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SHARED RESPONSIBILITIES: MANAGEMENT
CHALLENGES IN AN ENVIRONMENT OF
INCREASING GLOBAL CONCERNS

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PREFACE

The International Management Development Association (IMDA) welcomes you to the 17th Annual World Business Congress of the Association and is pleased to offer you the Proceedings of the Congress. The Congress is held in the city of Paramaribo from June 18–22, 2008. This year, the theme for the Congress is Shared Responsibilities: Management Challenges in an Environment of Increasing Global Concerns, an important topic around which competitive full papers, research-in-progress, and special sessions are presented. This year, we are proud to present some 70 papers that reflect scholarly contributions to the theme. We are also very proud to indicate that those papers come from scholar authors representing countries from different continents. As well, there are paper contributions from public policy makers, consultants and business people who gather around this year’s main congress theme.

As in previous Congresses of the IMDA, the paper selection process was tough but thorough. All papers submitted went through a blind-review process and area subject experts examined the research-in-progress proposals and submitted full papers. The reviewers evaluated the papers on the basis of their original contribution, overall quality, and interest to the Association’s members. Those chosen as competitive papers are now included in the Congress Proceedings. As in the past years, we are particularly thankful to the dedicated reviewers who contributed to the success of this Congress. On top of this blind review processes, we jointly went through each and every accepted full paper and made stylistic changes and brought them in conformity with the overall IMDA style guidelines. Congress organizers, paper contributors, track chairpersons, and paper reviewers have all worked hard to develop a high quality Congress program and proceedings edition.

The co-editors would like to take this opportunity to recognize the Executive Board Members and Country Board of Directors of the International Management Development Association (IMDA), for their leadership and assistance to make the Congress and this Proceeding possible. We are particularly thankful to Dr. Kip Becker, Dr. Richard Alan Nelson and Dr. Hans R. Lim A Po, Dr. Ronald S.J. Tuninga for their help and assistance. We are also extremely grateful to session co-chairs and manuscript reviewers for their help and encouragement at different phases of the congress proceedings development and organization.

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Our hope is for you to have an enjoyable reading of the Proceedings. Thank you all for your interest in the IMDA Congress, and we look forward to meeting you at our 18th World Business Congress which will be held in Tbilisi, Republic of Georgia from July 2-5, 2009.

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Corporate Diversification and the Internal Capital Market Building Motive in China

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This research extends the investigation of the diversification performance into the Chinese market, but with a specific focus on the issue of the internal capital market building motive being behind such corporate strategy. The empirical findings here provide persuasive evidence to suggest that, like firms in the western countries, the Chinese firms diversify in search of, among other things, a financing solution to relax the constraints from the external capital market. However, inconsistent with most of the western literature, the study does provide statistically significant evidence to support the proposition that in China, diversification is positively related to corporate financial performance when diversification is under the internal capital market building consideration. This new evidence implies that in China’s economic and institutional environment, the benefits of building such an internal capital market within the conglomerated firm seem to offset its costs.

Introduction

Diversification, whereby a firm expands into various business lines under one centralized control, has been a popular practice for firm growth and expansion for almost six decades, and a dominant strategy in the global economy since the late 1990s. While Martin & Sayrak (2003) has emphasized that the study of corporate diversification should play a fundamental role in understanding the modern economy, the answers to the questions, whether diversification is a beneficial strategy or not, and what could be the rationale behind such a diversification wave in significant emerging markets like China, will be of great significance not only to the academic researchers, but also to the decision makers in the corporation and the policy makers in any economy.

Up to this point in time, most of the empirical evidence available has found a negative relationship between diversification and firm financial performance. Such evidence implies that diversified firms have undergone the decline in their returns or value and diversification may therefore not be a beneficial practice for the firm. But surprisingly enough, while the majority of the negative relationship evidence comes from America, most of the American enterprises have grown diversified rather than single product or specialized.

But, some of the literature still argues that diversified firms have better performance than un-diversified ones, which means diversification could still be a good practice for a growing or expanding firm. (Jahera, Lloyd & Page, 1987; Grant, Jammine & Thomas, 1988; Stein, 1997; Anil & Narendar, 1998). Whether diversification is a beneficial strategy or not is therefore still a critical outstanding question left largely unanswered with rather inconclusive empirical answers.

Another intriguing phenomenon is that while developing countries, such as China, are increasingly significant contributors in the economic world, the empirical evidence from developing countries or emerging markets on the impact of diversification on firm’s return and rationale or motive behind such corporate strategy is still rather rare.

In China, since the late 1980s and early 1990s, many firms have grown largely by diversifying. Lins & Servaes (1999) and Wan & Hoskisson (2003) both point out emphatically that home country environment will have an important impact on the diversification strategy used by a firm and the diversification performance which ensues. Thus, this research is broadly designed to extend the investigation of the diversification performance into the Chinese market, but with a specific focus on the issue of the rationale behind such corporate strategy. Such an investigation would not only be useful for Chinese business development, but also would provide new insights into this topic for other firms and developing economies as well.

The rest of the paper is developed into four sections. Section two is the literature review, and based on which, the hypothesis will be developed. The third section describes the research methodology, including the variables definition, data collection, and modeling issues. The fourth section discusses the data analysis results, and the last part

* The author would like to thank the Economic Development and Transition Research Center of the second “985” program, Nanjing University, for the finance support.
Internal Capital Market Building Rationale: Literature Review and Hypotheses

Corporate diversification has been attributed to a number of motives in the business literature including those related to risk management. However many studies in the Western market economics and finance literature have specifically found out that the urge to build an internal capital market is one of the main driving factors contributing to corporate diversification. The rationale for internal capital market building through diversification is to raise funds for a given project, which basically is in response to the external capital market inefficiency or credit constraints due to underdevelopment, information, incentives, asset specificity and transaction cost problems (Stein, 1997; Lamont, 1997).

The credit constraints in the external capital market, related to the reliability of capital supply or other reasons, will largely cause business to be short of capital over time or occasionally (Rajan, 1994; Gertler & Gilchrist, 1994). For a given segment or investment project, a diversified firm can become capital-sufficient in the aggregate by configuring its business portfolios as a whole. Through the cross-segment subsidization, which allows capital flows from surplus segment to the constrained one, internal capital market will correct inefficient choking-off and prevent business from being irrationally starved of capital due to cyclicalities and investment fads (Liebeskind, 2000).

Lamont (1997) and Shin & Stulz (1998) find the evidence to prove that the diversified firm is an internal capital market. More interestingly, Triantis (2002) and Lamont (1997) provide a strong argument that internal capital market building motive factor and the level of diversification, then we have the evidence consistent with the hypothesis that in China the factor under investigation does influence the decision of diversification, otherwise we should reject the hypothesis.

Logically, since diversification relaxes external funding constraints by internalizing transactions of capital, diversification driven by this consideration should benefit the firm in general. However, the nature of the relationship between diversification and firm financial performance, or the value of diversification will largely depend on whether internal capital markets are relatively efficient or not (Liebeskind, 2000).

Based on transaction costs economics, Williamson (1975) argues that managers with more firm-specific knowledge have information advantage over the outside investors. Thus, less information asymmetry ensures the capital will be invested more efficiently. Also, following Williamson (1975)’s steps, Stein (1997) develops a “winner-picking” model, arguing that because of the internal competing usage of capital, the headquarters can actively shift funds toward more valuable projects.

Nevertheless, Hubbard and Palia (1998), Liebeskind (2000), Matsusaka and Nanda (2002) contend that efficiency only exists under limited circumstances; for example under scare resources and other capital constraints; otherwise, centralization of capital allocation functions tends to impose additional costs.

Furthermore, researches, largely based on the agency theory, argue that due to the struggle over the control of resources between the headquarters and the divisions (Gautier and Heider, 2001), and the cross-subsidization or “socialism” within the diversified firm, internal capital market may be inefficient practically.

Although the theoretical conclusions are diverse, the empirical study tends to support the negative diversification value perspective as a whole. Rajan, Servaes & Zingales (2000) investigated U.S. diversified firms during the period of 1979-1993, finding that the diversification discount is positively related to the extent of investment misallocation and diversity of the investment opportunities. Consistently, Lamont and Polk (2000) also disclose that diversified firms have low value because they allocate capital inefficiently across their different parts. Kaiser and Stournaritis (2001), by examining one UK-based diversified conglomerate, also provide evidence that diversification discount is due to the...
inability to function effectively as an internal capital market for its divisions, and that all its businesses were suffering from under-investment.

In sum, although diversification has a function to relax the external financing constraints, the majority of the empirical evidences imply that the internal capital market is practically inefficient, and this is what eventually leads to diversification performance value discount. As a result, we hypothesize also in this case that:

Hypothesis 2: There is a negative relationship between the degree of diversification and corporate performance intervened by internal capital market building factor in China.

Research Methodology

Sampling and Data Collection

From around 1000 publicly traded companies, which disclosed their year 2004 annual reports on the China Securities Regulatory Commission’s website before May 30th, 2005, a random sample of 300 listed companies is chosen from the two major Chinese stock exchanges, in which 150 are from Shenzhen stock market and 150 are from Shanghai stock market.

The publicly traded companies have been the main research objective in the existing studies. Moreover, in China, the listed companies have become the representatives for the main trend and characteristics of firm’s growth. Another important reason to select listed companies as the sample is that it is the desired source for standard and legal data, and especially since the end of year 1999, the business segments information has been required in the information disclosure report.

Most of the data of the sample are collected from their annual reports posted on the website of China Securities Regulatory Commission. The price information is acquired from the market report on the newspaper, China Securities, authorized by China Securities Regulatory Commission.

Among those 300 firms, we exclude 6 finance companies because their data are not consistent with those of the non-finance companies. And we are leaving out another 15 companies due to the data shortage. Five of these are 2004 newly listed companies; one was a company banned from trading because of heavy losses, and nine companies had negative equity value. Thus, the actual operational sample size is 279.

Variable Definition and Measurement

Diversification as a strategy is characterized by multi-business operations under a common control of a single firm. Due to its standard and concrete character, some researchers argue that the Standard Industrial Code (SIC) system should be a better method to evaluate diversification.

However, the SIC data system itself is not flawless. And the most serious problem is its insufficient information about business segments. While diversification, as a corporate strategy, takes place only when the firm expands to make or sell products or a product line having no market interaction with each of the firm’s other products, the industry categories cannot meet the research purpose.

In this case, the diversification variable is measured according to Rumelt (1982)’s SR (specification ratio) value, which is defined as the fraction of revenues accounted for by its largest single business unit. The smaller the SR value, the higher the degree of diversification is.

According to Rumelt’s diversification level scheme, we computed the SR for each company and categorized the sample companies into three groups as showed in table 1:

Table 1: Classification by degree of diversification

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<th>Un-diversified firms</th>
<th>Label</th>
<th>SR Value</th>
<th>Number</th>
<th>Proportion</th>
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<tr>
<td>Group1 [0.95, 1]</td>
<td>55</td>
<td>19.71%</td>
<td></td>
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<tr>
<td>Moderately diversified firms</td>
<td>Group2 [0.7, 0.95]</td>
<td>98</td>
<td>35.13%</td>
<td></td>
</tr>
<tr>
<td>Highly diversified firms</td>
<td>Group3 [0, 0.7]</td>
<td>126</td>
<td>45.16%</td>
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Un-diversified firms category, labeled as group 1, are those firms with the SR value ranging between 0.95 and 1, moderately diversified firms, labeled as group 2, are those firms with the SR value ranging between 0.7 and 0.95 (excluding 0.95), and highly diversified firms, labeled as group 3, are those with the SR value ranging between 0 and 0.7 (excluding 0.7).

There are only 55 companies belonging to the undiversified category. Two hundred and twenty four firms (224 or more than 80% of the sample) are diversified companies. And almost half of the sample consists of highly diversified firms. This implies that in China, diversification is a widely adopted firm strategy.

Several measures are employed in this study to capture corporate financial performance; but none of them can be claimed to be a perfect reflector of long term economic value in this case. The accounting indicators, return on equity (ROE) and return on assets (ROA), are commonly used as the corporate performance measures. It is not only because they are easily available and easy to compute from financial statements, but also because they could reflect how well the managers operate the assets of the firm. For the sake of consistency with the relevant literature, these will be employed as performance measures.

However, accounting measures are generally criticized for being inaccurate and unreliable measures of economic
values because of the conventions and premises used in their derivation. As a result, market value ratio (MVR) is also calculated as a complementary measure because it usually reflects a firm’s true value in the long term, in as much as some like Hu & Wang (2002), Liu (2003) and Zhang (2005) may still contend that market valuations in relatively small capital markets found in developing economies with institutional fragilities may not be all that dependable. As argued by Anil & Narendar (1998), the market value ratio is calculated for a calendar year by adding the difference between current year’s ending stock price and the previous year’s ending price with the dividends paid out for the year, then dividing the result by the previous year’s ending price.

\[ MVR = \frac{(P_1 - P_0) + \text{Payout}}{P_0} \]

Where \( P_1 \) is the current year (2004)’s ending stock price, \( P_0 \) is the ending price for the previous year (2003), and Payout is the cash bonus plus the equivalent value for the share bonus distributed during the year.

Internal capital market building factor relates to the external resource strategic environment, aiming at financing projects within the firm. Segments cross-subsidization within the conglomerated firm (whereby surplus segments finance deficit segments) can be employed to reflect such finance interdependence. The more the cross-subsidization happens, the stronger the interdependence is; which implies that this motivation is stronger.

The cross-subsidization is measured by non-operational capital flow in and out of the sample company to the affiliated companies within the conglomerate, which describes the reallocation of financing resources within the conglomerate and indicates how large the scale of the internal capital market is. The variable is calculated by summing the book value of each non-operational capital flow at the end of accounting year. The figures are recorded in the annual information disclosure document, which is required by the Chinese Security Regulatory Commission for every listed company.

**Data Analysis and Results**

**Internal Capital Market Building Consideration as a Diversification Motive**

A linear regression is used to test the hypothesis 1, which proposes that there is a relationship between the internal capital market building consideration and the degree of diversification. The dependent variable is the degree of diversification, and the independent variable is the internal capital market building motive. The basic idea is that if a relationship between the diversification driving factor and the level of diversification does exist, we should observe a statistically significant coefficient of the motive. Otherwise we should reject the hypothesis.

The output of regression analysis comes out as given in Table 2 below:

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig. F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>(Constant) (.720)</td>
<td>(.013)</td>
<td>53.973</td>
<td>.000</td>
<td>107</td>
</tr>
<tr>
<td></td>
<td>CAPTIAL (-2.574E-07)</td>
<td>(.000)</td>
<td>-.100</td>
<td>-1.643</td>
<td>.101</td>
</tr>
</tbody>
</table>

The regression reports a significant negative sign for the coefficient of the internal capital market building factor. Although the model is not a good estimation, the t-value of the coefficient is a significant enough to indicate that the international capital building motive variable is good. And hypothesis 1 should not be rejected.

Because of the way the SR value is calculated, it implies actually a positive direction for the relationship between diversification and the internal capital market building factor. Such results provide evidence consistent with the argument that in China, because of the constrained external capital market, the firms take diversification as a method to provide a financing solution.

Therefore, the next step of work is to investigate into the diversification value while considering the influence of internal capital market building motivation.

**Corporate Performance under the Internal Capital Market Building Motive**

To examine whether there is a negative relationship between the degree of diversification and corporate performance intervened by the internal capital market building factor, (as hypothesized above), we first ran a multiple-linear regression analysis, which is defined as:

\[ y = b_0 + b_1x_1 + b_2x_2 \]  

(1)

where \( x_1 \) is the diversification degree value SR, \( x_2 \) is the internal capital market building consideration factor, \( y \) is the corporate performance (as measured by ROA, ROE or MVR).

The results (see table 3 as below) generate a consistent negative coefficient for the SR variable. Particularly when the corporate performance is measured by the MVR, the result is statistically significant for both the whole model and each variable.
Table 3: Regression output of the corporate performance under internal capital market building motive

<table>
<thead>
<tr>
<th></th>
<th>Unstandardized Coefficients</th>
<th>Std. Error</th>
<th>t</th>
<th>Sig.</th>
<th>F.</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROE</td>
<td>Constant</td>
<td>2.183E-02</td>
<td>.047</td>
<td>.467</td>
<td>.641</td>
<td>0.091</td>
</tr>
<tr>
<td></td>
<td>SR</td>
<td>3.467E-03</td>
<td>.062</td>
<td>.056</td>
<td>.956</td>
<td></td>
</tr>
<tr>
<td></td>
<td>CAPITAL</td>
<td>-6.638E-08</td>
<td>.000</td>
<td>-.414</td>
<td>.679</td>
<td></td>
</tr>
<tr>
<td>ROA</td>
<td>Constant</td>
<td>1.032E-02</td>
<td>.023</td>
<td>.451</td>
<td>.652</td>
<td>0.031</td>
</tr>
<tr>
<td></td>
<td>SR</td>
<td>4.108E-03</td>
<td>.030</td>
<td>.135</td>
<td>.893</td>
<td></td>
</tr>
<tr>
<td></td>
<td>CAPITAL</td>
<td>-1.534E-08</td>
<td>.000</td>
<td>-.196</td>
<td>.845</td>
<td></td>
</tr>
<tr>
<td>MVR</td>
<td>Constant</td>
<td>-7.899E-02</td>
<td>.048</td>
<td>-1.646</td>
<td>.101</td>
<td>2.511</td>
</tr>
<tr>
<td></td>
<td>SR</td>
<td>-8.202E-02</td>
<td>.064</td>
<td>-1.286</td>
<td>.200</td>
<td></td>
</tr>
<tr>
<td></td>
<td>CAPITAL</td>
<td>2.790E-07</td>
<td>.000</td>
<td>1.697</td>
<td>.091</td>
<td></td>
</tr>
</tbody>
</table>

The negative relationship between the SR value and the corporate performance suggests that the lower the SR value, the higher firm performance is. Because the SR is defined as the fraction of revenues accounted for by its largest single business unit, the lower the SR value, the higher the degree of diversification is. The data analysis actually implies that the firm performance is positively related to the level of diversification. Thus, the statistics outcome suggests that we should reject the hypothesis 2.

Furthermore, according to the MVR analysis, the coefficient for the internal capital market building factor is significant positive, which suggests a positive relationship between the intra-firm financing activity and firm’s performance. This statistical output throws doubts on the notion that due to the agency problem and socialism within the diversified firm internal capital market may be inefficient. (Gautier & Heider, 2001; Scharfstein & Stein, 1997).

Robustness Analysis

Since the results are inconsistent with most of the publications in the literature, for the robustness of the results, we incorporate the most common firm level variables, firm size and industrial membership, into the analysis.

Independent of size effects

Firm size can be correlated with firm performance through economies of scale and economies of scope. Compared to small firms, large firms tend to have larger market share because of better bargain power, superior financing position, and more efficient cost control. Thus, diversified firms could have higher returns for normally diversified firm has larger size than stand-alone one. As a result, firm size should be controlled for while examining the diversification value.

We take the scale of asset as the indicator for firm size and run the regression (1) again by adding firm size as the control variable. The formulation in this test is defined as:

\[ Y = b_1 + b_2X_1 + b_3X_2 + b_4X_3 \]  

where the variables and parameters have the same definitions as in the previous formulation (1), except that here \( X_3 \) is the scale of asset.

Table 4 reports the result of this test as follows:

Table 4: Regression output for the size effect

<table>
<thead>
<tr>
<th></th>
<th>Unstandardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>F.</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROE</td>
<td>Constant</td>
<td>2.428E-03</td>
<td>.051</td>
<td>.960</td>
</tr>
<tr>
<td></td>
<td>SR</td>
<td>7.572E-03</td>
<td>.122</td>
<td>.902</td>
</tr>
<tr>
<td></td>
<td>CAPITAL</td>
<td>-7.28E-08</td>
<td>-.456</td>
<td>.649</td>
</tr>
<tr>
<td></td>
<td>ASSET</td>
<td>6.130E-08</td>
<td>1.679</td>
<td>.094</td>
</tr>
<tr>
<td>ROA</td>
<td>Constant</td>
<td>2.4E-03</td>
<td>.102</td>
<td>.919</td>
</tr>
<tr>
<td></td>
<td>SR</td>
<td>5.784E-03</td>
<td>.190</td>
<td>.849</td>
</tr>
<tr>
<td></td>
<td>CAPITAL</td>
<td>-1.80E-03</td>
<td>-.230</td>
<td>.818</td>
</tr>
<tr>
<td></td>
<td>ASSET</td>
<td>2.502E-08</td>
<td>1.399</td>
<td>.163</td>
</tr>
<tr>
<td>MVR</td>
<td>Constant</td>
<td>-8.04E-02</td>
<td>-1.624</td>
<td>.106</td>
</tr>
<tr>
<td></td>
<td>SR</td>
<td>-8.17E-02</td>
<td>-1.691</td>
<td>.202</td>
</tr>
<tr>
<td></td>
<td>CAPITAL</td>
<td>2.786E-07</td>
<td>-2.707</td>
<td>.092</td>
</tr>
<tr>
<td></td>
<td>ASSET</td>
<td>.4.472E-09</td>
<td>.119</td>
<td>.906</td>
</tr>
</tbody>
</table>

According to the results, no statistically significant influence is found on the diversification-performance relationship while firm size is taken into account. Therefore, the empirical findings above are still reliable.
Independent of governmental ownership effect

There is a widely accepted idea that government owned company doesn’t operate well in terms of financial performance, because the government shareholder tends to put a lot of pressures on the management, other than pursuing the profit maximization objective, but for keeping employees, gaining reputation for the nation, maintaining social stability and also for many other non-economic reasons. And the real case is that China’s state-owned companies have been suffering from the inefficiency and investment loss broadly.

