difficulties service providers experience identifying poor customers in need of help, and 2 - The informal ways of circumventing the organization's policy and bureaucracy in order to help impoverished customers, and the fact that most organizations do not have a policy for dealing with poor customers. These themes recurred throughout most of the interviews reflecting strong emotions (such as helplessness and frustration), as well as a basic moral intuition that "something basic is very wrong".

## Discussion and summary

When speaking about service providers it is customary to include three "participants" in the process: the service recipient, the service provider, and the organization within which the service is provided (Yagil, 2008). I wish to add another central participant –society. As we know, organizations operate within a society that has values, and priorities that reflect it.

Statement #1 of the UN's 1948 Universal Declaration of Human Rights states: "All human beings are born free and equal in **dignity** and **rights**". Consequently, democratic countries have developed a legal approach forbidding discrimination based on things such as race, sex, disability, and "circumstances beyond a person's control". It seems that the common perceptions that view the poor as being "responsible" for their situation (Lister, 2004) preclude them from receiving equal treatment, for according to this perception, these are not "circumstances beyond a person's control".

However, society needs to realize that in The Service Age the ability to receive needs-oriented services is a basic right, which can be easily translated into the term "equal opportunity". As such, it constitutes what philosopher John Rawls (1971) terms "primary social goods", and therefore, the principle of justice should be applied to their distribution.

The present age, which some call the Age of Greed (Brobeck, 1991), raises the need for government intervention and greater regulation in the services marketplace, in order to protect low-income consumers.

On a personal level the findings of this study teach us that human solidarity is common, and so is the desire to extend help and do well by your customers. However, the traditional mechanisms for helping the disadvantaged (such as charity and bending the organizations' rules) cannot serve as a substitute for a services system that is **compelled** by society, its laws, its values and its elected representatives to provide

services not only to customers with financial means, but first and foremost to its weakest customers: impoverished consumers.

**Keywords:** Service-providers, Poverty, Qualitative research, Ethics

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