On the other hand, the firm with government ownership could perform well in the market because of the efficiency of governance mechanism. Since the government still has strong influence on the nomination and promotion of the top managers, there is a kind of pressure on the managers to run the business right. The incentive is that if the business goes well, the managers would be awarded with honor, higher position, and etc., while if the business doesn’t go well, the managers could be punished severely.

In short, the government ownership could conduct both downside and good side influence on the managerial behavior, which eventually influences the firm’s performance. Thus, we retest the regression by controlling for this factor. And the regression output is showed in Table 5:

Table 5: Regression output for the governmental ownership effect

<table>
<thead>
<tr>
<th></th>
<th>Unstandardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>F</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROE</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>4.979E-03</td>
<td>.101</td>
<td>.920</td>
<td>.417</td>
</tr>
<tr>
<td>SR</td>
<td>1.676E-04</td>
<td>.003</td>
<td>.998</td>
<td></td>
</tr>
<tr>
<td>CAPITAL</td>
<td>-7.87E-08</td>
<td>-.490</td>
<td>.625</td>
<td></td>
</tr>
<tr>
<td>GOVSHARE</td>
<td>5.363E-04</td>
<td>1.034</td>
<td>.302</td>
<td></td>
</tr>
<tr>
<td>ROA</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>-3.67E-03</td>
<td>-.152</td>
<td>.879</td>
<td>1.055</td>
</tr>
<tr>
<td>SR</td>
<td>1.368E-03</td>
<td>.045</td>
<td>.963</td>
<td></td>
</tr>
<tr>
<td>CAPITAL</td>
<td>-2.55E-08</td>
<td>-.326</td>
<td>.744</td>
<td></td>
</tr>
<tr>
<td>GOVSHARE</td>
<td>4.454E-04</td>
<td>1.752</td>
<td>.079</td>
<td></td>
</tr>
<tr>
<td>MVR</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>-5.13E-02</td>
<td>-1.013</td>
<td>.312</td>
<td>2.604</td>
</tr>
<tr>
<td>SR</td>
<td>-7.66E-02</td>
<td>-1.603</td>
<td>.130</td>
<td></td>
</tr>
<tr>
<td>CAPITAL</td>
<td>2.992E-07</td>
<td>1.821</td>
<td>.070</td>
<td></td>
</tr>
<tr>
<td>GOVSHARE</td>
<td>-8.82E-04</td>
<td>-1.660</td>
<td>.098</td>
<td></td>
</tr>
</tbody>
</table>

The MVR analysis shows a significant positive relationship between the internal capital market building motive and the firm value, and a significant positive diversification-performance relation. The analysis also reports a significant negative relationship between the government share and the firm market value, indicating a downside effect of the government ownership during the time period of this study is conducted. On the contrary, according to the ROA analysis, the firm’s performance is positively related to the government share. Therefore, the result is inconclusive regarding the aggregate influence of the government ownership on the firm’s performance.

Although the ownership structure affects the firm’s performance in one way or another, the effect seems not influence the diversification-performance relationship under the internal capital market building consideration.

Independent of industry effects

Since different industries tend to have different levels of return, industry differences have strong influence on the firm’s performance. So the concern is that the industry effects would eventually affect the nature of diversification-performance relationship.

The strategy in evaluating the dummy variable is that: when the firm performs above the mean level according to ROE, the variable will be assigned as 1, otherwise, it will be assigned as 0. The logic is that if the relationship between diversification degree and performance holds true, it would be the same by controlling for this industry profitability. Here we choose ROE as the criterion is only for the sake of convenience. The regression equation is defined as:

\[ Y = b_1 + b_2x_1 + b_3x_2 + b_4DV \] \hspace{1cm} (3)

The analysis outcome is showed in Table 6:

Table 6: Regression output for the industry effect

<table>
<thead>
<tr>
<th></th>
<th>Unstandardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>F</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROE</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>-9.90E-02</td>
<td>-2.221</td>
<td>.027</td>
<td>21.785</td>
</tr>
<tr>
<td>SR</td>
<td>-4.49E-03</td>
<td>-.081</td>
<td>.936</td>
<td></td>
</tr>
<tr>
<td>CAPITAL</td>
<td>-3.99E-08</td>
<td>-.278</td>
<td>.782</td>
<td></td>
</tr>
<tr>
<td>DV</td>
<td>.199</td>
<td>8.070</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td>ROA</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>-4.42E-02</td>
<td>-1.993</td>
<td>.047</td>
<td>17.881</td>
</tr>
</tbody>
</table>
All the F-values have been improved dramatically since we add a variable significantly correlated to the performance. However, the MVR analysis, where the variables are satisfactory, shows that, considering the industry dummy variable, the directions of those relationships don’t change. It implies that the previous empirical evidences hold true.

The robust test outcome is consistent with the former regression test, which reveals that diversification has a positive relationship to the firm’s performance when it is considered as a strategy to relax the financing constraints from the external capital market.

The significant limitation of this investigation is the quality and reliability of the data. Most of the data employed here are either of an accounting nature which may always be questionable for reliability and comparability or are based on market value data drawn from markets which are relatively small and shallow and with institutional constraints. It would be the replication of such a study elsewhere in similar emerging markets, possibly with even better measures of corporate performance, which would provide more credence to these research findings.

Conclusions and Implications

The empirical analysis implemented in this study provides new evidence about the strategic value of diversification for a firm.

To begin with, broadly, there is no evidence to support the notion, which has been tested by most of the empirical studies, that diversification per se is a rent-reducing practice.

Secondly and finally, China’s case does not support the argument that the agency costs would off-set the advantages of the internal capital market and it would be inefficient practically. The analysis indicates that when the external finance market is under constraints, the diversification strategy as a tool of easing these constraints will benefit the firm and shareholders eventually.

The Chinese enterprises, like firms in other countries, are facing difficulties in financing projects. Especially with the limited financing alternatives, strictly regulated stock and bonds markets, and a changing banking mechanism, the external capital market is quite constrained in China. Although we do not have the evidence to demonstrate the existence of the “winner-picking” mechanism within the diversified firms, we at least find that the benefits of building internal capital market offset its costs in China’s economic environment; but for reasons which are yet to be fully explored.

The next challenge in this research is to formulate a new conceptual framework or model which explicitly lays out factors and assumptions as well as logic which would fully account for the findings revealed in this research.

References


Positioning Strategies against Nations with Perceived Quality Advantages

Kip Becker, Boston University, USA

The literature, while shifting in outcome as the understanding of where a product has been actually produced becomes blurred, has shown that consumers may assign value/price quality relationships as a function of the country offering the good or service. It was the objective of the research to determine the extent that quality is perceived as the main competitive feature and explore the possibility of constructing a practical strategy which would take into account competing against nations with perceived advantages. A model with three scenarios is presented providing an overview of the problems involved and a positive means of marketing against such situations.

Consumers have long been exposed to products from abroad. Ancient Persian shipping, desert camel spice caravans, and early American trading with Japan and China all served to provide consumers with the quality goods at prices they were willing to pay. Buyers have readily accepted foreign commodities and have often developed preconceptions concerning the quality of foreign goods and the prices which should be paid for those goods. Through the sixties consumers generally considered foreign goods to be of lesser quality than North American products except for those of specific categories. For example, dresses and perfumes from France, fine instruments from Germany, wools from Scotland and, of course, tulips from Holland have made their impressions on consumers. Even services appear to have had perceived regional differences.

Generally, the sought after imported items were considered to be worthy of premium prices as a result of perceived high quality. It is only since the 1960s that consumers have been introduced to high quality products at lower prices. Shoppers have seen items, such as computers and stereos; improve yearly while at the same time their prices have declined. The buyer now has come to associate both lower prices and higher quality with many types of imports.

Price/Quality Relationships and Strategy

Throughout the past two decades American manufactures have attempted to increase domestic sales through marketing efforts and attention to production standards. It is interesting to note, however, that despite intensive "Buy American" campaigns of the eighties, studies charting the effectiveness of the efforts are inconclusive (Hughes, 1987; Kern, 1986). Even the 2000s decline of the U.S. dollar, causing foreign goods prices to rise, has been unable to deter consumer preferences toward foreign goods. One explanation might be that due to prospering economic conditions consumers appeared to redirect primary interest away from price concerns and toward a desire for products of higher perceived quality.

A number of researchers (Bedelian, 1977; Gardner, 1970; Hagerty, 1978; Gabor & Granger, 1963; Monroe, 1973; Monroe & Bitta, 1978) during the seventies commented that their findings that consumers expect price and quality to be positively correlated. Others believe that price is the number one consumer issue (Dickinson, 1982; Advertising Age, 1977).

Leavett (1954) found that when individuals selected between two differently priced products they tended to choose the higher priced brand when price was the only information provided. This study was replicated by Tull, Boring and Gonsior (1964) with similar results. Lawson (2002) in a discussion of the “lemon effect” notes that the basic features of a transaction may themselves provide information about a price/quality relationship. Jacoby, Olson and Haddock (1971) reported that price served as an indication of quality when it was the only cue available, but not when embedded in a multi-cue setting. Ulgado, F & McIntyre, J.(2000) have added an additional dimension to the country of origin discussion by noting that country of ecommerce infrastructure may affect consumer perception. That is to say where the consumer believes a website originates can affect the company image. In support of a multi-cue concept they list seven issues believed to be relevant to forming impressions of quality. These are: price, packaging, manufacturing, past experience and advertising.

Considering current research it seems appropriate to add country of origin to Jacoby et al's list of issues believed to be relevant to forming impressions of quality. This is important as it is rare that a purchaser has no information, other than price, upon which to base a selection. For most goods some information concerning location of manufacture is available.

In a study conducted by Allison and Uhl (1973) the perceived quality, rather than the actual quality, of a product...
was of considerable importance in consumer preferences. Numerous studies (Anderson & Cunningham, 1972; Bilkey & Ness, 1982; Rasky, 1986; Schooler, 1965) have explored the "made in" implications to consumers as they relate to country of origin and its effect on the consumer's perception of quality. These findings would appear to reinforce the concept that purchasing is not a simple two axis function of price and quality but the relationship may be confounded by knowledge of the product's origin. Understanding the importance of origin of country is paramount when attempting to market against foreign competition whose goods are perceived by the consumer to be of superior quality. Holt, Quelch and Taylor (2004) stress the importance of the global brand which is a form of broadcasting both quality level and national origin. 

One interesting aspect of the global brand as a signal of quality is that as several authors have pointed out (e.g. Chao, 2001 and Cheung, 2004) globalization has led to international outsourcing as a means of competitiveness. Jaffe and Nebenzahl (2001) illustrate this through noting that a GM auto could be designed in Italy, have engine and transmission components from Japan and be assembled in Mexico. International supply chain management has led to considerable misunderstandings about where a product, or the parts of a product, actually come from. In many cases individuals do not correctly identify the country related to a brand. Weiss (2007) found, for example, that only 4.4% of a survey knew that Nokia was made in Finland or that only 9% identified LG cell phones as a product of Korea. Since these products were perceived as coming from a valued brand nation it appears that product value is not only a function of price and actual quality but also the quality that is perceived. This is important as perceived value can be effected by marketing, additional information and country of origin knowledge. The concept can be expressed as:

\[
\text{Value} (F) = \text{Price} + \text{Quality}_{\text{actual}} \pm \text{Quality}_{\text{perceived}}
\]

Nakra (2004) notes that consumers biases for goods exist for both products in general as well as categories of goods and for both end users and industrial buyers alike. That these biases are affected by product category, product stimulus employed in the research, demographics, consumer knowledge and experience with the class of goods and the consumer’s information processing style. Perceived value is becoming an increasingly pressing issue in the international marketplace as firms seek factors other than price with which to compete. Consumers have discovered that it may be possible to obtain higher quality goods at competitive or even lower prices through international competition. Johansson and Thorelli (1985) state that the country of origin cues will often be an important factor in the buyer evaluation process. They state, "The effect of country stereotype will be to shift the position of the product in the perceptual space and alter the overall evaluation of its merits" (p.57). Chuiyim, Garma and Polonsky (2007) results indicated that this effect is true for developing nations as well as the more studied post industrials. They note that experience does affect purchase likelihood for home versus foreign products among Chinese and that Chinese prefer the rather complicated origin of parts as the most significant cue in determining product quality.

Some authors have suggested that discount pricing strategies could be effective counter measures against imports. There is only limited research which demonstrates the effectiveness of this. The work of Schooler and Wildt (1968) indicates that often the halo effect can be offset by price concessions. They report that consumers switched to a previously negatively rated country's product when the price of the domestic product rose relative to the foreign good. Johansson and Thorelli's (1985) research on international product positioning has demonstrated that the value of certain products can be greatly over or understated when a consumer considers the country of origin. Relating this issue to it’s affect on product positioning Johansson and Torelli also focus on product price. They suggest that manufacturers should determine the perceived position (in contrast to the actual) of their products in relationship to their competitors. They state that, "differences can be related indirectly to the required price premiums or discounts necessary to make two alternative products of equal value to the buyer" (p.72).

Price reductions based on perceived value are certainly important considerations. Price reductions are not, however, always possible or even advisable. Often U.S. domestic goods have higher break evens or are affected by differing currency values in the international market place. Attempting to compete with goods manufactured in nations with lower costs may result in negative profit margins or inconsistent returns. Another important consideration is how deep those reductions must be to be effective. White and Cundiff (1978) found that no effect on perceived quality was found by manipulating price within ten percent. It is possible that to counteract variances caused by perceived quality discounts exceeding profit margins might be incurred. It is also important to note that if the perceived quality of the product is based on a halo effect, and not on actual construction differences, it does not necessarily make sense to reduce price to compete. In this case promoting product quality or even demarketing the competitor might be a more appropriate approach. Based on price/quality research it would seem that price reductions could reinforce a consumer's belief that the product's quality is inferior to the competition.

**Consumer Preferences for Foreign Goods**

Consumer preferences for domestic or foreign goods appear to involve a complicated set variables. Holt, Quelch and Taylor (2004) have even pointed to the location of the
company headquarters as being a prime issue in brand selection. Pricing appears less important than quality in the selection of foreign versus domestic products. There is an increasing sentiment that blaming losses of U.S. sales to foreign competition based upon price differences is narrow and often inaccurate. This would be consistent with the findings of Jacoby (1971) that price served as an indicator of product quality when it was the only cue available but not when embedded in a multi-cue setting. International marketing studies have, additionally, suggested that issues other than simple price/demand relationships effect purchasing behavior (Cateora, 1983).

Buying shifts have been responsible for major market declines in numerous North American and European industries. This decline has resulted in an increase of government programs designed to increase domestic sales. One early political strategy was to seek protective import quotas and raise tariffs. This strategy resulted in only limited success due to a lack of unified political support and an unwillingness of the consumer to absorb price increases due to import tariffs. A second approach was the development of joint ventures with the competition. While offering attractive short term benefits, the long term success of U.S. industry can not be based on the formation of joint ventures in lieu of research and the development of competitive products. Furthermore, this approach adds little to a nation's understanding of global competitive strategies. What appears to be required is the development of a comprehensive strategy which includes the complicated issue of quality and price and how that relationship is affected by country of origin information.

It was the intention of this project to examine the perceptions of products from two competing postindustrial nations (United States and Japan). Questions asked related to both why specific products were selected and what changes would have to be made so that domestic products would be chosen over imports. It was believed that this information would provide valuable input for the development of a strategy designed to market domestic goods against those from countries with more favorable product perceptions. Two experiments were conducted. Each investigated the issue of country of origin "halo effect" on the consumer. In the first experiment 1,800 individuals were questioned concerning actual ownership of goods (foreign or domestic) and what influenced their purchase. They were additionally asked what would be necessary to change foreign purchases to domestic.

The second experiment requested 700 individuals to respond to pictures of two stereo components. Experimental conditions were altered so that the relationships between country of origin and pricing changed. Individuals were requested to supply information concerning what conditions would be necessary to purchase the domestic good.

**Methods**

**Methods Experiment 1**

**Subjects.** Eighteen hundred individuals participated by completing an initial questionnaire. The subjects were drawn from those passing a table in the Quincy Market Place. A second questionnaire was administered to a limited subset of the 1,800. This group was determined by the toss of a coin after each participant completed with the initial phase. Subjects with a "Heads" were asked to complete a second questionnaire. The actual number participating was 501 of 532 asked.

The Quincy Market area is located in a major pedestrian traffic and tourist area in the downtown area of Boston. Participants would be expected to represent a cross section of middle class Americans from clerical, non-professional, professional and support staff vocations. Since Boston has a high percentage of foreign tourists and their responses would confuse results only residents were included in the data. All subjects were asked the initial question "How long have you lived in the United States". If individuals stated less than 20 years they were asked one "dummy" question, so as not to offend a foreign respondent by exclusion and their answers were no longer considered in the data pool. This question was also used to reject individuals who were less than twenty years old. It was felt that these subjects had not developed sufficient buying patterns with earned income.

**Instruments** Eighteen hundred individuals were administered a consumer preference survey (Appendix A) which requested that individuals state a country of origin preference (foreign or American) for specific products and indicate whether "quality", "style", "price" or "other" were reasons for the selection. If a foreign product was selected subjects were requested to indicate what would have to change to cause a shift in product choice toward domestic. Five hundred and one of the original eighteen hundred respondents completed a second questionnaire (Appendix B). The purpose of this questionnaire was to determine if individuals actually purchased the products from the nations stated to be favored.

**Methods Experiment 2**

**Subjects** Seven hundred individuals were selected, by the use of a random numbers table, from those attending a major stereo and video exhibit in the Boston convention center. It was believed that individuals attending the exhibition had an above average interest in the products shown in the questionnaires which was supported by interest in purchasing surveys conducted by the exhibit management. Exhibitor literature stated that 80% would buy some form of stereo component within a year and 10% would actually make that purchase at the show. Individuals whose entry corresponded to the number from a random numbers table were requested to...
“participate in a very brief survey that would take less than two minutes”. All subjects according to the numbers table were approached and no provisions for exclusions were made. Any individual who declined to participate was replaced by the next individual entering the area until a response was obtained.

Each subject answered only one of four possible questionnaires. One hundred subjects were administered question one and two hundred completed questionnaires number two, three and four. Questionnaire numbers were drawn from a bin containing seven hundred scrambled small pieces of paper labeled 1, 2, 3 or 4. Each subject then received the version of the questionnaire which corresponded to the number drawn. Questioners were instructed to continue to obtain responses until the prepared seven hundred questionnaires had been completed. The total number of individuals approached to obtain the required seven hundred responses was 983.

**Instruments** Four different questionnaires were administered. Each individual answered only one question. The first question was a control to assure that differing responses were not a function of the pictures presented. Questionnaire two, three and four provided actual data.

Each subject was given a piece of paper which had pictures of two different VCR's at the top. Below each picture was price information and (except questionnaire 1) information concerning country of origin. These pictures and their actual prices had been copied from a local newspaper advertisement supplement. As such, individuals were presented with pictures of real products with name brands removed. The actual price of the American product $319 and the price of the Japanese product was $399. As noted below, only in questionnaire four was the true price and country of origin of the products presented. Each subject was asked one of the following questions:

**Questionnaire 1** Below the two stereo pictures were prices which had been altered so that each item was of equal price ($399). One stereo was labeled L and the other C.

**Questionnaire 2** Below the two stereo pictures were prices which had been altered so that the two items were displayed with equal prices ($399). This time, however, the items were labeled Japanese and American.

**Questionnaire 3** Below the two stereo pictures were two unequally priced items. The item on the left ($399) was labeled American and the right ($319), labeled Japanese.

**Questionnaire 4** Below the two stereo pictures were the same two unequally priced items depicted in question three. This time, however, the item on the left ($399) was labeled Japanese and the right ($319) item labeled American.

**Results**

**Results: experiment 1** Table 1 provides the responses to the consumer preference survey and presents information concerning reasons for that selection as well as the national origin of the preferred good. The Probability level of .01 was used as the rejection level for all tests and the test used was the Chi-Square.

<table>
<thead>
<tr>
<th>ITEM</th>
<th>PREFERENCE</th>
<th>%</th>
<th>LEVEL</th>
<th>H₀ REJECTED</th>
</tr>
</thead>
<tbody>
<tr>
<td>PREFERRED PRODUCT ORIGIN IS FOREIGN</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CAR QUALITY</td>
<td>68</td>
<td>.01</td>
<td>Reject</td>
<td></td>
</tr>
<tr>
<td>STEREO QUALITY</td>
<td>54</td>
<td>.01</td>
<td>Reject</td>
<td></td>
</tr>
<tr>
<td>APPAREL STYLE/PRICE</td>
<td>41/46</td>
<td>.01</td>
<td>Reject</td>
<td></td>
</tr>
<tr>
<td>CAMERA QUALITY</td>
<td>74</td>
<td>.01</td>
<td>Reject</td>
<td></td>
</tr>
<tr>
<td>WATCH QUALITY</td>
<td>52</td>
<td>.01</td>
<td>Reject</td>
<td></td>
</tr>
<tr>
<td>Overall choice of foreign products 64%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ITEM</th>
<th>Must be Changed</th>
<th>H₀</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cars Quality</td>
<td>Reject</td>
<td></td>
</tr>
<tr>
<td>Electronic Quality</td>
<td>Reject</td>
<td></td>
</tr>
<tr>
<td>Camera Quality</td>
<td>Reject</td>
<td></td>
</tr>
<tr>
<td>Watch Quality</td>
<td>Reject</td>
<td></td>
</tr>
<tr>
<td>Overall foreign preference vs Domestic</td>
<td>Reject</td>
<td></td>
</tr>
</tbody>
</table>

* H₀: There is no significant difference between the preference selections among respondents

Table 2 depicts the area (quality, price, style, other) which must be changed in order for consumers to state they would shift in product choice. The H₀ "there is no difference among consumer preferences" was tested at the P=.01 level of significance using the Chi-Square. Table 3 depicts the percent of responses to the national origin of respondent's purchases questionnaire comparing current ownership (appendix B) and stated preference (appendix A). Table 4 presents information relating to the comparison of current ownership (appendix B) and stated product origin preference if the item was purchased now (appendix A). Both table three and table four have an N = 501.

**Table 3. Current Ownership & Stated Preference**

<table>
<thead>
<tr>
<th>Item</th>
<th>Prefer Foreign Domestic</th>
<th>Own Foreign Domestic</th>
<th>H₀</th>
</tr>
</thead>
<tbody>
<tr>
<td>Car</td>
<td>86 09</td>
<td>77 23</td>
<td>Reject</td>
</tr>
<tr>
<td>Stereo</td>
<td>68 09</td>
<td>59 32</td>
<td>Fail</td>
</tr>
<tr>
<td>Apparel</td>
<td>43 41</td>
<td>46 36</td>
<td>Fail</td>
</tr>
<tr>
<td>Wines</td>
<td>23 54</td>
<td>51 27</td>
<td>Fail</td>
</tr>
<tr>
<td>Beer</td>
<td>18 68</td>
<td>23 64</td>
<td>Reject</td>
</tr>
<tr>
<td>Watches</td>
<td>68 17</td>
<td>82 11</td>
<td>Reject</td>
</tr>
<tr>
<td>Cameras</td>
<td>64 36</td>
<td>86 13</td>
<td>Reject</td>
</tr>
</tbody>
</table>

* H₀: There is no difference in preference between domestic & foreign goods (P=.01)
Table 4. Current Ownership & Preference if Purchasing Item Now

<table>
<thead>
<tr>
<th>Item</th>
<th>Would buy Now</th>
<th>Current Ownership</th>
<th>H&lt;sub&gt;a&lt;/sub&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Car</td>
<td>Foreign</td>
<td>Domestic</td>
<td></td>
</tr>
<tr>
<td></td>
<td>77</td>
<td>14</td>
<td></td>
</tr>
<tr>
<td>Stereo</td>
<td>59</td>
<td>9</td>
<td></td>
</tr>
<tr>
<td>Apparel</td>
<td>42</td>
<td>51</td>
<td></td>
</tr>
<tr>
<td>Wines</td>
<td>42</td>
<td>51</td>
<td></td>
</tr>
<tr>
<td>Beer</td>
<td>16</td>
<td>77</td>
<td></td>
</tr>
<tr>
<td>Watches</td>
<td>69</td>
<td>12</td>
<td></td>
</tr>
<tr>
<td>Cameras</td>
<td>93</td>
<td>2</td>
<td></td>
</tr>
</tbody>
</table>

H<sub>a</sub>: There is no difference between current ownership and what would be purchased now (P=.01)

Results: experiment 2

Information concerning the four stereo questionnaires and the selection of either the Japanese or American product at differing prices is presented in table 5. Table 6 presents information relating to what would be necessary for individuals to consider the American product if they had selected the Japanese or no preference. The hypothesis was that there is no difference between the selection of Japanese, American or no preference choices. This was tested at the P =.01 level.

Table 5. Under Different Pricing conditions Which National origin’s Product Was Considered the Best?

<table>
<thead>
<tr>
<th>Price condition</th>
<th>H&lt;sub&gt;a&lt;/sub&gt;</th>
<th>Favored Origin</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control</td>
<td>Fail</td>
<td>No Preference</td>
</tr>
<tr>
<td>A&lt;J</td>
<td>Reject</td>
<td>Japanese</td>
</tr>
<tr>
<td>A&gt;J</td>
<td>Reject</td>
<td>Japanese</td>
</tr>
<tr>
<td>A=J</td>
<td>Reject</td>
<td>Japanese</td>
</tr>
</tbody>
</table>

H<sub>a</sub>: There is no difference between the choice for American or Japanese products (P=.01)

Table 6. What Would be Necessary for Consumer to purchase the American Product?

<table>
<thead>
<tr>
<th>Price Relationship</th>
<th>H&lt;sub&gt;a&lt;/sub&gt;</th>
<th>Price</th>
<th>Reduce Quality</th>
<th>Increase Quality</th>
</tr>
</thead>
<tbody>
<tr>
<td>A&gt;J</td>
<td>Reject</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A&lt;J</td>
<td>Reject</td>
<td>X</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

H<sub>a</sub>: There is no difference between the choice for American or Japanese products (P=.01)

Discussion

It would appear that there is merit to Narayana's (1981) comment, that international trade is highly dependent on consumer's perceptions of national versus foreign offerings. It was observed in the majority of cases, that respondents in both the first and the second experiment preferred foreign goods over domestic. In the first experiment there was an overall preference for imported products (64%) over domestic (36%) and the Japanese stereo was selected when its price was less, equal and more than the American product. There was a tendency to select foreign products (experiment I) even when a specific country of origin was not identified and individuals only understanding was that the alternative products were not made in America. It is possible, however, that some products have become so identified with a particular country that the two have become synonymous. That is to say that VCRs or TVs are to the Japanese as XEROX is to copiers and KLEENEX is to facial tissues. This could serve as a source of error but might also demonstrate the power of a country "halo".

Earlier discussions concerning the complexity of the buying decision appear to be supported by the first experiment as most choices were based on attributes other than price. The most important basis for a purchase decision, as supported by both experiments, was quality. It is interesting that for the higher priced items (cars and electronic equipment) that quality was more important than price. Price did seem to be more important with higher volume consumables (beer) than with the durables (cars, stereos, watches). It may be that higher priced items were considered to be investments as well as purchases. As such, buyers may be looking for an item such as a car or stereo which will last longer and thus, while of higher initial cost, be a better investment over time. It was interesting that when questioned concerning ownership, survey participants actually owned foreign cars and electronic equipment. In spite of rigorous efforts during the last decade to reverse the trend toward foreign goods individuals reported for a repurchase that a foreign product would, again, be selected. This may demonstrate the perseverance of the "halo effect" once established and the difficulty in undermining it. One complication is that someone owning a “Japanese” Toyota might find it was actually constructed in Tennessee, USA.

No preference was demonstrated for foreign versus domestic apparel but there was a strong preference for domestic beer. U.S. apparel makers have focused a great deal of media attention toward their industry's difficulties which they claim are a result of foreign competition. In addition to this visibility there may have been confusion due to the difference between types of apparel imports. It is possible that European designer imports from Italy and France are not viewed equally as clothing imports from Mexico Taiwan or Korea. Consumers may view apparel imports as much less of a class than perhaps telecommunications or stereo equipment. It is clear that in the case of apparel much of what is perceived to be made in a specific nation, such as Italy, is actually manufactured elsewhere and shipped to the final “nation of origin” for distribution clouding the actual national relationships.

The preference for domestic beer may be a result of a rather limited importing effort combined with small advertising budgets compared to the massive promotional campaigns of the major U.S. producers. It was also interesting that price was stated as the major consideration required for a change in purchase. This may provide some further indication...
that some items are more price competitive than others. Imported beer is often twice the price of domestic beer making the consumer much more aware of the difference in consumption price. Additionally, it is often noted that prepared food is one of the most difficult items to export due to local taste preferences. What could be considered quality might be, in reality, domestic taste differences. It could be that even if a majority of a country's products could be encompassed by a "halo" that certain products, with high domestic influence, might well be excluded. While experiencing some shift during the 2000s in specific US regions American consumers, for example, do not appear to seek out Japanese restaurants, or beers, with the same passion that they do their high technology products.

Two important considerations of the first experiment seem to be that: (1) There is clearly a strong personal desire to purchase foreign produced goods and (2) Perceived quality seems to be a more important decision factors than price. This is at least true for higher priced items. These findings indicate that strategies which focus on pricing or increased tariffs and dollar devaluations to drastically improve domestic sales will likely meet with long term disappointment.

Hamel and Prahalad (1985) have stressed the old ways of pricing competition are not working in the international market and must be replaced by a more complex global strategy. The concept of a modern marketing strategy, designed for competition in today's sophisticated environment, is truly important. It would seem that such a strategy must have provisions for competition against nations with favored perceptions toward their goods. Insights from such researchers as Rierson (1967) and Narayana (1981) have pointed to possible considerations for the development of an effective global marketing strategy. One which is devised to compete against goods from positively perceived countries. A significant number of researchers have discussed the merits of pricing strategy. In most cases (in both experiment I and II) individuals stated that if the foreign good was of greater price the American firm would have to increase quality, not simply decrease price, in order to compete. It is interesting to note that if the foreign good was of lesser price, rather than reporting that the domestic good was of superior quality, it was reported as costing too much. This truly indicates that previous buyer conceptions which related quality as a function of price have been disrupted. When consumers have pre-formed concepts of a nation's quality competing with price may have disastrous results. It is possible that the message to the consumer when a more expensive American good is reduced in price is that it was initially overpriced. This seems to be particularly true if the item is being compared to a similar, but less expensive, item from a country of perceived higher quality. When both countries' products were of equal price (experiment II) individuals considered the Japanese to be of greater quality. To compete, individuals stated that the domestic had to increase quality (at least increase perceived quality). If price reductions serve to support consumer beliefs that the product is of inferior quality marketing strategies other than price must be considered. It was the objective of this research to further explore the possibility of constructing a marketing strategy which could be effective in competing against more favorably perceived countries. Such a strategy would have to include not only actual quality and price relationships but also the perceptions of consumers to fully understand the output of buyer actions.

Several options are available to a firm which is interested in using information concerning country of origin preferences in the marketing strategy. These may include forming joint ventures, seeking import restrictions, relocating manufacturing to a more desirably perceived country, "masking" the actual manufacturing location and repositioning perception.

In both experiment one and two individuals were asked what changes would be necessary in domestic products to induce their purchase. The purpose of information was to develop a model for repositioning domestic products against those originating from countries with higher perceived quality. Three marketing situations were presented in experiment II which offered individuals different price and country of origin combinations. The control situation (question one) indicated that differences attributed to the stereos were not a result of the photos themselves. Respondents failed to demonstrate a preference for either of the pictures when presented in generic form without additional information. It was, therefore, assumed that differences reported in questions two, three and four were a function of the additional country of origin and price information provided. It is important to note that only pictures of the stereos were presented. Since there were no technical cues available statements concerning quality had to relate to perceived quality as actual quality was impossible to assess.

Possible Scenarios

Scenario I

It was interesting in question two that when price was held constant ($399) there was an overwhelming response (141 to 37) supporting the belief that the Japanese product was better. It should be noted that a definition of "better" was intentionally not offered or sought throughout the research. As such, better can only be taken at face value and problems with this are acknowledged. Those who selected the Japanese product stated that it would require an increase in quality as opposed to a decrease in price (suggested strategy by Johasson and Thorelli,1985) for them to consider the U.S. product (Figure 1).

Scenario II

When the Japanese product was presented as less expensive (question 3) there was again an overwhelming preference for the Japanese product (182 vs. 11). The price difference between the American and Japanese labeled products was twenty percent so as to represent a clear price difference. White and Cundiff (1978) had noted that
differences of less than ten percent do not appear significant to consumers. Those selecting the Japanese product stated that a decrease in price would be necessary for them to consider the American product.

Figure 1. Strategy When Purchase Prices Are equal

Competitors from countries with highly perceived products often use price as a competitive strategy to penetrate or gain market share. In these situations countries with goods of lesser perceived quality could be forced into price reductions to maintain market share. This presents a particularly awkward situation. Scenario I indicates that when price is reduced to equal competition consumers will still select the foreign good, if it has originated from a country with higher perceived quality. It appears that any strategy must include an increase in quality even after (or during) price reductions. It seems appropriate to strongly consider "Halo" based strategies in these situations as opposed to competition based on price (figure 2).

Figure 2. Strategy when foreign price is less

Scenario III There was more mixed response when the American product was twenty percent less expensive than the Japanese product (question 4). A significant difference, however, continued to exist with a preference of the Japanese product. This situation should serve as a caveat for those who consider price reductions alone as a sufficient means to market against foreign goods of perceived greater quality. Those selecting the Japanese product stated that an increase in product quality, not further price reductions, would be required for them to select the American product. It appears that strategies based upon price reductions would not induce significant additional sales volume to avoid a possible decrease in revenue. In this case it seems that the firm must improve the quality image of the product while slowly increasing price (Figure 3). Holt, Quelch and Taylor (2004) present the example of the use of these types of strategies when the South Korean firm, Samsung, launched a global advertising campaign depicting their great international engineering and design feats. The campaign was able to reposition Samsung against Sony and Nokia as a global provider of leading edge technologies.

Figure 3. Strategy when domestic price is less

Summary

It appears that the effect of country of origin information can greatly influence consumer decisions. The two studies highlight the importance of an adequate assessment of one's competition to include consumer perceptions of the country of origin. Strategies based on pricing appear questionable when firms are in competition against nations with perceived higher quality goods. While U.S. companies have reintroduced the "Made in USA" label as fashionable and associated such purchases with "American pride" they must not neglect or fail to fully understand the difficulties involved selling to sophisticated consumers with established beliefs. It is essential that the pervasiveness of consumer perceptions be acknowledged. In some instances only specific products from a country will be considered special while it appears, in other cases, most products will be so considered. Companies must clearly determine if all products from a specific country are included in the "halo" or if perceptions only relate to particular product classes? While increasing efforts to enhance product quality they must concomitantly position their products to be of equal high quality through genuine production and marketing efforts.

To increase sales domestically and perhaps in most post industrial countries abroad, it will be essential for companies to recognize that consumers expect quality goods and have developed well formulated perceptions concerning the ability of some nations to produce them. Nakra (2006) notes that country of origin biases have been found for both both developed and less developed countries and that goods from developed nations area awarded greater prestige. A model for marketing against nations with perceived greater quality was presented. Three scenarios involving different price and perceived quality relationships were discussed. It was the objective to provide not only a overview of the problems
involved but also a positive means of marketing against such situations. These models are, of course, confounded by the discussions relating to where a produced, parts come from, location of home office and even location of ecommerce infrastructure.

Historically, hope has been an insufficient business strategy. Prior attempts to focus blame for lower domestic sales on competitor's lower wage structures and unique governmental-business relationships for has accomplished little. American business may also find that faith in external solutions such as dollar devaluation or national pride campaigns, which fail to consider the complexity of the buying situation, will be even more inadequate during the next decade. Increased pressure from Eastern European and developing Third World Nations will soon join an even stronger Asian community in the production of quality goods. Hamel and Prahalad (1985) have stated that the old ways of competition are not working in the international market and must be replaced by a more complex global strategy. This research supports the work of others in demonstrating how complex that strategy may need to be.

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Best Practices in Currency Risk Management in the U.S. Public Sector

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David Shetterly, Troy University Atlantic, USA

The purpose of this paper is to extend the literature on financial derivatives to the public sector. The issue is investigated by comparing three federal government agencies, the Departments of Defense and State as well as the Agency for International development, with respect to their currency exposure, and highlighting some best practices in risk management. The authors argue that although the U.S. government does not actively engage in risk management techniques, it is just as important an issue in the public sector as it is in the private sector. Given the scope of their worldwide operations, the federal government of the United States has much to gain from the adoption of risk management techniques that will lessen the budgetary and tax implications of currency rate fluctuations.

Introduction

Currency exchange rates are a major source of uncertainty for multinationals and also in some degree to companies that do not do business outside the United States. Since an appreciation of the U.S. dollar makes foreign imports relatively inexpensive compared to U.S. goods, fluctuations in the value of the dollar can impact a company even if it does not do business outside the home country. This issue has been thoroughly investigated in the private sector; however, the stream of research with respect to the public sector is scant at best. This paper tackles this issue with respect to three U.S. federal government agencies: The Department of Defense, Department of State and the Agency for International Development (USAID). All three agencies have extensive worldwide operations and as such are vulnerable to exchange-rate exposure.

Exchange rates are typically four times as volatile as interest rates and ten times as volatile as inflation. Hence, to hedge or not to hedge is an extremely critical multinational decision area. Prior to discussing derivative usage in the public sector, a brief summary of the issues as it applies to the private sector is presented. This approach is utilized in order to demonstrate that the issues faced by the public sector are not far removed from the issues pertaining to corporations.

Multinational corporations (MNCs) are exposed to exchange rate fluctuations by the nature of their business. MNCs that have outstanding obligations denominated in other currencies are subject to gains or losses due to exchange rate movements before the obligation is satisfied. For conglomerate firms, such gains and losses can potentially be measured in USD billions. Hence, many MNCs attempt to shield themselves from exchange rate exposure through the effective use of derivative instruments such as currency futures and forward contracts. Such instruments often times mitigate the effects of unfavorable exchange-rate movements by locking in a predetermined rate. These contracts are usually executed through a financial intermediary.

Furthermore, many MNCs attempt to use “natural or geographic hedges” to shield themselves from unfavorable exchange rate movements. In doing so, companies diversify themselves across many countries and currencies so that exchange rate movements that affect their operations and subsequently their profits may have some canceling effects.

The issues discussed above have been addressed in the international finance literature extensively. On the other hand, only a small handful of studies have addressed the implications of financial derivatives in the public sector. This is primarily due to the fact that there is less publicly available information on the public sector and one often needs internal contacts within the federal government in order to conduct such a study.

This study is an extension of earlier studies that discussed exchange-rate exposure for various federal government agencies. According to previous studies in the field, the federal government does not take steps to actively mitigate their currency exposure. However, each agency has some discretion when it comes to managing its level of exposure. This study compares currency management techniques employed by three federal government agencies that have extensive overseas operations. The results of the study qualitatively demonstrate that, although each agency has a slightly different approach to risk management and some are superior to others, the ultimate result is the same for all three agencies: They do not take steps to actively mitigate their level of currency exposure.
The remainder of this paper is organized as follows: The next section provides a brief overview of the existing literature in the field of derivative usage. Although the stream of research on this topic goes back several decades, this section only lists some recent publications in the field. The literature review will be followed by a discussion of the nature of the exposure faced by these three federal government agencies. This will then be followed by a discussion of the exposure management techniques employed by each of the three agencies. The subsequent section will focus on the best practices of each agency with respect to currency risk management. The final section concludes.

**Review of Related Literature**

Geczy, Minton and Schrand (1997) examine the use of currency derivatives in order to differentiate among existing theories of hedging behavior. Firms with greater growth opportunities and tighter financial constraints are more likely to use currency derivatives. Firms might use derivatives to reduce cash flow variation that might otherwise preclude firms from investing in valuable growth opportunities. Firms with extensive foreign exchange rate exposure are also more likely to use currency derivatives. The source of exposure is an important factor in the choice among types of currency derivatives. For example, firms with currency exposure resulting from foreign operations or import competition are more likely to use forwards only or forwards in combination with futures or options, than currency swaps.

Makar and Huffman (1997) claim that foreign exchange derivatives can be used to manage currency risk. The results indicate that the use of foreign exchange derivatives is a positive function of the degree of foreign involvement, which is a proxy for foreign currency exposure. According to the authors, these results are not sensitive to industry membership or other differences across firms.

Makar, DeBruin and Huffman (1999) investigate how large U.S. MNCs use foreign exchange derivatives. The evidence indicates that the use of derivatives is inversely related to natural hedging.

Groshek and Felli (2000) demonstrate that the use of forward contracts and options outperform the current Department of Defense exchange-rate policy which is risk neutrality. Their results suggest that entities in the public sector should also actively engage in risk management techniques like their private sector counterparts.

Groshek (2000) discusses exchange rate exposure for the Department of Defense between 1993 and 1997. Like his previous study, this study demonstrates that risk neutrality is not the best approach. The use of forward contracts would inject greater certainty into the budgeting process and might release limited defense funds for use elsewhere.

Allayannis et al (2001) investigate the importance of financial and operational hedges for managing foreign exchange exposure. Their results indicate that the use of financial hedges decreases the exposure level while the use of operational hedges does not decrease exchange rate exposure. Using a combination of the two generally increases the value of the firm.

Makar and Huffman (2002) investigate the effectiveness of foreign currency risk management practices of U.S. MNCs. Their results indicate that derivative use and natural hedging associated with geographic asset-sales alignment and geographic asset concentration are effective in reducing currency risk.

Krishnamoorthy and Shetterly (2003) discuss the implications of currency exposure and derivative usage for the U.S. Department of Defense (DOD). A case is qualitatively made that although the DOD does not engage in hedging activities, it is even more critical than in the private sector.

Krishnamoorthy and Shetterly (2006 and 2007) also investigate exchange-rate exposure faced by the U.S. Department of State and the U.S. Agency for international Development. The current study is an extension of the 2003, 2006 and 2007 papers. The previous three studies considered each federal agency in isolation. The present study compares three separate government entities with respect to managing exchange-rate exposure and presents some best practices in currency risk management within the federal bureaucracy. The contribution of this paper is as follows: Each agency with international operations should benefit from the adoption of best practices of another agency that also has extensive operations in foreign countries and is subsequently exposed to foreign currencies.

**Exchange Rate Exposure Faced by the USAID**

This section discusses the nature of the exchange-rate exposure faced by the USAID. The data presented in this section was obtained by reviewing internal USAID memorandums and information presented on their website. In order to understand and appreciate the magnitude of their currency exposure, one needs to understand their mission and objectives. Hence, the agency’s reasons for existence are discussed in the succeeding few paragraphs.

The USAID is a quasi autonomous federal government agency. Their work supports long-term and equitable economic growth and advances U.S. foreign policy objectives by supporting the following global initiatives: Economic growth, agriculture, trade, global health,
democracy, conflict prevention and humanitarian assistance.

With headquarters in Washington, DC, USAID maintains field offices in four regions of the world: Sub-Saharan Africa; Asia and the Near East; Latin America and the Caribbean; and Europe and Eurasia. The agency works in close partnership with private voluntary organizations, indigenous organizations, universities, American businesses, international agencies, foreign governments and other U.S. government agencies. The agency has operations in over 100 developing countries around the globe.

Overseas, the agency provides assistance in the following areas: Technical assistance, capacity building, training, scholarships, food aid, disaster relief, infrastructure development, small business loans, budget support and credit guarantees. In order to provide needed assistance in an efficient manner, the agency maintains both geographic and functional bureaus. Each bureau is staffed with highly skilled individuals who are responsible for the major subdivisions of the agency’s activities.

Furthermore, maintaining their own infrastructure, such as rent and utility payments for overseas field offices, involve expending cash in foreign currencies. Although the U.S. employees stationed at overseas locations are paid in dollars, they are compensated for cost of living adjustments (COLA) caused by fluctuating exchange rates. Local employees who work for the USAID at overseas locations are typically paid in the local currency.

The agency’s overseas programs are grouped into four major types of country organizations: Countries where USAID assistance is based on an integrated strategy that includes clearly defined program objectives and performance targets; countries where USAID presence is limited, but where aid to non-governmental sectors is necessary to facilitate the emergence of a civic society, help alleviate repression, meet basic humanitarian needs, enhance food security or influence a problem with regional or global implications; countries that have recently experienced a national crisis, a significant political transition, or a natural disaster and where timely assistance is needed to reinforce institutions and national order; and countries where the USAID works with various international development organizations, such as the World Bank and IMF, that represent U.S. and USAID interests in development assistance matters.

The preceding paragraphs have provided an overview of the worldwide operations of the USAID. The very nature of their operations makes them vulnerable to exchange-rate volatility. Much of their activities in foreign countries, such as providing small business loans and infrastructure development, involve expending funds, at least partially and in some cases entirely, in the local currency of the country in question.

In addition to the basic causes of exposure, the USAID has to deal with one more issue that increases its vulnerability. Much of their operations are based in less developed countries (LDC) and/or countries that are in the midst of profound political and economic reforms. Hence, the USAID is primarily exposed to the currencies of LDC countries. The currencies of LDC countries tend to be more volatile than those of highly developed economies such as the UK and Japan. The highly volatile nature of LDC currencies tends to further increase the exchange-rate exposure faced by the USAID.

**Exchange Rate Exposure Faced by the Department of State**

The U.S. Government maintains diplomatic relations with about 180 countries with more than 250 posts throughout the world. Embassies, consulates and other diplomatic missions are manned by Foreign Service and career civil service employees and perform a variety of functions. The authors obtained data on U.S. diplomatic posts overseas by conducting an exhaustive search of internal State Department memorandums. This data was obtained by invoking the Freedom of Information Act (FOIA).

The Department of State speaks with one voice to others on U.S. policy (and ensuring mission staff do likewise) while providing to the President and Secretary of State expert guidance and frank counsel. They direct and coordinate all executive branch offices and personnel (except for those under the command of a U.S. area military commander, under another chief of mission, or on the staff of an international organization). They cooperate with the U.S. legislative and judicial branches so that U.S. foreign policy goals are advanced, security is maintained, and executive, legislative, and judicial responsibilities are carried out. They review communications to/from mission elements. They take direct responsibility for the security of the mission (including security from terrorism) and protect all U.S. government personnel on official duty (other than those personnel under the command of a U.S. area military commander) and their dependents. They carefully use mission resources through regular reviews of programs, personnel, and funding levels. They reshape the mission to serve American interests and values and to ensure that all executive branch agencies attached to the mission do likewise. Finally, they serve Americans with professional excellence, the highest standards of ethical conduct, and diplomatic discretion.

Embassies and consulates are analogous to small communities with infrastructure support that requires expenditures within local economies. Maintenance of residential facilities and other family support units mandates funding in local currencies. Furthermore, high-
ranking diplomatic officials are entitled to domestic help such as chauffeurs and maids at their respective locations. In addition, embassies and consulates rely on local residents for cultural and language services and such infrastructure needs as facility security. Although some local employees, commonly referred to as Foreign Service nationals (FSN), may be paid in U.S. dollars, a majority of them are paid in the local currency thereby increasing the State Department’s exchange rate exposure. In summary, the annual maintenance expenditure associated with carrying out U.S. foreign policy worldwide amounts to billions of dollars of transactions that are denominated in foreign currencies.

Exchange Rate Exposure Faced by the Department of Defense

The department of Defense (DOD) projects forces throughout the world. The maintenance of massive military infrastructure overseas leaves it vulnerable to currency volatility. The data on the DOD was obtained by interviewing current and former employees of the Defense Finance and Accounting Service (DFAS) on condition on anonymity.

To accomplish force projection, the DOD operates within the framework of nine unified commands. The United States Pacific Command (PACOM) is an example of a unified command. It is headed by a four star general and has jurisdiction over 43 countries and 10 U.S. territories. In order to carry out its mission, PACOM employs about 300,000 military personnel.

In order to carry out its mission, the DOD maintains military bases in numerous countries around the world. A military base is like a small American town. It has shopping centers, schools, convenience stores, a fitness center and the like. Expenditures associated with these bases often need to be paid in local currenies and can amount to billions of U.S. dollars.

The maintenance of military bases overseas requires the consent of the host government. This consent is given on the basis of two considerations: Security and economics. In addition to carrying out U.S. interests overseas, the DOD is also responsible for providing security to host nations. For example, part of the mission of United States Forces Korea (USFK) is to protect South Korea from an attack launched by its northern neighbor.

Furthermore, the presence of the U.S. military overseas provides employment for host country nationals and thereby stimulates their economy. Often times, local employees who work at on-post positions are paid in the local currency thereby increasing the exchange-rate exposure faced by the DOD.

In summary, the DOD is exposed to foreign currency fluctuations due to the nature of their operations. The maintenance of heavy infrastructure, plus the employment of local nationals creates exposures that amount to billions of dollars annually.

Current USAID Policy on Managing Exchange-rate Exposure

This section of the paper addresses the policies of the USAID as it pertains to managing currency exposure. The data for this section was primarily obtained through an analysis of internal USAID memorandums and the agency’s Internet website.

Throughout its 45-year history, the agency’s exchange-rate policy has been aimed at encouraging foreign governments to adopt and move towards unified exchange rates at realistic levels. The agency strongly believes that adoption of market-determined exchange rates for all transactions is a key element for stabilizing economies and stimulating economic growth. However, in many of the countries in which the USAID has operations, this is a pipe dream and so the agency has felt the need to address ways to mitigate its exposure.

Standard USAID project grant and loan agreements provide that U.S. funds be exchanged for local currency at the highest rate per USD, hereafter referred to as the HR, which at the time of the transaction is not unlawful in the recipient country. This policy is applicable to all project and non-project assistance and mission operating expenses in which U.S. dollars are exchanged for local currencies.

For local currency expenditures that are not directly related to project and non-project assistance, the appropriate exchange rate to use for conversion is the rate of exchange determined by the U.S. government’s disbursement Officer (USDO) on the day the voucher is prepared. The U.S. Treasury Financial Manual contains the following statement: “Unless otherwise authorized by the Treasury, exchange transactions for accommodation purposes or for official expenditures will be computed at the prevailing rate of exchange, where the prevailing rate is defined to be the rate that would be legally available to the U.S. government for the acquisition of foreign exchange for its official disbursements. Elsewhere the USDO rate for commercial transactions is defined to be the highest legal rate obtainable from a legally authorized exchange dealer. If the USDO rate is lower than the HR, USAID dollars are to be exchanged at the USDO rate until such time as a satisfactory solution to exchange USAID dollars at a higher rate, be it the HR or not, can be negotiated with the recipient government.”

As mentioned earlier, local currency expenditures that are tied to project and non-project assistance involve converting U.S. dollars into foreign currencies at the HR. In countries where a unified exchange rate that is
determined by market forces exists, the HR is the unified exchange rate.

In countries where a freely competitive auction system for foreign exchange has been developed, the HR is the auction rate. USAID funds can be auctioned off or sold at the latest auction rate. In countries where financial institutions are allowed to engage in foreign exchange transactions without being subject to penalties, the HR is the commercial bank rate.

In countries where foreign exchange transactions are controlled, but commercial bank exchange rates and unofficial markets also exist, the HR is the higher of the commercial bank rate, the unofficial rate or the controlled official rate. In countries where foreign exchange transactions are strictly controlled under a single and official rate and where no unofficial market exists, the HR is the controlled official exchange rate.

In some foreign locations, it is not feasible to rely solely on the HR policy. In such locations, the appropriate exchange rate is determined by arm’s length negotiation between two parties. Insistence on an exchange rate equal to the HR in such circumstances may be counterproductive and inhibit the orderly conduct of business transactions and the increased rate of economic growth that the USAID seeks to stimulate.

The USAID has significant operations in some countries that are subject to hyperinflation. At such locations, USAID missions negotiate with appropriate host government officials, or private party borrowers, USD disbursement schemes based on need. Gradual disbursements of dollars would reduce the problem of rapid depreciation of local currencies deposited into special accounts.

Current Department of State Policy on Managing Exchange-rate Exposure

The State Department uses a revolving fund from which exchange-rate losses are covered; the fund is periodically replenished by gains due to favorable currency movements.

At the beginning of each fiscal year (October 1st), financial plan allocations are adjusted for prior year exchange rate fluctuations and the current spot rates for each post. Exchange rate changes during the year are calculated for each post with an allowance made for hyperinflation. Financial plans may be revised based on a quarterly financial review. Exchange rate gains are held in a central fund for decision on disposition. Losses are generally covered by withdrawing from this centrally managed fund; however, they are sometimes accommodated by reprioritization of existing financial plan allocations.

Decisions are made on the use of exchange rate gains and the source of funds for exchange rate losses within the context of quarterly financial plan reviews including consideration of all funding demands. The quarterly financial plan reviews reprioritize financial plan allocations by considering funding availability, including exchange rate gains or losses, against the approved level of operations. Approved level of operations for the purposes of this policy is considered to be the level of activity for the department envisioned in the authorization and appropriation acts. Decisions regarding the allocation of gains to cover losses or the reprioritization of financial plans require clearance from the Office of Management and Budget (OMB).

Current Department of Defense Policy on Managing Exchange-rate Exposure

Current policy on managing exposure was established by Congress in the DOD appropriations Act of 1979. The approach involves the use of a revolving fund into which gains from currency fluctuations are transferred and from which military installations may withdraw funds to cover losses. In 1987, Congress amended this piece of legislation to include construction, housing and NATO infrastructure. Furthermore, the DOD maintains what is referred to as a Centrally Managed Allotment (CMA). At the start of each fiscal year, the CMA is replenished in accordance with the department’s budget for the given fiscal year. Funds in the CMA can be used to cover losses resulting from exchange-rate movements. Any gains resulting from favorable currency movements must be transferred into the CMA.

Unlike the USAID and the Department of State, DOD internal memorandums do make a reference to hedging their exposure. The DOD can utilize forward contracts with prior approval from the U.S. Treasury Department. However, there is no evidence that they have ever taken advantage of this privilege.

Best Practices in Currency Risk Management

This section discusses some best practices in currency risk management employed by these three agencies. The Departments of State and Defense employ similar polices with respect to exchange-rate exposure. In a nutshell, their policy involves a revolving fund that is used to cover losses due to unfavorable exchange-rate movements; gains resulting from favorable currency movements are used to replenish the fund. This fund is adjusted on October 1st of each year (the beginning of the federal government’s fiscal year) and is based on exchange-rate movements during the
previous fiscal year. Neither agency engages in active risk management to mitigate its exposure resulting from currency volatility.

As mentioned in the last sentence of the preceding paragraph, neither the DOD nor the State Department has engaged in active risk management techniques. However, the DOD can use forward contracts with prior approval from the U.S. Treasury. According to State Department internal memorandums, there is no such provision in the department’s charter.

The USAID, on the other hand, follows a slightly different procedure. This is owing to the fact that the AID, by decree, has more autonomy than the State and Defense Departments within the executive branch of the U.S. federal government. Hence, it has more latitude in various facets of its operations include managing its exchange-rate exposure.

Standard USAID project grant and loan agreements provide that U.S. funds be exchanged for local currency at the highest rate per USD which, at the time of the transaction, is not unlawful in the recipient country. Hence, the USAID ensures that it receives the most favorable treatment possible in its foreign currency transactions.

As mentioned earlier in the paper, the USAID engages in lengthy negotiations with foreign governments for the best rate of exchange. This is especially true in countries where there is not one official rate of exchange and/or countries where hyperinflation exists. Hence, the agency is not totally at the mercy of spot exchange rates at the time a given transaction is executed.

Research results indicate that the USAID is more active in managing its exchange-rate exposure than the Departments of State and Defense. However, it is still a far cry from techniques employed by the private sector.

Conclusions

The purpose of this paper has been to discuss currency risk management techniques used by public sector entities. This was accomplished by discussing risk management techniques employed by three federal agencies and highlighting some best practices when it comes to managing their exchange-rate exposure.

The private sector uses financial derivatives to manage their exchange rate risk. To some extent, such usage is even more critical in the public sector since they are subject to more one-sided cash flows. The three federal agencies discussed in this paper have large expenditures in foreign currencies, but they do not generate much revenue overseas. Furthermore, government agencies are driven primarily by the need to carry out their respective missions and as such have fewer options than in the private sector. For example, the Department of State cannot shut down its Embassy and Consulates in Saudi Arabia simply because the region is politically unstable. When conditions become extremely volatile, as in the Middle East at the present time, government agencies ask nonessential personnel and dependents to leave the country. However, this does little to relieve them of their currency exposure.

The U.S. federal income tax code is adjusted periodically and generally rises when government expenditures increase. Foreign currency volatility is one of the determinants of corporate and personal income taxes. In other words, mounting losses due to currency fluctuations are often passed on to the U.S. taxpayer in the form of an increase in their rate of taxation.

Although none of the agencies discussed in this paper take active steps to mitigate their exchange-rate exposure, the USAID seems to be ahead of the game in this regard. Perhaps the Department of State and the Department of Defense should employ some of the negotiation techniques used by the USAID in order to reduce their level of exposure and, in doing so, reduce the burden on the U.S. taxpayer.

The federal government, as a whole, should be more proactive when it comes to managing its exchange rate risk rather than passing off the resulting losses to U.S. taxpayers. American taxpayers should be rather interested in the results of this paper since it demonstrates one more expense they are picking up which can be avoided with some prudent risk management techniques that have been used by the private sector for decades.

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From Yellow Peril to Trading and Security Partners: Australia - Japan Relations

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This paper provides an overview of Australia’s distinctive approach to Japan, currently one of its main trading and security partners, in the context of global and regional challenges. The paper traces how Australia—as Asia’s ‘Down Under’, with a history of the ‘White Australia Policy’ and a fear of the ‘Yellow Peril’—has developed a warm and successful relationship with Japan, its former enemy. In doing so, Australia has shared the benefits of the latter’s economic growth and dynamism. The paper focuses on Australia’s need to manage a strategic balance between advancing its national economic and business interests, and regional security concerns, especially since 9/11, and the rise of China.

Introduction

Australia is an ethnically and culturally diverse society. As of 2007, Australia’s population of 21 million people includes 5 million born overseas, and an additional 5.4 million having at least one parent born overseas (ABS 2008). Around 200 different ethnic groups and nationalities are embraced within the country, an achievement that the Department of Foreign Affairs and Trade (DFAT) now recognizes as a strength in advancing Australia’s national interest, at home and abroad (DFAT 2003). Over the past two to three generations, young Australia has managed to transform itself from an ‘outpost’ of the British Empire into an active part of a globalizing world. This has particularly been the case in the East Asian region—which, in itself, poses opportunities as well as challenges.

Among the nations of the Asia Pacific, Japan, to date, has been acknowledged as one of the most important and useful allies of Australia, helping to strengthen Australia’s economic growth and prosperity. Perhaps, second only to the US, Japan has also become a staunch strategic and security partner during the past decade, a period of uncertainty and threat aggravated by global terrorism, wars in Afghanistan and Iraq, the nuclear proliferation of North Korea, to the rise of China.

This paper aims to provide an overview of how Australia has transformed its relations with Japan from a former threat and enemy to currently one of its main trading and security partners, in the context of global and regional challenges. Throughout, this transition has been beset by numerous complexities, requiring great skill and dexterity by the Australian political leadership.

Australia’s Fear of the ‘Yellow Peril’

From the establishment of the Australian Federation (1901) and prior to the end of World War II (1939-1945), Australia still considered itself very much as an ‘outpost’ of the British Empire, relying upon the ‘motherland’ for most of its trade, identity, and security needs. In addition, as a Western nation, Australia was located in an unknown, and potentially hostile, geopolitical environment. Partly as a result, and partly also due to the general Western socio-cultural thinking of the times, Australia’s greatest fear was the ‘Yellow Peril’, which included perceptions of racial threat and of being swamped by ‘teeming hordes’ of Asians. For example, when Prime Minister Alfred Deakin welcomed the US Great White Fleet to Sydney and Melbourne, in 1908, he remarked on Australians’ “distrust of the Yellow Race in the North Pacific and our recognition of the ‘entente cordiale’ spreading among all white men who realize the Yellow peril to the Caucasian civilization, creeds and politics” (cited in Meaney 2008, p. 401).

Consequently, Australia sought to erect institutional and strategic barriers against any potential infiltration or invasion from Asia (see also: Kelly 1992).

One such barrier was the ‘White Australia Policy’, which, whilst not a formal ‘policy’, as such, was a set of legislative arrangements and procedures that intentionally attempted to keep Australia’s national racial profile ‘white’. A major component of this was the 1901 Immigration Restriction Act, which limited the immigration of non-whites to Australia, indirectly, through the use of language dictation tests. Overall, the official orientation of Australian immigration policy, as well as that of indigenous affairs, in this era, was ‘assimilationist’, so that although some Continental Europeans were accepted, the overwhelming preference was for British migrants.

The rise of Japan as a great power, after its victory over Russia at the turn of the twentieth century only
aggravated Australia’s fear of the ‘Yellow Peril’ from its geopolitical north. Despite the Anglo-Japanese Alliance (1902), which should have made Japan an ally/friend, given Australia’s formal status as a dominion of the British Empire, Australia continued to regard Japan as a threat. And, although Australia and Japan were de facto allies, in World War I (1914-1918), their relationship was based more on suspicion and distrust than on collaboration or mutual understanding. Moreover, in the 1930s, when Japan embarked upon a confrontationist course with nationalist China, the USSR, and the League of Nations, by incorporating Manchuria, the Australian Minister for External Affairs openly raised the possibility, in conversation with the Japanese Foreign Minister, that Japan might someday undertake ‘military adventures to the South’ (Dalrymple 2003, pp. 14-15).

Japan’s subsequent attacks, in December 1941, on Pearl Harbor and Southeast Asia, seemed finally to justify Australia’s long-held fear of the ‘Yellow Peril’. One hour after the Japanese bombing of Pearl Harbor, Australian Prime Minister, John Curtin, declared, “from one hour ago, Australia has been at war with the Japanese Empire...We did not want war in the Pacific...No other country than Japan desired war in the Pacific...Australia goes to its battle stations in defense of its very way of living” (Curtin 1941). Japan’s stated desire, during the Pacific War, was to create what it referred to as the ‘Greater East Asia Co-Prosperty Sphere’, which would be a Western-free zone, with Japan at its center. In defending against this expansionism, Australian defence forces fought Japan in battles across Southeast Asia and Papua New Guinea.

Starting in February 1942, Japan launched air raids against Darwin, in northern Australia. These air raids, between 1942-1943, remain the first and only such attack on Australian soil by a foreign power (not including the European colonization). They were accompanied by submarine attacks against Sydney Harbour and Newcastle, and against shipping routes along the eastern Australian coastline. An example of the latter is the sinking of the Centaur, a hospital ship, in 1943, killing 268 people (AWM 2008b). In addition, of the around 22,000 Australian POWs captured by Japan, during the Pacific War, over 8,000 died in custody, from disease and malnutrition (AWM 2008a). This very real experience of Japanese aggression and atrocities against Australia, during World War II, more-than-ever confirmed Australians’ fears of the ‘Yellow Peril’.

In the immediate post-World War II period, the Australian government of Prime Minister Robert Menzies set about attracting immigrants to Australia as labour for the new industries that had been established during the war, as well as for defense, under the slogan ‘Populate or Perish!’ After relatively unsuccessful efforts to attract Britons in sufficient numbers [For many years Britons remained, however, the large single migrant group], Australia then turned more towards Continental Europe as a source for immigrants, especially ‘displaced persons’ from the war. These “New Australians”, as the new Minister for Immigration, Arthur Calwell, called them, would be “the new life blood which will make Australia’s national heart beat with the strong and measured pulse of prosperity and security” (cited in Lack & Templeton, p. 10). But immigration from Asia was still a long way off. Indeed, in rejecting the immigration of Japanese war brides, in 1948, Calwell declared: “Japanese women should not be allowed to pollute our shores” (cited in Rix 1999, p. 18). Although the Japanese threat to national survival had been aborted, the legacy of the Pacific War still lingered on in the Australian psyche, and Japan could not easily be forgiven.

Australia’s wartime experience also helped to turn it more towards the United States as a ‘great and powerful friend’. In the context of the beginning of the Cold War, the emergence of the People’s Republic of China (PRC), in 1949, and the start of the Korean War (1950-1953), the US wished to rebuild Japan as a bulwark in its policy of ‘containment’ against the spread of global communism. The Australian Minister for External Affairs, Percy Spender, vehemently opposed any such rearmament of Japan, concerned that it might renew aggression in the Asia Pacific, and proposing instead for the US to create a ‘Pacific Pact’, modeled along similar lines to that of NATO to counter communism (Meaney 2008). It was also clear that Australian public opinion still harbored “much ill will towards Japan” (Greenwood 1950, p. 168). For example, a Morgan Poll conducted in 1951, after the signing of the Japanese Peace Treaty (between Japan and the Allied Powers), revealed 67 percent of Australians opposed the Treaty (Meaney 2008, p. 408), presumably because it did not contain any prohibitions against Japanese rearmament. In the event, Spender’s efforts to get a ‘Pacific Pact’ were stunningly successful insofar as they resulted in the US conceding to sign a new Australia, New Zealand, United States Security Treaty (ANZUS), in September 1951. Indeed, according to DFAT, to this day, “[s]trengthened by fifty years of cooperation, ANZUS continues to be the foundation of a dynamic and broad-ranging security relationship” (DFAT 2003, p. 88).

From ‘Yellow Peril’ to Trading Partners

Successful Australian governments had been quick to ascertain that, to quote later Prime Minister, Paul Keating: “Asia is no longer the ‘Far East’. It is the ‘near North’” (cited in Weightman 2006, p. 19), and where Australia’s future lies. Already, in the early 1930s, Sir John Latham, the then Minister for External Affairs, had foreseen the need for better understanding, and even collaboration, with the Asia Pacific region. In 1934, he expressed: “It is inevitable that the relations between Australia and the East will become closer and more intimate as the years pass.
Although Australia was colonized and developed by people of European stock, and although our cultural past story and our present connections are such that our eyes turn most naturally towards Europe, our geographical situation is such that we must inevitably be brought into close touch with the peoples of Asia. If we make no effort to understand their problems, we can scarcely expect them to make an effort to understand ours. Differences of race, religion, language and culture could easily lead to regrettable misunderstandings which might adversely affect our relations with them (DFAT 1951).

With Japan, in particular, Australia eventually had to do a summersault, due primarily, in the end, to economic necessity. Australia had to put aside its wartime resentment and bow to Japan’s pressure to relax its discriminatory controls on Japanese manufactured imports, so as to make sure that Japan would continue to purchase Australian wool exports. The result of three years of hard and difficult negotiations was a landmark bilateral trade treaty, the Australia-Japan Commerce Agreement, of July 1957, which is now widely considered to have “set in motion Australia’s most successful bilateral trade relationship in history” (AGJ 2007). The commerce treaty allowed Australia to tap into post-war Japan’s increasing economic growth, by granting Most Favored Nation status (MFN) between the two countries. Yet, still only just over a decade after the Pacific War, the agreement was not accompanied by substantial political trust. Consequently, in the 1960s, coal, not people, bound Japan and Australia together.

With the period of Cold War détente beginning in the late 1960s, Australia became freer to pursue a more independently-minded foreign policy in the Asia Pacific. At the same time, Australian business and political leaders were also keenly observing the emergence of Japanese economic power, which had begun to rise rapidly from the ashes of military defeat. Already, by 1966, Japan had eclipsed the UK to become the largest market for Australian exports. Interestingly, this was also the period when the Australian political leadership began to dismantle the ‘White Australia Policy’, with bipartisan support. In particular, from the period 1972-1978, they introduced ‘multiculturalism’ into Australian society and immigration policy (Jupp 1998, pp. 138-139). This shift helped capture the strength of Australian cultural and linguistic diversity to meet national and regional challenges, and to eliminate the perception that Australia was a racist country.

In this atmosphere of gradually increasing Australian engagement with Asia, premised, first and foremost, upon economic interest, the Basic Treaty of Friendship and Cooperation between Japan and Australia, also known as the ‘Nippon-Australia Relations Agreement’ (NARA), was signed in 1976. While little attention was given to it at the time by the Australian media and public, it was the first such treaty of friendship, commerce, and navigation (FCN) that Australia had successfully concluded (Stockwin 2004, pp. 201, 212). Again the NARA took years of protracted negotiations between the two countries. It is notable, however, that the agreement, like the shift in Australia’s immigration policy, had been the result of bipartisan efforts in Australian domestic politics.

NARA, however, was mostly symbolic in nature, “not designed, after all, substantially to change behavior but to ratify existing behavior and at the same time to provide assurances and guarantees of predictability in certain areas of the relationship” (ibid. p. 214). Yet in the sense of helping to build trust between Australia and Japan, NARA advanced bilateral relations, particularly in the areas of cultural and personal exchange, and sister-city links. Under its umbrella there have been many organizations established such as the Japan-Australia Academic and Cultural Center, and the Japan-Australia Research committee.

From the 1970s to the 1990s, the rapid economic growth of Japan, as well as the astonishing economic successes of the ‘East Asian Tigers’ (Taiwan, Singapore, Hong Kong, and South Korea), helped even further to turn the focus of Australia’s foreign policy towards the Asia Pacific. Throughout the 1980s and 1990s Australia-Japan relations deepened, especially on the economic front. For example, the establishment of the Asia Pacific Economic Cooperation (APEC) was largely the fruit of joint efforts by the Australian Prime Minister, Bob Hawke, and the Japanese Ministry of International Trade and Industry (MITI). This was also one of the first examples of Australia and Japan increasingly working together to advance the cause of regional cooperation and integration in the Asia Pacific. Clearly, Australia had come a long way—on the back of economic interest—from the dark old days when fear of the ‘Yellow Peril’ dominated its concerns.

**From Trading to Security Partners**

Australian popular attitudes towards the Asia Pacific have evolved steadily over the past two to three generations, although sometimes lagging behind those of the political leadership. As Rix argues, “[i]t is clear that [international] relationships do not necessarily rely on a compliant and supportive public…public opinion has not necessarily followed government policy” (Rix 1999, p. 4).
Indeed, this was the case for a long time in Australia-Japan relations, and towards the Asia Pacific, in general. Even though the political and business leadership had begun to move away from a purely self-interested economic relationship towards one built more on trust and even of partnership, it did not necessarily follow that the attitudes of the domestic Australian electorate were yet fully prepared to accept this evolution. While the bipartisan shift to ‘multiculturalism’, from the early 1970s, had borne out some noticeable results in cultivating more tolerant attitudes and behavior—by 1992, for example, Asian immigration to Australia had already increased to 50.7 of the total intake, up from only 5.3 percent, in 1971 (McDougall 1998, pp. 158-159)—the Australian government, under Prime Minister Paul Keating (1991-1996), believed that a more comprehensive vision of Australia’s engagement with Asia was desirable.

Thus, in the mid 1990s, Keating attempted to promote what he referred to as the ‘Big Picture’, which included approaching the Asia Pacific in a self-conscious move beyond just trade and financial ties, and to also encompass closer all-round people-to-people and cultural links (even going so far as to endorse the ‘Asianisation’ of Australia), as well as extensive cooperation with Asian countries in several other areas. However, many Australians rejected these enthusiastic attempts outright, while others remained deeply skeptical. A part of the populist backlash against the ‘Big Picture’ was the rise of Pauline Hanson’s extreme nationalist One Nation Party, from 1996-1998. Hanson, gaining wall-to-wall media coverage in Australia, and even in Asia, itself, repeatedly uttered ‘politically incorrect’ remarks such as, “I believe we are in danger of being swamped by Asians” (Hanson 1996).

Keating’s successor as Prime Minister, John Howard (1996-2007), had campaigned instead, for a ‘confident Australia’, where “[t]urning our faces to the East does not however mean turning our backs on the West” (cited in Curran 2006, p. 349). While not explicitly seeking to lessen Australia’s relations with the Asia Pacific, this approach sought to be more ‘comfortable and relaxed’ (cited in ABC 1996). A major component involved ‘reinvigorating’ Australia’s relationships with its ‘great and powerful friends’, the US and UK. And, while, in 1999 (during Australia’s lead role in the East Timor peacekeeping operations), Howard had seemed briefly to subscribe to seeing Australia as a ‘deputy sheriff’ in Southeast Asia and the Southwest Pacific, to the US ‘global policeman’, he latter clarified that Australian foreign policy was aimed at acting “in concert with friendly nations within our region to achieve mutually shared objectives” (cited in ABC 1996). A major component involved selectively enhancing relations with other countries having ‘shared values’, such as liberalism, democracy, and human rights (Beeson & Yoshimatsu 2007, pp. 235-236). Australia considered Japan to be a key exponent of these ‘shared values’.

In the security environment of the contemporary Asia Pacific, the strategies of Australia, the US, and Japan, are now so completely intertwined that Australia-Japan relations can hardly be viewed without also discussing the US-Japan relationship. Japan has emerged as a key ally of the US as a bulwark against communist China, especially in the context of the economic and military rise of China. The East Asia Strategy Report released by the US Department of Defense, in 1995, concluded that the regional balance-of-power rests upon the strategic triangle of the US, China, and Japan, and recommended that the US further strengthen its relations with Japan so as to help counter-balance the rise of China. After the September 11, 2001 terrorist attacks, the US began a Global Posture Realignment for its defence forces, globally (Kamphausen 2005). As a part of this, the US has continued to encourage Japan, as a key ally, to reform its ‘pacifist’ constitution, so as to allow for its Self-Defense Forces to take on more regional and global security responsibilities. Partly as a response, Japan’s October 2001 anti-terrorism legislation has paved the way for the dispatch of its forces to Afghanistan and Iraq, in non-combat supporting roles for the US-led Coalition (Blumenthal 2005, pp. 1-3). Notably, Australia has successfully provided military protection for these forces while they engaged in humanitarian assistance work in Iraq.

This three-way security partnership (Australia, US and Japan) has now been formalized by the inaugural Trilateral Strategic Dialogue (TSD), held in March 2006, in Sydney, at the level of the countries’ foreign ministers. In the words of the Japanese Ambassador to Australia, in his 2007 speech entitled ‘Strengthening the Comprehensive Strategic Partnership’: “Asia still holds potential threats of conflict and security challenges. Although the trilateral cooperation is not targeted at any specific country, it is important for both Japan and Australia to coordinate security strategies with the US, whose presence has been a cornerstone for the security of the region for many years” (Kojima 2007).

Finally, on March 13 2007, Australia and Japan signed a joint security pact, the Japan-Australia Joint Declaration on Security Cooperation (JADSC), in Tokyo. The treaty was Japan’s first security cooperation treaty since the 1960 Treaty of Mutual Cooperation and Security Between the United States and Japan. As such, it created “a surfeit of hyperbole” from the Japanese and Australian press and commentariat (cited in Bisley 2008, p 39). Indeed, this is an historic treaty, demonstrating that the Australia-Japan partnership has gone from strength to strength. It further indicates that Australia and Japan are now ‘indispensable partners’ (Downer, 2007b), in a region still beset by threats from terrorism, North Korea’s nuclear proliferation, and human rights concerns.
Conclusion

Looking back over the relationship during the past 50 years, spanning from the signing of the landmark commerce treaty, in 1957, to the security treaty, in 2007, Australia and Japan have achieved more than a milestone. The partnership is now “one of the strongest in the Asia Pacific region” (DFAT 2008a). In terms of two-way trade, for example, Japan is the single largest destination for Australian exports—worth $35.5 billion AUD, in 2006-2007—and has been for the past 40 years. Only recently has Japan been overtaken by China as Australia’s largest trading partner, with the total value of Australia-Japan trade worth almost $50 billion AUD, in 2007 (DFAT 2008a). Japan is also the third largest source of imports to Australia, after the US and China, comprised mainly of merchandise (especially motor vehicles), worth $18 billion AUD in 2007 (DFAT 2008a; DFAT 2008b). In addition, Australia is currently ranked tenth among Japanese export destinations, and third as a source of Japan’s imports (MOFA 2008). Overall, Australia reaps its largest trade surplus with Japan, and in April 2007, the two countries commenced negotiations for a bilateral Free Trade Agreement (FTA).

As already shown, however, the Australia-Japan relationship has also progressed in other areas, not only in security. Indeed, as the two countries celebrated the thirtieth anniversary of NARA, in 2006, the Australian Minister for Foreign Affairs, Alexander Downer, declared that the partnership was based not only upon shared interests, but also “shared commitments to liberal democratic values” (Downer 2006). In terms of people-to-people links, to date, there are approximately 60,000 Japanese residents in Australia, while Japanese students enrolled in various Australian educational institutions reached 18,000 in 2006, and 572,900 Japanese visited Australia in 2007 (DFAT 2008a). Through time, 16 Australia-Japan and 46 Japan-Australia societies, and 99 sister-city relationships have emerged (DFAT 2008a). These figures, alone, suggest a strengthening of the Australia-Japan relationship beyond the economic and security front.

Moreover, according to a 2005 public opinion poll by the Lowy Institute for International Policy, 84 percent of Australians surveyed said that they felt positive towards Japan. As the author of the Lowy Poll remarks, “[t]hat Japan should be liked almost as much as the United Kingdom [at 86 percent] shows how far our focus has shifted eastwards in the past 60 years” (Cook 2005, pp. 7-8). Indeed, such results as these indicate conclusively that the Australian political leadership has been remarkably successful in helping to transform public opinion from a widespread fear of the ‘Yellow Peril’, to a high level of acceptance, and to even embracing Japan, as a major trading and security partner. This has occurred despite demonstrative resistance, at times, such as in the mid 1990s, when Prime Minister Keating had attempted too quickly to force through change, and Prime Minister Howard had eventually prevailed by taking a more gradual approach, selectively focusing upon Japan as an ally with ‘shared values’.

In more recent times, although some have been worried that the new Prime Minister Kevin Rudd (elected in November 2007), is well known to have a personal interest in Chinese culture—he gained first-class honours in Chinese history and language at university, served as a diplomat to China earlier in his career, and has a Hong Kong-born son-in-law—there is also no doubt that he will maintain Australia’s strategic relationships with both Japan and the US. In March 2008, Rudd’s government attracted some minor controversy by announcing that he would visit China, and not Japan, during his first world tour as Prime Minister, even though he is due to visit Japan in early July, as Japan’s invited guest, for the annual G8 Summit. As Opposition Leader, Brendan Nelson remarked: “I know Mr. Rudd speaks Mandarin. He needs to brush up on his Japanese and visit the Japanese prime minister” (cited in SMH 2008)! But, by the same token, in early 2008, the new Treasurer, Wayne Swan, also received criticism for releasing revised guidelines on foreign investment, regarded by some as discriminating against Chinese SOEs, such as Chinalco, which recently took a sizable stake in BHP Billiton takeover target, the Anglo-Australian natural resources company, Rio Tinto.

Finally, as already mentioned, Japan has recently been overtaken by China to become Australia’s largest trading partner. This occurred prior to the election of the new Rudd government. In June 2006, Prime Minister John Howard had already signed a massive $25 billion AUD deal to supply gas to China over the next 25 years, at which time he said: “We welcome China’s growth and China’s development...We see it in a positive light” (China Daily 2006). Yet, overall the Australia-China relationship still lags far behind that of Australia-Japan. In terms of other indicators such as ‘shared values’ and security cooperation, there is nothing. Hence, the Rudd government will continue to maintain strong strategic relations with both Japan and the US, while gradually improving Australia-China relations. Indeed, Australia and Japan will very likely continue to build their relationship. Tensions will arise from time to time, as is to be expected. However, the relationship has weathered many storms, and has progressed successfully, bringing mutual benefit.

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Foreign Policy for A Better Future, accessed online on March 8, 2008:


This paper covers a survey of determinants of foreign direct investment (FDI) in emerging economies since post World War II up to now. It delves into not only the theoretical aspects, but also cites evidence from empirical studies in specific countries. Our conclusion is that FDI has been expanding through push and pull drivers from both sides of home country and host country. The article focuses on two major aspects of the determinants of FDI: the economic and the political as main drivers. The evidence from empirical studies demonstrates that the most important determinant factors of FDI are based on existing political and economic theories.

Key words: theoretical aspects of FDI, empirical evidence of FDI, country cases, developing countries

Introduction

Hymer (1966) wrote in his PhD dissertation “Direct investment is capital associated with the international operations of firms, and movements of direct investment are determined by the extent of international operations”. Hymer examines the multinational enterprise (MNE) as the institution for international production, rather than international exchange. Meanwhile, McClintock (1988) presents “MNE as an enterprise involved in the control and management of production facilities located in two or more nations”, and “direct foreign investment is defined as financial, physical, and human capital movements directed at control over the management and pecuniary of the MNE”. According to Buckley and Brooke (1992), FDI is “a packaged transfer of capital, technology, management and other skills, which takes place internally within multinational corporations” (MNCs). From these points of view, we can see that FDI and MNE have strong ties, and that theories on FDI are similar to theories of MNE in general.

To understand FDI per se and why it has gradually played a pivotal role in the world economy, huge studies have been attempted after the Second World War (WWII) in order to discover an embraceable theory. However, Kojima (1978) indicates that “conditions in foreign investment and MNCs have been changing so rapidly that reliable economic theory has not been able to keep pace, and an appropriate theory has not yet been fully developed”. As lacking in one overall accepted theoretical framework, this absence has led researchers to rely on empirical evidence to estimate the importance of the different determinants of FDI. Furthermore, as FDI becomes an emerging phenomenon, there are extensive empirical studies about the determinants of FDI in a range of countries, especially in developing countries. It is incomplete if we do not mention determinants of FDI in certain countries. In fact, most researchers only pay attention to theoretical and empirical evidence while reviewing literature, ignoring specific country cases. Our study will cover all three aspects: the theoretical, the empirical and specific country cases.

Obviously, FDI only occurs if there are two sides: the investor (called home country) and the recipient (called host country). A demand from one side is a supply to the other. Thus, our designed structure of theoretical review includes push drivers from home country, and pull drivers from host country. Then, we will classify the theories into two groups of economic and political stands by ignoring the theories that explain FDI tendency, e.g. behavioral economics of firms, the impacts of culture, ethnicity, religion, languages and distance. We limit our scope on theories to explain the birth of FDI, including traditional FDI (movement from abundant developed to developed and developing countries) and modern FDI (investment from developing/ transitional economies to developing countries, South – South corridor).

Determinants of FDI: Theoretical Review

Overview

Various surveys of FDI theories have been conducted. Different structures have been reviewed such as perfect – imperfect markets [Agarwal (1980), Lizondo (1991), Twimukye (2006)], and economic and political explanation Brewer (1992). Most researchers have focused on the economic aspect with famous theories such as (1) industrial organization, (2) internalization, (3) product cycle, and (4) the Kojima approach. Recently, the emergence of transnational corporations (TNCs) from developing countries and transitional economies has given a large
contribution to the growth of FDI. It creates a new investment corridor and imparts a greater momentum to South–South cooperation (WIR, 2006). This event also leads to new developments in the theory of FDI. UNCTAD classifies drivers that trigger company’s internationalization in terms of “pull” – “push” drivers, and “policy” factors. Push driver boosts a source country company to move abroad, while pull drivers encourage a company to invest in specific economies. Each driver consists of four main types, quite similar in nature.

**Table 1. Push and Pull Drivers**

<table>
<thead>
<tr>
<th>Condition</th>
<th>Push - Home Country</th>
<th>Pull - Host Country</th>
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<tbody>
<tr>
<td>1. Market and Trade</td>
<td>Limited home market</td>
<td>Large/ growing market</td>
</tr>
<tr>
<td>2. Cost of production</td>
<td>Scarcity of resources/ inputs, high labor cost</td>
<td>Available required resources/ low cost of labor</td>
</tr>
<tr>
<td>3. Local business</td>
<td>Global and local competitive pressure</td>
<td>Bilateral, multilateral trade, investment treaties</td>
</tr>
<tr>
<td>4. Government policies</td>
<td>Supportive policies</td>
<td>Incentive policies such</td>
</tr>
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**Economic Explanation**

**Industrial organization theories** These theories postulate that FDI is a result of an imperfect global market environment. Heckscher (1919) and Ohlin (1933) are the earliest authors who laid the groundwork for substantial development in the theory of international trade. They draw a factor–proportion model, which focuses on the relationships between the composition of countries’ factor endowments and commodity trade patterns, as well as the consequences of free trade for the functional distribution of income within countries. Their research states that factor-endowment differs between countries. This means that factor prices cannot be equalized internationally. Capital flows occur from capital abundant to capital scarce countries. Consequently, FDI is motivated mainly by the possibility of high profitability in growing markets, at relatively low rates of interest in the host country, and the necessity to overcome trade barriers and to secure sources of raw materials. Hymer was the first to systematically analyze issues relating to the advantages of large multinationals, market imperfections, and control. He successfully splits the theory of FDI into industrial organization from the neoclassical international theories of trade and finance. In his dissertation, Hymer’s work motivated studies on FDI based on market conditions because MNEs present one or more advantages, such as internal or external scale economies, managerial expertise, and imperfect competition in the factor market (technological or knowledge/skill advantage), monopoly, imperfect competition (product differentiation), financial strength, governmental intervention, and restriction on imports. There are two conditions that must be fulfilled for FDI to take place in this scenario. First, if MNEs are able to compete with local firms that have a better knowledge of the local market and environment, and with these advantages, MNEs would prefer to supply the foreign market by investing directly (in developing countries) instead of through exports. Second, the market for this advantage must be imperfect. Instead of MNE behavior determining the market structure, Kindleberger (1969) slightly modified Hymer’s analysis that the market structure will determine the conduct of the firm, by internalizing its production. He argued that FDI exists because of imperfections in either goods (e.g., a differentiated product or marketing proficiency), or factor markets (e.g., distinctive technology, access to capital, managerial excellence), and that MNE is based on some monopolistic advantage held by the parent firm. Its monopolistic advantage might be the results of the achievement in internal economies of scale through horizontal or internalization of other external economics through vertical integration. Still talking about the market factor, Cave (1971) explained that the FDI occurs mainly in industries characterized by certain market structures in both the "lending" (home) and "borrowing" (host) countries. FDI will be made basically in sectors that are dominated by oligopolies. With product differentiation, corporations make "horizontal" investments (specialized intangible assets with low marginal costs of expansion) to produce abroad the same lines of goods as they produce in the home market. If there is no product differentiation, “vertical” investments (reduction of uncertainty and building of barriers to entry) will be made to produce abroad a raw material or other input in the production process at home, in sectors that are behind in the productive chain of firms. According to Caves (ibid), direct investment tends to involve market conduct that extends the recognition of mutual market dependence - the essence of oligopoly - beyond national boundaries. Likewise, it tends broadly to equalize the rate of return on (equity) capita throughout a given industry in all countries, where production actually takes place. Markusen and Venables (1998) have the same general idea about horizontal direct investment in which an MNE produces the same product in multiple plants; and FDI arises from an interaction between firm-level economies of scale and trade cost. Their general finding is that multinationals become more important relative to trade as countries become more similar in size, relative endowments, and as world income grows. The vertical model by Helpman (1984) postulates that FDI comes from the skill abundant country to the unskilled country. Later on, Markusen and Venables (1996), and Markusen (1997) combined the horizontal and vertical model into a knowledge-capital model that allows for both multi-plant
scale economies and exploitation of factor-price differences (Bruce, 1993).

**The internalization theories** The internalization theory describes that FDI emerges because of ownership, internalization, and locational advantages. Buckley and Casson (1976), and Buckley (1985) extend Coase's (1937) explanation as to why multinationals internalize intermediate markets. They begin with the idea that the intermediate product markets are imperfect, having higher transaction costs, when managed by different firms. There are two decisions that the firm must make concerning location or mode of control. The firm exports if production and control are located in the host country. If the transaction costs, when managed by different firms. There are two decisions that the firm must make concerning location or mode of control. The firm exports if production and control take place in the host country; then FDI is made. Therefore, the internalization of intermediate production processes reduces uncertainty by circumventing market imperfections. Related to the transaction cost approach in which hierarchical organizational structures replace markets, Rugman (1981; 1986), argued that the theory of FDI is really a theory of the MNE. According to Rugman (ibid), there are three possible avenues for a firm to consider explicitly the relative costs of servicing foreign markets: (1) export to foreign markets, (2) engage in FDI, (i.e., set up an overseas subsidiary to produce for a local market), and (3) give license to a servicing a foreign market. He also established conditions under which foreign markets can be serviced by a firm endowed with distinct advantages such as technology, knowledge, and other types of significant firm-specific advantage (e.g. managerial skills, strong capital and strong competitive capacity). Rugman also holds that, generally, if there are no barriers to free trade, then exporting takes place. If, on the other hand, there are existing barriers, then that opens the way for FDI. Licensing is an inferior method compared to FDI, since the MNE loses control of its firm-specific advantage. Thus, the firm-specific advantages of the MNE are best explained by the new concept of internalization. Dunning (1973; 1981) was the first to provide a more comprehensive analysis based on an integration of ownership advantage, locational advantage, and internalization theories. Dunning’s paradigm may be schematically presented as follows:

- **Foreign firms hold assets related to ownership advantages** over domestic firms in a given sector. Product advantages include patents, blueprint and trade secrets, and confer market power or cost advantage, \( \rightarrow \) the foreign firm has two choices that are either internalized or sell its ownership advantage. In the case in which the firm holds an internalizing advantage (I), \( \rightarrow \) the foreign firm will decide to produce in the host country, which offers a sufficient locational advantage (L) that makes it profitable.

Based on the OLI paradigm, Dunning (1993, 2000), and UNCTAD (WIR, 1998) developed four reasons that a firm invests abroad. The firm wants to search for resources, for markets, for efficiency, and for new strategic assets. Singh and Jun (1995) wrote that Dunning’s eclectic theory provides some answers about the geographic distribution of FDI by analyzing location factors.

**Product internationalization theories** The product internationalization theories assert that FDI appears from the life cycle of the product. Vernon (1966) developed an international product life cycle theory that is an extension of the monopoly advantage theory to explain why a manufacturing firm shifts from exporting to FDI. The author builds upon the technological advantage theory, analyzing strategic market implications of the product life cycle. Vernon’s model can be summarized as follows: Innovations initially appear in countries, which are more capital intensive \( \rightarrow \) gradually, production is relocated to less capital intensive countries \( \rightarrow \) lastly, capital is shifted to a developing country; concurrently, new products incorporate innovations in products and processes which were developed in a capital rich country. Depending on this route, firms would initially supply the export market. In this stage, a firm may gain advantage by monopoly. Subsequently, if there are intensive competitive products in the same market, then the firm might establish trade representatives abroad, and in order to maintain profitability, the firm may have to reduce costs by investing in production facilities abroad, eventually setting up a subsidiary. In addition, Vernon (1979) re-evaluated his own theory by indicating that multinational firms are now more geographically diffused than the product cycle would warrant, and the cycle has shortened considerably. Also along the production internationalization line of thinking, Graham (1978) raises a new hypothesis based on rivalistic behavior among firms. This test builds upon U.S. multinational firms in Europe, which had preceded the entry of European firms in to the U.S. The results are: (i) High levels of industry concentration are positively associated with high rates of investment in research and development in the same country, (ii) High rates of investment in research and development are positively associated with high degrees of product differentiation, however, (iii) High degrees of product differentiation are positively associated with high levels of industry concentration. The results tell us that European direct investment in the U.S. occurs as a result of rivalistic behavior in oligopolistic industries, stimulated by U.S. direct investment in Europe (Graham, 1978).

**Kojima approach** The Kojima approach is considered a part of the product-cycle approach of Vernon (1976) that observes that U.S. firms go abroad. Kojima examines in similar ways the Japanese movement. The difference is that Japanese FDI is ‘trade-oriented’, while US FDI is ‘anti-trade oriented’. Kojima discusses whether FDI complements trade, or substitutes for it. The core of his analysis is that firms must consider the comparative cost between home and host country. The thrust of his argument is ‘Japan should undertake direct foreign investment in an industry becoming comparatively disadvantageous in Japan
which at the same time has the potential of becoming comparatively advantageous in the host country. Furthermore, ‘Japan should enlarge another industry in which it has comparative advantage so that the capital and labor force of the industry which undertook direct investment abroad are transferred to this promising industry.’ Thus, both investor and recipient country can enhance harmonious trade without making mention of industrial structure, and create more complementary and more profitable trade, and both will grow pari passu, bringing about prosperity of the international economy. It is the Japanese style. 

Finance-oriented theory Aliber (1970; 1993) emphasizes the variables of interest rates, exchange rates, and finance. He suggests that the theory of FDI must cover the dynamic events such as the source of advantages. The substantial part of US FDI has been by firms since WWII, the different pattern of direct investments has been by industry, companies are established abroad, and foreign firms often invest in the U.S. while U.S. firms invest abroad. According to the author, the perfect competition model is not relevant to explain why firms engage in FDI. The theory of industrial organization cannot predict the country pattern of FDI or its industrial pattern. Therefore, he explained FDI as a custom-area phenomenon or a currency-area phenomenon. He wrote that ‘the long-term interest rates on securities denominated in the currencies of some countries are lower than the interest rates on comparable securities denominated in the currencies of other country’. For him, the key factor in explaining the pattern of FDI involves capital market relationships, exchange rate risk, and the market’s preferences for holding assets denominated in selected currencies (Aliber, 1970).

Political Explanation - Governmental Policies

Since the 1970’s, many authors have concerned themselves with political factors when they examine FDI theory. Vernon (1971), with the "sovereignty at bay" model, views governments as sources of "ineffective obstacles" to FDI. Gilpin (1975), with his model of "neo-mercantilist", expresses that governments are largely ineffective in efforts to restrain FDI and harness it to serve national security interests. And the "dependency" model of Barnett and MuUer (1974) found home governments of industrialized countries as facilitators of outbound FDI from industrial home countries to developing host countries (Brewer, 1992). It is incomplete if revising theories of FDI to not consider political factors. Brewer (1992, 1993) analyzes the role of government policy in the internalization theory of FDI. The "Eco-political" model of Schneider and Frey (1985) confirmed both factors impact FDI inflows in developing countries. By combining the factors of politics and economics, they developed a matrix of effects of government policies on market imperfections and relative attractiveness of FDI. In general, they find that government policies can affect market imperfections and FDI. Some government policies such as anti-predatory dumping measures and countervailing duties to reduce subsidies can reduce market imperfections, which can make FDI more attractive. On the contrary, the restrictions of host countries on inward FDI and home country on outward FDI increase market imperfection, and decrease FDI. For instance, the antitrust (competition) policies and the pollution control policies can make a reduction of both market imperfections and FDI. UNCTAD has strongly emphasized the role of government policies to boost inflows and outflows of FDI, especially with the emergence of TNCs. The policies in a host country have been able to trigger significant changes in the role of TNCs in the extractive industries since the 1960’s (WIR, 2007). The Chinese strategy, ‘China’s going global’ in 2000”, is among the most explicit recent policy initiatives taken to boost FDI overseas (WIR, 2006). UNCTAD recorded 149 policy changes in 2005; and most of the changes made conditions more favorable for foreign companies to enter and operate (WIR, 2006).

Determinants of FDI: Evidence

Empirical Studies

An overall accepted theoretical framework that accounts for all of the different aspects of FDI is lacking. This absence has led researchers to rely on empirical evidence (Ioannatos, 2001) in an attempt to estimate the importance of the different determinants of FDI. These empirical measures concentrate more on attraction factors. The main variables normally used are the size of the market, the growth rate of the market, labor cost, amount of skilled labor, degree of openness of the economy, economic stability, as well as several institutional variables e.g. political factors, investment climates. It is very satisfying that since 1985, Schneider and Frey (1985) have mentioned political factors in addition to economic factors that help us determine FDI. By developing four econometric models: (a) political, (b) economic, (c) amalgamated, and (d) politico-economic, they tested politico-economic determinants of FDI inflows to 54 developing countries in different years of 1976, 1979, and 1980. The results demonstrate that both economic and political factors affect FDI inflows in developing countries. The most important economic factors found by Schneider and Frey are real per capita gross national product (GNP) and the balance of payments, followed by the growth of GNP and the workers’ skill level. In political aspects, they found the amount of bilateral aid coming from Western countries had the strongest effect, followed by multilateral aid. Political instability reduces FDI. Tsai (1991) analyzes the decades of 1970 and 1980 and addresses the endogenous problem between FDI and growth by developing a system of simultaneous equations. In addition, FDI was alternately measured as a flow, and as a stock. Market-size turned out to be more important for FDI inflows than growth. The trade surplus presented a negative sign and was significant for FDI, while the flow of FDI
decreased as the nominal wage decreased. He also found that the impact of FDI on economic growth was quite limited. Singh and Jun (1995) attempted to fill a gap in the literature by testing three groups of hypotheses on what influences direct investments and FDI inflows. They divided their variables into three categories: Sociopolitical instability, Business operating conditions, and Export orientation. By using a pooled model, and an analysis that covered 1970-1993 for thirty-one countries, they found that the determinants of FDI flows are different for high and low FDI countries. For the high-FDI group, there was a higher qualitative political risk index. Size of exports had the strongest correlation with FDI flows. Business conditions and manufacturing exports were also significant factors for FDI inflows. For the low-FDI group, production efficiency was the more significant variable with FDI. Ioannatos (2001) found determinant factors that host countries demanded for U.S. FDI by model specification are consistent with theories of international production. He tested three hypotheses that concentrated on economic, social, and political aspects. The economic factors include some domestic factors such as market size, trade balance, the cost of labor, financial performance such as inflation, and effectiveness of the service sector. The social attributes identified are four factors of human capital, extent of urban development, quality of life, and extent of the health care system. In addition, four related factors with political considerations identified are the political system, government ethics, investment climates, and the geography proximity. In order to broaden the existing knowledge on the demand structure of FDI, the author used cross-sectional data in his analysis. He affirmed that economic, social, and political determinants are equally important for the ability of the host country to attract FDI; none alone could sufficiently explain this phenomenon. With a sample of 71 developing countries (half of them are in Sub-Saharan African (SSA)), Asiedu (2002) examines whether there are different determinants of FDI between SSA and non-SSA countries (Asia, Latin America, and other African countries are not in SSA). He used the period of 1988-1997 in his analysis. His econometric model included the dependent variable FDI and eight independent variables: return on investment, infrastructure development, openness, political risk, financial depth, size of government, economic stability, and attractiveness of the market. By using ordinary least squares (OLS), he established that SSA countries received less FDI than others by virtue of their geographical location. Further, FDI has no sign with higher return on capital and infrastructure development, while these factors were positively related with FDI inflow to SSA countries. The openness to trade increased FDI to both SSA and non-SSA countries. Bengoa and Sanchez-Robles (2003) explore the interplay between economic freedom, FDI, and economic growth. By using panel data analysis for a sample of 18 Latin American countries for the period of 1970–1999 and running multiple regressions, they found some of the following factors influence FDI inflows: the index of economic freedom, the level of GDP, and public investment is positive, while debt service and inflation are negatively correlated with FDI. Nonnemberg and de Mendonça (2004) desired to shed light on the determinants of FDI in developing countries. Using an econometric model based on panel data analysis for 38 developing countries and transition economies for the 1975-2000 period, their results demonstrated that both GDP and the average rate of growth strongly positively affect the rate of inflow of FDI. The level of schooling is highly significant as well as being an important determinant of FDI. The degree of openness, as a proxy for the willingness of a country to accept foreign investment, is also highly significant. As an indicator of macroeconomic stability, inflation had a negative sign in the larger sample, but appeared insignificant in the smaller sample, as a variable of risk. In their model, they also used the DOW JONES indicator, which related to the source countries of direct investment. They indicated that capital market growth in developed countries is a strong determinant of the outflows of these investments. Based on the idea that FDI home and host country are mutual gravity, Frenkel, Funke, & Stadtmann (2004) expanded a theoretical model for gravity-like forces first developed by Brainard (1993, 1997). They applied OLS to aid in identifying the determinants of FDI flows. They observed movements from the five largest industrialized countries, G-5 (USA, Japan, Germany, the United Kingdom, and France) to 22 emerging economies in Asia, Latin American, and Central and Eastern Europe for the period 1992 – 2000. A panel approach was used to analyze a compiled data set of bilateral FDI flows. From the results, they determined that distance plays a significant role, and that the GDP growth rate and the extent of risk are additionally important factors. Inflation and the type of exchange rate system used are less significant in determining FDI flows. Twimukye (2006) developed a panel data model using annual data from 1990 through to 2003 for 45 African countries. He ran two times least squares with and without the population size included to estimate FDI in Africa. Results of generalized least squares without the population variable being included demonstrate that gross domestic product, literacy rate, and the exchange rate are positive influencers of FDI. The remoteness and inflation rate are negative indicators as expected. Results with the population variable included demonstrated that paved roads do not have a significant relationship with FDI in Africa, while the openness and population are positive (as expected). UNCTAD (WIR, 1998) categorized host country determinants of inflow FDI into three groups:

(i) Policy framework for FDI includes economic, political, and social stability; rules and regulations on FDI; policies on functioning and structure of markets; international agreements on FDI; privatization policy; tax and trade policies.

(ii) Economic determinants:
- Market – seeking FDI: market size, market structure, per capita income, market growth, assess to regional and global markets, country-specific consumer preferences
- Resource/asset - seeking FDI: raw materials, low-cost, unskilled labor and availability of skilled labor, technological, innovatory and other created assets such as brand names, physical infrastructure (ports, roads, power, telecommunication)
- Efficiency – seeking FDI: resources/ asset and input costs, access to regional and global markets for exports

(iii) Business facilitation includes investment promotion (including image-building and investment-generating activities, investment-facilitation and after-investment services), investment incentives, hassle costs derived from excessive bureaucracy or corruption, social amenities (availability of bilingual schools, quality of life).

To attract high quality FDI, WIR (2001) presents a convincing argument that the host country must actively draw upon international competitive advantages such as proximity to markets, low cost factors of production, and productive synergies derived from a network of producers–competitors, demanders, and suppliers. In WIR (2006), UNCTAD mentions four drivers to internationalization by developing-country transitional companies (TNCs). These are:

1. Market and Trade factors such as large markets, the growth of market are likely to be the foremost determinants of FDI in particular host economies.
2. Cost factors: host countries with low costs of labor or other required resources are more likely to receive inward FDI.
3. Business conditions: these drivers can include competition from low-cost producers, liberalization and privatization policies, low cost of entry, and a positive reception.
4. Government policies and the macroeconomic framework; these include transparent governance, investment in infrastructure, property rights and minimal exchange-rate regulations, and strong currencies and political stability in host countries. The other is macroeconomic uncertainty in the home economy, and a common monetary area (e.g. the euro area).

It is very interesting to note that Adam and Filippaios (2007) demonstrate that democracy discourages FDI and MNEs tend to invest in countries with low civil, but with high political liberties. They employed a panel data, fixed-effects model and used a log-linear equation in order to test the relationship between FDI and 13 independent variables that were FDI flows from US firms normalized by GDP (FDIP). Their sample involved 105 developing and developed countries for the time of period 1989–1997. The results express that there are positive signs between FDI and civil liberties repression, gross domestic product per capita, lower levels of expropriation risks, and higher levels of bureaucratic quality of the economy variable, whilst the political liberties repression, real GDP chain per worker, and corruption level of the economy variables are negatively related. Focusing on the linkages among political risk - institutions - FDI, Busse and Hefeker (2007) ran cross-country analysis and Arellano–Bond GMM ran a dynamic estimator with a sample of 83 developing countries covering 1984 to 2003. Their results demonstrate that government stability, internal and external conflict, law and order, ethic tensions, bureaucratic quality and, to a lesser extent, corruption and democratic accountability are important determinants of foreign investment inflows.

**Evidence from Country Cases**

With FDI becoming an emerging phenomenon, there have been a variety of empirical studies about the determinants of FDI in a range of countries, especially in developing countries, from a macroeconomic perspective. In this part, we introduce some developing country cases that focus on the attractiveness of a particular host country to foreign investors.

**Africa** Bende-Nabende (2002) provided an empirical assessment of the factors that significantly influenced the long run transnational corporation’s investment decision-making process in Sub-Sahara Africa (SSA). The empirical evidence based on a co-integration analysis of 19 countries suggests that the most dominant long run determinants of FDI in SSA are market growth, export orientation policy, and FDI liberalization. These are followed by real exchange rates and market size. Bottom on the list is openness. However, because of data limitations, no definite conclusion could be drawn from the results for real wage rates and human capital. In the case of South Africa, Fedderke and Romm (2006) tested the growth impact on the determinants of FDI. In term of these determinants, they used annual time series data for South Africa from 1960 to 2002. After analyzing their data using a vector error correction model structure (VECM), they concluded that FDI is dominated by horizontal rather than vertical investment in South Africa. FDI has positive correlation with market size, and openness of the economy, and negative signs with corporate tax, and wage costs. They also found the opposite influences on FDI of imports and exports: ‘increased imports lower FDI, increased exports raise FDI’. With political institutional factors, they recognized that ‘both improved property rights’, as well as ‘improved political stability’ serve to raise the attractiveness of South Africa as a destination of foreign investment”. Udo and Obiora (2006) use annual data from 1980 to 2002 to test the determinants of FDI in five countries (Nigeria, Sierra Leone, Ghana, the Gambia, and Guinea). These are called ‘West African Monetary Zone (WAMZ)’ countries. The results demonstrate that FDI has a positive correlation with public investment, a negative correlation with macroeconomic instability and external debt service, and no significant relationship to the growth rate, and to the high cost of domestic capital.
Asia Dees et al. (1995) addressed such questions as: “Why had China become one of the largest recipients of FDI in the world?”; “What were the most important determinants of FDI in China?”; and “What were the effects of FDI on the Chinese economy?” Their empirical work was from 1983 to 1995, and was based on a panel data analysis, which covers 11 countries: Hong Kong, Taiwan, United States, Japan, Singapore, South Korea, Thailand, United Kingdom, France, Canada, and Italy. They found that the level of GDP has a large positive effect on the stock of inward investment. The real wage demonstrated a negative and a significant coefficient. The effect of the real exchange rate was negative as expected. Trade relationships between the home countries and China, and the degree of innovation had a positive influence on FDI inflows. They also included the Tiananmen Square incident, and found that it had a negative and a significant impact on FDI in China, but only in the short-term. In the case of Thailand, Chandrapapalert (2000) used primary data based on survey results. The scope of the study covered U.S. firms operating in Thailand. He obtained 100 usable responses out of 360 questionnaires. His integrated model was based on Dunning’s eclectic paradigm and Behrman’s (1972) strategic motivation model. The factors included were firm size, firm’s multinational experience, market potential, host government policy, investment risk, resource seeking, and marketing seeking. The results demonstrated that FDI has strong positive relationships with market potential, resource seeking and market seeking; strong negative relationships with investment risk; and is not statistically significant with firm size, and the firm’s multinational experience. In an empirical investigation on the determinants of FDI in Pakistan, Shah and Ahmed (2003) used time-series data for the period 1960-1961 to 1999-2000. The results suggest that cost is effective and is quite valid for the inclusion of the cost of capital factor as an explanatory variable in determining FDI flows in Pakistan. The governmental role in infrastructural provision has positive effects on inward FDI. An increase in tariff encouraged more investment to the cost of capital factor as an explanatory variable in that cost is effective and is quite valid for the inclusion of the period 1960-1961 to 1999-2000. The results suggest empirical investigation on the determinants of FDI in size, and the firm’s multinational experience. In an investment risk; and is not statistically significant with firm market seeking; strong negative relationships with relationships with market potential, resource seeking and experience, market potential, host government policy, Trade Agreement (BTA) on the inflow of FDI in clothing, furniture and fisheries was positive. In regional determinants, Nguyen (2002) used cross-provinces of Vietnam data in 2000. She stated that the regional factors that determine FDI are provincial GDP, human capital, GDP per capita, and the number of industrial zones. For the same purpose, Pham (2002) found that local market, wage rate, labor force, infrastructure and incentive government policies are important factors. Nguyen (2007) also examined the impact of locational choice on FDI, and the impact of FDI on the Vietnamese economy. Her results indicate that the market, labor, and infrastructure are determining factors in attracting FDI. Caribbean and Latin America With a multivariate regression model used to test the effects of political and economic determinants, Tuman and Emmert (1999) set out to explain the variation in Japanese FDI in Latin America between 1979 and 1992. Their analysis focused on twelve countries: Argentina, Brazil, Chile, Colombia, Costa Rica, El Salvador, Honduras, Mexico, Paraguay, Peru, Uruguay, and Venezuela. The findings suggested that potential market size, adjustment policies, and political instability have influenced the behavior of Japanese firms in the region; while the exchange rates and skilled workforce did not play a significant role in Latin America. Lall, Norman, & Featherstone (2003) evaluated two groups of variables (economic and structural/ locational) associated with U.S. short and long run direct foreign investment in the Caribbean area over the 1983–1994 periods. For long-run FDI in the Caribbean, nine (the monetary, exchange rate, market size, square of GDP, growth rate differential, cost differential, fiscal policy, education, physical infrastructure, and distance) of the twelve variables, and eight variables GDP, infrastructure development, and trade openness. On the contrary, a higher statutory corporate tax rate and appreciation of the real exchange rate appeared to discourage FDI inflows. He found especially, that higher macroeconomic uncertainty induced more FDI inflows in case of Malaysia. In the case of Vietnam, some researchers in examining FDI found that discussed national and regional determinants. In aspect of national determinants, Nguyen and Haughton (2002) developed a model for sixteen Asian countries from 1991-1999 and found openness, real exchange rate, government budget deficit, and domestic savings are important factors in attracting FDI. Hafiz and Giround (2004) did a survey on subsidiaries of transnational corporations (TNC) in ASEAN, and recognized that the political stability, government policies, size of the local market and quality of the labor force are strong factors to attract FDI in the area. Hsieh (2005) analyzed the determinants of FDI inflows in Southeast Asia transition economies including Cambodia, Laos, Myanmar and Vietnam from 1990 to 2003. The results show that the most important determinants are one period-lagged FDI inflows, GDP per capita, and the degree of openness. Parker et al (2005) found the effect of the US-Vietnam Bilateral Trade Agreement (BTA) on the inflow of FDI in clothing, furniture and fisheries was positive. In regional determinants, Nguyen (2002) used cross-provinces of Vietnam data in 2000. She stated that the regional factors that determine FDI are provincial GDP, human capital, GDP per capita, and the number of industrial zones. For the same purpose, Pham (2002) found that local market, wage rate, labor force, infrastructure and incentive government policies are important factors. Nguyen (2007) also examined the impact of locational choice on FDI, and the impact of FDI on the Vietnamese economy. Her results indicate that the market, labor, and infrastructure are determining factors in attracting FDI.
(market size, square of GDP, growth rate differential, physical infrastructure, political right, and distance) of Latin America are statistically significant. In the short run, the results for the Caribbean included seven variables (the monetary, exchange rate, market size, cost differential, education, physical infrastructure, and distance) of twelve variables, and in the Latin American model, five (the market size with GDP, Square of GDP, and growth rate differential, physical infrastructure, and political right) of the twelve variables were significant in both the economic and structural/location related groups.

**Conclusion**

Earlier reviews gives us a clear picture that FDI was born in one country and by push (home country) and pull (host country) drivers under the influence of economic and political factors either increases, decreases, or is unchanged. There are several factors at work: market factors (demand new market vs. growing market), cost factors (reduce cost vs. low cost), business condition factors (competition vs. liberalization), and government policies (supportive vs. incentive policies). Widely accepted theories are based on economic and political factors such as industrial organization (trade theory), internalization theory, internationalization (product cycle theory), financial-oriented theory, and government policies. The empirical evidence shows that the most important determinants of FDI are based on existing political and economic theories appropriately adapted to the nations and situations involved. There are a great many factors such as GDP (per capita), growth rate, openness, labor cost, infrastructure and human capital, available natural resources, political stability and country risk among others. Each country has different factors to be considered in receiving FDI. In general, Africa has shown a negative relationship with FDI by its eco-political instability and undeveloped physical infrastructure and human capital, while Asia and the Caribbean and Latin America have positive signs. Asia is stronger in growth rate and size of market, while the Caribbean and Latin America dominate in adjustment policies and exchange rate.

**References**


Attrition and Retention in Distance Learning: The Case of the Arab Open University at Saudi Arabia

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This study was developed to predict the withdrawal versus completion of university distance education programs. The model was examined among a pilot sample of 127 students and then re-examined among 587 students. Mixed paradigms were used. The quantitative approach, using factor analysis followed by discriminant analysis, was the dominant technique. This study seems to suggest that, reading abilities; syllabus content; as well as friends’ encouragement, and their belief in distance learning are the three factors that significantly discriminate between the students who intend to leave and those who remain at the Arab Open University in Saudi Arabia.

Introduction

Students’ retention has been a concern throughout the years for administrators of educational and training institutions all over the world. The major problem discussed and analyzed in this research is: "Why do students complete their distance learning (DL) programs, and hence fulfill their educational goals?" A variety of terms have been used to describe attrition, and moreover these terms have been defined in different ways (McGivney, 2004). Gallie (2005) defines attrition as the number of students at the start of the course minus those who complete the course. While retention refers to students who are promoted from one phase of education to the next, and are enrolled over a considerable period (Martinez, 2004). In this study, attrition refers to any student who is enrolled at the Arab Open University (AOU) for one semester but who does not get enrolled the next semester. Retention refers to any student who is enrolled at the AOU for one semester and continues to be enrolled the next semester.

The Arab Open University and the Obstacles of DL in the Arab Region

The Arab Open University was established under the umbrella of the Arab Gulf Program for United Nations Development Organizations (AGFUND). The model of the AOU is adopted by the UK Open University, with a few changes in pre-entry qualifications. The main campus of the AOU is in Kuwait, and it extends to cover six different Arab countries: Bahrain, Egypt, Lebanon, Jordan, and Saudi Arabia.

There are two important obstacles hindering the process of distance learning in the Arab region. First, the majority of the Arab societies are still skeptical about the practices of distance learning education programs, believing that distance learning is another form of correspondence, and not a novel approach to instruction. This blurred image is reinforced by the fact that some distance learning students fail to finish their program. Second, some Arab countries do not recognize distance education institutions, and therefore do not grant a license to anyone UNESCO (1998-2002). These situations have serious implications for the development of distance learning modes in the region. The notion that distance learning is new to the Arab region denotes that distance education may be distrusted because its graduates are often left without being awarded recognized qualifications (Mohamed, 2005). To redress the doubt surrounding the concept and the practice of distance education, great efforts should be made to ensure high quality of the courses and low attrition rates of such programs.

Review of the Literature

According to Tinto (1982), the percentage of students who drop out of traditional higher education remains constant between 40 and 45% during the past 100 years. In 344 colleges and universities in the USA, the average degree of completion rate was estimated to be 58%, while the drop out rate was almost 42% (CSRDE Report, 2000-2001). Seidman (2005) proclaimed that only 50% of those who enter higher education in the USA actually obtain a bachelor’s degree. In the context of distance and online learning, by some researchers, drop out rates are estimated to be 10 to 20% higher than that in the field of traditional education (Carr, 2000; Diaz, 2002; Frankola, 2001). In 1999, the Institute for Higher Education Policy in the USA stated: "Research does not adequately explain why the drop out rates of distance learners are higher than those in
regular education.” However, in the Arab world, this topic has not been investigated adequately. Thus there is a need for further research to explore the details of the attrition problem at a global level, including the Arab world.

Different Theories and Models of Students’ Attrition and Retention

Reviewing the academic as well as the theoretical literature shows that the phenomenon of retention incorporates a lot of controversy, complexity, and multidimensionality. In general, retention theories discuss the factors that influence students’ retention positively or negatively (Kinder, Gillis, Reed, Arooz & Carr-Locke, 2002). The studies conducted by Tinto (1982) not only constitute a widely recognized retention theory, but they also stimulated the bulk of empirical research in the field, as by many theorists the so-called accredited model of student departure and persistence is adopted (Martinez, 2004). For instance, Sweet (1986) used Tinto’s hypothetical framework and applied it to distance learning. Similarly, using Tinto’s model, Cabrera, Castaneda, Nora, and Hengstler (1992) pointed out that individual attrition from academic institutions could be ascribed to a longitudinal process of interaction. Another justification of Tinto’s study reported that factors such as goal satisfaction, institutional commitment, and tutor contact have their own influential bearing (Powell, Conway, & Ross 1990). Likewise, McEwen and Gueldenzoph (2003) said that Astin’s Student and Involvement Theory (1970, 1984, 1993) are analogous to that proposed by Tinto. In another treatment of the variables affecting students’ persistence, Braxton et al. (1997) indicated that five perspectives account for college students’ persistence: economic, societal, psychological, organizational, and international ones. Barbadillo (1989) designed a four-variable model, which is assumed to predict students’ completion of DL courses. The four variables thereby mentioned are categorized as follows: background variables, organizational variables, outcome/attitudinal variables and environmental variables. Bean and Metzger’s (1985), and Bean et al.’s (1987), external environment variables are expected to have an impact on the GPA (Grade Point Average), persistence, and progress. Berge and Huang (2004) endorse the model proposed by Boyles (2000) which includes three sets of variables: background and defining variables, environmental variables, and academic variables. Besides, the model has seven singular variables: academic self-confidence, academic integration, academic outcome (GPA), institutional size, social integration, psychological outcomes, and utility. As for the importance of the role played by the instructor, Frankola (2001) noted that, in the absence of interaction between them and the instructor, students will drop even in the most refined course. Such interactivity is a key component of successful online courses. However, Parker (1999) and Morris & Finnegan (2005) found that locus of control was highly significantly correlated with students’ drop out from distance learning. Learners with an internal locus of control tend to have higher rates of completion in distance learning because they invest the necessary time and hard work, which is expected to positively affect their academic achievement (Dille & Mezack, 1991). Dille and Mezack (1991) and Thompson (1998) wrote that external locus of control, together with attribution, are characteristic of at-risk distance learning students. Students who enjoy an independent learning style are more suitable for distance learning courses. Similarly, introverted individuals are more likely to be successful in distance learning classes (Barbadillo, 1998; Diaz, 2000, 2002; Diaz & Cartnal, 1999).

In conclusion, several models can be adopted to conduct our study of student retention. For example, Tinto (1975, 1987, 1992) and Astin (1975, 1984, 1993) argue that ‘institutional involvement’ is the main factor expected to have a direct effect on persistence. In this respect, goal commitment is hypothesized to influence both GPA and progress (academic outcomes). However, according to the model proposed by Bean and Metzner (1985), Bean et al. (1987), Boyles (2000), and Berge and Huang (2004), external environment variables are expected to have a straightforward impact on the GPA, persistence, and progress. While Diaz (2000, 2002), Diaz and Cartnal (1999), Parker (1999), and Morris & Finnegan (2005) focus on the effect of students’ characteristics, learning style and locus of control on profiling successful and non-successful students.

This paper will examine the factors that affect the retention of Saudi Arabian university distance learners with the purpose of comparing the relative importance of learner’s characteristics, institutional factors, and external life circumstances.

Conceptual Framework

From literature, it seems that several variables differentiate between those students who withdraw from distance learning universities, and those who retain. In this study, there are three hypotheses that have been examined and proven to be valid. The first suggests that learner’s characteristics affect the students’ attrition and retention. The second proposes that institutional factors influence the students’ attrition or retention. While the third suggests that external life circumstantial factors also explain students’ attrition or retention.

Learner’s Characteristics’ Variables involve factors that can be considered as learner’s characteristics. These factors identify the unique characteristics of distance learners, which could predict the likelihood of their retention as a would-be distance learner.

The learner’s characteristics involve three sets of variables:
- Demographics variables such as gender, nationality and belief in the value of DL are found to be effective variables affecting retention rates (Sweet, 1986; Thompson & Melody, 1998; Wojciechowski, 2005).
- Individual variables such as locus of control, and learning style are identified by different studies as predictors of retention rates (Dille & Mezack, 1991; Grasha, 1996; Morris & Finnegan, 2005; Parker, 1999).
- Prior Educational Variables such as reading and writing skills as well as High School Academic Performance (GPA) and computer savvy are considered to be predictors of attrition (Hong, Ridzuan, & Kuek, 2003; Liu, Macmillan, & Timmons, 1998; Murray, 2001; Thompson & Melody, 1998).

**Institutional Factors**, such as exclusive focus on the acquisition and utility of technology, irrespective of achieving development of opportunity for mutual interaction between the teacher and the learner, are the principles expected to reflect a good overall instructional design in any class. Also, this set of factors includes difficulty of course program, degree of faculty support, degree of administrative support, media varieties used for course delivery, interaction, and the quality of online instructors (Cohen, 2003; Ibrahim, Rwegasira, & Taher 2007).

- Academic Advising and the Feeling of Isolation: students in a distance learning course should be active and engaged in knowledge generation, collaboration, and process management. Many distance learning courses fail because they do not facilitate a collaborative learning process, leading to feelings of isolation. In this case, students may take the initiative of forming an online community of learners. Besides, they must be in charge of the whole process of becoming a successful student in a DL course (Cohen, 2003).
- The Amount of Interaction and the Transactional Distance: Student Involvement Theory stresses the role played by students’ motivation and behavior. Interaction has recently been given the attention it really deserves in meta-analytical research work, and was proved to be highly effective in telecourses. Interaction in the online environment has been explored in a variety of ways (Moore & Anderson, 2000). Social Isolation: students with a clear social involvement on the specific campus are more likely to persist than those who keep themselves socially isolated for one reason or another (Braxton et al., 1997).

**External Life Circumstances:** Largely, the academic success depends on the social systems in which the learner exists.

- Work Circumstances and Experience: students enrolled in DL courses are different from regular full-time students in traditional classes. In most cases, they not only fulfill the role of student, but also the role of worker and spouse. Full-time employment has proved to influence students’ decision of dropping out from the college before graduation (Astin, 1975; Bean et al., 1987; Bean & Metzner, 1985; Stahl & Pavel, 1992)
- Friends: many studies have recognized that a student’s close friends are to be taken into consideration when analyzing the decision about persistence in college. Close friends were found to have a considerable effect on the decisions made about withdrawal versus retention in college (Bean et al., 1987; Bean & Metzner, 1985; Stahl & Pavel, 1992).
- Family: in the field of education, the support students receive from their family members has always emerged as a main variable connected to persistence. This is even more strongly in the case of DL students because they do not stay on the campus for a long time, which means that they have stronger ties to their families than to the educational institute they are enrolled in (Bean et al., 1987; Bean & Metzner, 1985)

**Hypotheses**

Our general hypothesis is that university distance program student attrition/retention rate is influenced by learner’s characteristics, institutional factors, and the learner’s life circumstantial factors.

**The Research Design**

The dominant research strategy in this study is quantitative supported by qualitative methods. The followed strategy is partly confirmatory and partly exploratory. This study was developed to predict university undergraduate Arab students’ withdrawal from, or
completion of distance education courses in the AOU. According to the performed discriminant analysis, the AOU students are classified into those who intend to withdraw from, and those who intend to complete their distance education courses. This classification is based upon a set of linear combinations of the independent (or predictor) variables. In this way, discriminant analysis can be used to predict the withdrawal from or completion of their distance education courses as a single, non-metric dependent variable in the AOU, according to a set of metric independent variables.

Several in-depth interviews were conducted to explore and better understand the nature of the variables, and to define important areas of information from the professional experts and managers’ points of view. The random sampling technique has used for the study in order to select students who are enrolled in the AOU for participation to our study. To increase the generalizability of the data as far as the geographical region is concerned, the researcher tried to meet the students in various areas inside the AOU.

To create a sense of motivation among the students taking the questionnaire, the University Administration allowed the researcher to assign three gifts as an incentive, and a bonus to be given to those who completed the questionnaire with enthusiasm and accuracy. Using 95% of the bonus to be given to those who completed the questionnaire, the University Administration allowed the AOU researcher to meet the students in various areas inside the AOU. To determine the factors that distinguish between those who stay versus those who leave, a multiple discriminant analysis (DA) was used. The dependent variable is the two-group categorical variable indicating whether the student stays or leaves. The independent variables have been profiled using demographic variables to validate the discriminant function, and in order to ensure their correspondence with the conceptual bases used in the model formulation process (Hair et al., 1998). Such a profile pertains to a better understanding of the characteristics of each group according to the predictor variables. The cross-validation approach is another way for validating the discriminant results. A sample that consists of 400 respondents will be used for estimation and development of the discriminant function, while the additional 187 respondents were aimed to be used for the validation of the DA results using holdout sample. The basic sample (N = 400) was randomly selected from the 587 respondents. To minimize the measurement error, internal validity and face validity were investigated. Cronbach’s Alpha (α) test was applied to guarantee the internal consistency of the students’ responses. The reliability is appropriate > 0.5, which means that further analyses can be conducted. (Hair et al., 1998). More specifically, Alphabet (α) =.6511.

At the beginning, exploratory factor analysis was used as a reduction technique to handle the big number of measuring items. Given that this is the first time this study is performed in this context, the factor analysis was necessary to group the variables objectively. The used cut-off point for the Eigenvalues is 1, and a variable with factor scores below 0.5 were eliminated from the first factor analysis. Then a second factor analysis was used to eliminate any variable with loading < 0.55. At that stage, factor analysis was used as a further reduction technique. Multivariate Discriminant Analysis (MDA) has been applied to the variables with factor loadings equivalent to > 0.55 produced by the above-mentioned analysis where the dominant variable is: “Do you intend to leave the AOU?” As indicated above, the response to this question appears in two modes: affirmative (Yes) or negative (No). All factors were entered into the discriminant analysis using a stepwise technique, which allows for the determination of variables’ relative discriminant ability. See Table 1 for the outcomes of our analyses:
Table 1: Standardized Canonical Discriminant Function Coefficients

<table>
<thead>
<tr>
<th>Questionnaire Items for Discriminated Factors Only</th>
<th>Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reading abilities as an indicator for learner's characteristics</td>
<td>I enjoy reading books and magazines. In general, I do not like reading.</td>
</tr>
<tr>
<td>Syllabus content as an indicator for institutional factors.</td>
<td>I find a great difficulty in understanding the courses’ content. It is easy for me to recognize the content of syllabi.</td>
</tr>
<tr>
<td>Friends encouragement and believe in the value of DL as an indicator for external life circumstances.</td>
<td>My friends really believe in the value of distance learning. My friends do not appreciate the value of distance learning. I always receive a lot of verbal encouragement from my friends to continue my distance education.</td>
</tr>
</tbody>
</table>

The standardized discriminant function coefficients serve the same purpose as beta weights in multiple regression. That is to say, they indicate the relative importance of the independent variables in predicting the dependent.

The regression formula can be read as follows: Actual dropout = 0.708 * reading abilities + 0.574 * syllabus content + 0.605 * friends’ encouragement and believe in the value in DL

Figure 2. Resultant model of attrition/retention in distance learning

In conclusion, the results of our fieldwork seem to point out that having good reading abilities, appropriate syllabus content, and obtaining friends’ encouragement and believe in the value in DL are the key factors that make a difference to whether an individual stays or chooses to leave the OAU as shown in Figure 2.

Classification Statistics and Model Evaluation

How well does this model perform in such predictive categorization or classification?

This discriminant function was used to test the discriminating power of the two factors on the additional sample of 187 respondents. The overall hit ratio turns out to be 56.3% correctly classified cases (see Table 2). This performance is better than what could be achieved by mere chance. The use of the additional sample data helped in avoiding ‘over-fitting’ the model. Over-fitting could have happened in case the model was tested using the data, which were used to develop the model. This is why we chose for new data for our cross-validation purposes.

Table 2: Classification Results (on additional sample of 178 cases).

<table>
<thead>
<tr>
<th>Actual drop out During Fall 2006</th>
<th>Predicted Group Membership</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Drop out</td>
<td>65</td>
<td>72</td>
</tr>
<tr>
<td>Stay</td>
<td>109</td>
<td>168</td>
</tr>
<tr>
<td>Ungrouped cases</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Dropout</td>
<td>47.4</td>
<td>52.6</td>
</tr>
<tr>
<td>Stay</td>
<td>39.4</td>
<td>60.6</td>
</tr>
<tr>
<td>Ungrouped cases</td>
<td>0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

56.3% of original grouped cases correctly classified. Overall Hit Ratio = 56.3%

Errors = 43.7%

Correctly classified “Actual dropout” = 47.4%

Correctly classified “Actual stay” = 60.6%

Retention plays a vital role in policy development. For this reason, decision makers have to choose models that would best suit their individual institutions. In this study, three important categories of factors are used to help distance learning managers and syllabus designers to make the most appropriate decisions. Decisions those are likely to control students’ attrition. Reading abilities pertains to the first vital point for students’ retention in this study. Obviously, online courses often require more time to be assigned compared to the time needed for preparation work for study material for face-to-face sessions. It includes more reading in case the students construct and develop their knowledge by reading.
In the distance learning class, nearly most knowledge is achieved through reading, so it is necessary that students feel comfortable and motivated to study the reading material. Moreover, it may require remedial efforts on the part of the student him or herself. Meaningful and high quality input into the online classroom is an essential part of the learning process. Syllabus content is the second major factor predicting student retention. According to Moore and Anderson (2000), education can take place from the moment the learner starts to interact with the content. The more the content is understandable and clear, the more the interaction will take place, and retention rates will improve. In many instances, the obstacles caused by the curriculum content or by the perceived difficulties in dealing with syllabi are the primary causes of withdrawal from distance learning courses. Finally, friends’ encouragement and their belief in the value in DL is a key variable when analyzing the decision to stay in or leave the AOU. Friends usually have an effect on the student’s retention when they positively discuss alternatives to college attendance, in favor of distance learning. In this context, it was found that friends’ encouragement and their belief in DL is a highly influential factor. Sometimes it is easier to bear severe criticisms when you have a friend who is sharing the belief in the DL value with you. Besides, friends’ pressure expands beyond the adolescent years.

Future research using respondents from the AOU in Saudi Arabia should be conducted in the next few years to compare the results in the same branch, and to monitor any development of the decision-makers’ tactical skills. Based on the findings of this research, the authors recommend that the decision-makers at the AOU proceed to develop a strategy aimed at reducing the drop out rate. Moreover, the authors propose that similar studies be conducted in the other branches of the AOU which are spread over five different counties in the Arab world. The authors also recommends that other contexts, such as regular universities, continuing education centers, graduate schools, and DL universities in other parts of the world are included in future research in order to be able to compare their results with the results of the present study in Saudi Arabia.

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Creating a High Performance Organization through Integration of an ICT system: The case of Reliance Africa PLC

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In the dynamic and competition nature of the business environment, any organization has to strive for high performance. Beside, the rapid growth of ICT system has played a great role in organization effectiveness and efficiency. For the organization to benefit these, continues improvement through adapting the new technology on their performance is required. This research paper will investigate the core problems in performance management at Reliance and to look into the probability to create High performance organization though integration of ICT systems.

Introduction

Various surveys and studies on high performance organizations stated that high performance can be influenced by organizational design, structure, processes, technology, leadership, peoples, culture and the external environment. A high performance organization (HPO) is defined as:

“An organization that achieves financial and non-financial results that are better than those of its peer group over a period of time of at least five to ten years.” (Waal, 2008)

Information technology is only meaningful with the good performance management which ensures that all the business processes and functions clearly defined, concise and effective in the long term point of view. Some of the achievements or attributes of good performance management are (Epstein, 2004):

- Sustained growth through strong financial result over a longer period of time.
- Satisfied customers and employees.
- High levels of individual initiative: more effort on improving conditions and development opportunities of its workforce.
- Productivity and innovation: the ability to adapt the change and react quickly.

- Aligned performance measurement with reward system
- Strong leadership, Continuously improving and reinventing its core capabilities
- Management process which is integrated strategy, structure, processes and people are aligned throughout the organization in turn help the organization to reduces use of multiple resources, harmonization and unified problem solving and improves cost effectiveness.

Automation of business processes and functions is certainly advocated especially with the vast amount of cutting edge technology available today. Business Process Management (BPM) come up with the integration scene as a structured approach using different methods, policies, metrics, management practices, and software tools to manage and continuously optimize activities and processes. Application integration and BPM offer a scalable mechanism for the reliably upgrading business and integrating the existing and future systems to enable efficient information retrieval and performance analysis.

Enterprise Resource Planning (ERP) software systems integrate key BPM processes within and beyond an organization’s boundary. ERP systems help to integrate existing business processes systems for leverage and sustained advantage. Beside, ERP applications aim to integrate all departments and functions across the whole organization into a single system that can serve all the different department’s unique needs and requirements, ensuring accountability, and maintaining accurate and easily retrievable information to assist in overall planning and budgeting. Therefore, IT can be very important to improve performance in the organization. On the other hand, standalone implementation of ICT system has been shown not to help create a HPO and this discrepancy has to be investigated further. (Waal, 2008)

Research Problem

Reliance Africa PLC has been established with the vision to be the biggest and most reputed business support
Reliance is the first and only one-stop business solutions provider in Ethiopia, which is committed to identifying and diagnosing problems, understanding to consult and serving as per the requirements of the industry, businesses and institutions operating in all sectors that contribute to the economic, social and human development. Reliance helps a lot of companies to enhance and develop their individual and institutional (in private and public sectors) capability to achieve their targeted goals. Reliance is providing quality IT solutions and professional services in critical areas of training, leadership, market research, project and management consultancy including IT-enabling, creative art and graphic solutions, media development services, printing services, etc.

Even though Reliance is generating a profit each year, currently, the organization is facing major challenges which make the future existence questionable. As per the pilot study with some of management staff, they have commented on three major challenges. These are:-

- **Appropriate utilization of organization resources**, including human resource and information.

  The issue of resource utilization is important in the resource-based stream of work, since the ability of organization to utilize resources is a key indicator of their competitive abilities and successful promotion of business performance. Some of the challenges concerning resource were:

  - **Labour utilization**: For instance, some of the employees are working without specific job descriptions and have an uneven workload distribution. This leading to lack loyalty, accountability and responsibility of employee and unprovoked workforce.
  
  - **Use of information**: For instance, redundant and unnecessary record keeping in the departments as a result these departments facing a difficulty on data processing, retrieving and reporting of relevant information for decision making to the top management.

  This resources utilization management strategy must be reviewed so that it will work for long-term change.

- **Integration management system**

  This challenge includes communication within different management levels, and their interrelations and integration. For instance, during the implementation of some projects, it has been observed that lack of communication and confusion or misunderstanding of objectives resulted in low performance, conflict of interest among the teams, a waste of human, material, information and financial resources.

  - **Managing of organization culture**

    Currently Reliance is facing challenges managing attitudes toward organizational change and organizational outcome such as organizational commitment, job satisfaction, employee promotion, work ethic and the like. Consequently, this organization is having lack of trust between management and employees, short term commitment and less performance of employee.

    These problems are highly interrelated to the performance of the organization and help as an indicator for the improvement of the current performance management of Reliance. Thus the research will try to evaluate the current performance using the framework of HPO.

### Research objective

The main aim of this study is to investigate the core problems in performance management of Reliance and to look into the probability to create HPO though integration of ICT systems. These will help the company to have sustainable effectiveness and efficiency. The main objectives of this study are:-

- To investigate and evaluate the current performance management toward:
  - Effectiveness in utilization of organization resources.
  - Integration of information flow and among departments.
  - The organization culture in relation to organization operations.

- To suggest better ICT system solutions to be the high performance organization.

### Research Question

This study will began by questing two research questions. These are “How can current performance management of Reliance be improved so Reliance become HPO?” and “Can Reliance implement a highly integrated information technology system which will enhance the performance to be HPO?”

Business reality today requires that related systems are linked and integrated in order to assure effective attainment of objectives and avoid costly sub-optimization. This can only be achieved by having good performance management. Thus, the overall research questioner will be designed in a way that helps to investigate the core problems in performance management at Reliance and how
to integrate. ICT system while creating high performance organization. In order to give more emphasizes on the current challenges the main area of the questioners is categorized into three as follows:

- **Appropriate utilization of organization resources**
  - Is the management planning and control is effective? How well they will achieve their strategic objective? Does the organization have better communication strategy? Is there a clear set of accountability?
  - Is the employee’s long term committed? Is there a motivated workforce? How is the employee turnover? Is that reasonable?

- **Integration management system**
  - Does the management have integrity and is it transparent within themselves as well as their subordinate about the organization visions, mission, and strategic objectives?
  - Do departments look to change beyond their own area of responsibility? Is their developed shared sense of responsibility for the entire organization?
  - Is the organization structure well established in a way to enables management to act correctly in planning, directing and controlling and operations?

- **Managing of organization culture**
  - Is the organization culture & behavior well established?
  - Does it have an impact on the performance of the company?

### Theoretical Framework, Data Collection and Analysis

Among other theoretical frameworks on the performance management and BPM, mainly the framework of high performance organization will be used for this research paper. This framework is the result of a five year study of Prof. Andre De Waal aiming at the discovery of the secret of high performance organization and comeup with 35 charactereristics which he has categorized as the five HPO factors as shown in Figure 1. This five factors of HPO helps to determine to what extent the organization is a HPO and using these characteristis to be able to take targeted actions into achieving a sustainable and superior results.

In addition, this research will be conducted based on both primary and secondary data. For the primary data online survey, mail and phone interview survey will be used to collect data in Reliance. Secondary data will be from different books and internet, articles, journals and researches and others related document will be used as reference.

### Benefit and Beneficiaries

In an increasingly competition on this global market, neither client nor service provider can rest on the organization laurels if the organization wish to remain in the market. As a result, the companies have to change

Figure 1: The five HPO factors with their 35 characteristics
strategy or way of doing something and to improve its performance toward the expected target in effectiveness and efficiency ways. In addition, the rapid growth of information technology has played a great role in organization effectiveness and efficiency which in turn requires to have well established performance management. Thus, the output of this research on high performance with integration of ICT will be the relevant input for the current re-structuring of project held on Reliance and will benefits the overall stakeholder of Reliance.

Scope of the study

This research will deal with the performance management aspect in case of Reliance especially on the current major challenges. Besides, it will focus on figuring out the better ICT system based on Business Process Management (BPM) and Service Oriented Architecture (SOA) architecture and modeling tools.

Problems and Limitations

The expected problems and limitation of this study are:

- The number of customer participants in research study may be too small to be representative of the all customer of Reliance.
- Some employee participants tend to express views that are consistent with organizational standards and try not to present themselves negatively to the organization due to high power distance in the organization (cultural constraint).
- Some relevant information may not be accessible for the sake of confidentiality.
- Even though online questioner has lot of advantage’s, these research will be expected to face some problem due to:
  - Lack of knowledge in IT (a certain level of computer literacy) for the participant to fill the online questioners.
  - Sometimes internet connection problem may also causes some inconvenience on the collection process.
  - Security of the questioner to protect some garbage data filled online.
  - Some computer connections lack sufficient bandwidth for some media.
  - Some participant doesn’t have easy access to the Internet.

Even though this limitation exist, the researcher will try to use different mechanizes to overcome. These mechanizes includes creating clear awareness to the participant about the research objective (owner, management staff and employee), assigning one or two IT specialist to assets on filling online questioner and using a security feature such us creating user account to
limited user (to give access to the authorized user only).

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Components of Organizational Mission Statements

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This paper presents ideas to aid strategists in developing more effective organizational mission statements. Well-crafted mission statements are generally considered vital to the effective conduct of the strategic management process (strategic analysis, strategy formulation, strategy implementation, strategy assessment). While the reasons for mission statements have been studied and generally agreed on, less so are the explicit components to be included in the mission statement. In this paper a framework of six components is presented that may be applied in developing the content of the mission statement. A case study of an existing firm’s organizational mission is employed in the identification of the six components.

The creation of effective organizational mission statements is generally considered vital to the effective conduct of the strategic management process (strategic analysis, strategy formulation, strategy implementation, strategy assessment) and organizational leadership (Kotter, 2001). While the reasons for mission statements have been studied and generally agreed on, less so are the explicit components to be included in the mission statement. This paper begins with a discussion of the reasons for creating, and components to be considered in, an organizational mission statement. Then, a particular mission statement is analyzed, followed by a discussion of the mission statement components identified. Finally, the findings are discussed.

Strategic Intent / Strategic Direction

A Mission statement may be considered as a part of the strategic intent (cf., strategic direction) of an organization (de Kluyver & Pearce, 2009). The strategic intent may be viewed as a hierarchy which expresses the future direction organizations wish to pursue, through, for example, explanations of the key organizational priorities (Hamel & Prahalad, 1989). The extant literature contains different labels for the contents of this hierarchy (for example, it could be interpreted that what Angwin, Cummings, and Smith (2007) label as mission and vision, Grant (2008) labels as vision and mission, respectively). For purposes of this paper the hierarchy of vision, mission, goals, objectives and plans presented by Miller (1998) was employed. The Vision represents the long-term overarching future state the organization aspires to attain; it is an aspirational view of what the organization will be like in the future (Grant, 2008). For example, an orchestra may have as a Vision “to play the most beautiful music, most beautifully”. While this statement may be inspiring, it is not very practical as a means of coordinating and marshaling the organizational (i.e., an orchestra’s) resources toward a tangible direction, for use in explicit decision-making, or assessing whether someone is playing the ‘right music’. Thus, a Mission statement is formulated to operationalize the Vision (Lasher, 1999). The Mission presents a ‘statement of purpose’, describing what the organization seeks to achieve over the long-term; it does not provide a distinct statement of strategy but offers a pointer to the overall direction in which strategy will take the organization (Grant, 2008) (e.g., focus on classical music, to a particular audience, with an identification of how it is known whether the music was played ‘beautifully’). Further along the hierarchy, Goals are operationalizations of the Mission; for example, if the Mission includes organizational ‘growth’ as a desired future direction, a Goal could be growth via mergers and acquisitions (M&A); Objectives are operationalizations of Goals (e.g., identify and evaluate three M&A opportunities within the next eighteen months); and Plans are operationalizations of Objectives (i.e., specific activities with specific responsibilities with specific time frames) (Miller, 1998).

This hierarchy flows from Vision to Mission to Goal to Objective to Plan and, at the extreme ends of the hierarchy (i.e., from Vision to Plan), reflects the following characteristics: ends to means, long-term to short-term, most stable to most flexible, most vague to most precise, most broad to most narrow, general to specific (Miller, 1998; see also Dess, Lumpkin, & Eisner, 2008). Because the Mission represents the first operationalization (i.e., of the Vision), it is often employed as the foundation from which explicit strategic directions and organizational strategies are formulated and evaluated. Hence, Mission statements and their purposes have received much attention, as exemplified in the next section.

Purposes of Mission Statements

Aside from operationalizing Visions, what is the explicit purpose of Mission statements? As discussed below, the extant literature is unclear on the answer to this question, as there are numerous, varied, and at times confusing purposes of Mission statements; however, three themes seem to emerge.
The first theme suggests that an important purpose of Mission statements is to provide the organization with (strategic) decision-making criteria. Some researchers have argued that if “strategy consists of an integrated set of choices” (Hambrick & Fredrickson, 2001:49), which in particular are to making controversial choices (Karnani, 2006), in the presence of finite / limited organizational resources, then Mission statements provide criteria (e.g., boundaries) for making the controversial choices, e.g., generating and screening strategic options (Aaker, 2001), putting boundaries around the types of investments that are consistent with the identity of the business (Walker, 2007), filters for making decisions (Robert, 2000). In essence, these decisions are manifested in the allocation of the organizational resources - for the need to align the organizational mission with the organization’s external environment (e.g., opportunities and threats) (Andrews, 1987; Powell, 1992) and with the internal organizational environment (e.g., internal organizational processes), as prior research has found such alignment to be positively linked to organizational performance (Crott, Dickson, & Ford, 2005; Bart, Bontis, & Taggar, 2001). This importance of creating ‘effective’ (aligned with external environmental opportunities and threats and with internal strengths and weaknesses so as to generate competitive advantage for the organization) mission statements appears to be well-established in the strategic management literature, as evidenced by their general inclusion in strategic management texts (e.g., Miller, 1998; Dess, et. al., 2008; de Wit & Meyer, 2004).

The second theme suggests that an important purpose of Mission statements is to provide the organization with a means of communicating strategic change. If a Mission is viewed as a direction for the future (Kotter, 2001), i.e., the ‘grand goal’ stated in terms of what it does for its stakeholders (Lasher, 1999), and a way of proceeding to where you want to get to in the future (Angwin, et.al., 2007), by identifying what business you want to be in, the organization’s reason for being, and the content of the business (e.g., products and their benefits, customers served) (Haines, 2000), it may be employed to communicate strategic change (de Wit & Meyer, 2004) through the choice of words used and their changes over time (Rogers, Gunesekera, & Yang, 2007).

The third theme suggests that another important purpose for Mission statements is motivational - to provide stakeholders with senses of purpose, identity, commitment (Aaker, 2001), common purpose, and cohesive values (Karnani, 2006).

With such important purposes, Mission statements ought to be created with much care, the components of which are discussed in the next section.

Components of Mission Statements

What, then, ought to be the components of an organizational Mission Statement? As for the purposes of Mission statements, the extant literature is unclear on the answer to this question, as, discussed below, there are presented numerous, varied, and at times confusing components of Mission statements.

Applying the Ashridge Mission Model (Koch, 2006) to Dana Corporation’s 1987 Philosophy and Policies of Dana, Rogers, et. al., (2007) identified the following as being involved in the creation of a mission statement: an organizational purpose (e.g., to develop superior value to customers, earn money for shareholders, ...), values (e.g., regard people as the most important asset, ...), behavior standards (e.g., be dedicated to customers), and strategy (e.g., ..., achieve market share leadership, ...). (Although, however, from the foregoing, it is unclear what business the company is in, or where this is articulated in the model.)

Aaker (2001) argued that the components of a mission statement include such statements as the values associated with the organization, the business scope and growth direction, the product and market definition, and key assets and skills on which the business is based. However, Robert (2000) argued that the Mission (equivalent to the business concept) should include the one component which is the driving force of the company’s strategy, the products / markets / customers the driving force focuses on, the company’s distinctive strategy of competitive advantage, and the tone of growth and future intent. Rouse (1998) specifically focused on the Mission as a statement of an organization’s values and should include: who are the customers and where are they located, what benefits does the organization provide them and how are the benefits provided. Lasher (1999) argued that the Mission should include three distinct parts - the company’s business definition (which may include the geographic scope), the future position the firm hopes to achieve in its industry, and the firm’s operating philosophy.

According to Haines (2000), the following should be contained in the Mission statement: the firm’s product/services, customers, reason for being (e.g., stakeholders needs), values / beliefs / philosophies, and strategies. Per Barney (2006), the Mission included the firm’s fundamental, long-term purposes and long-term objectives, how to plan to accomplish the purposes, the core values held by the firm, and specific actions the firm is willing to pursue to gain competitive advantage.

As is evident from the foregoing, there exists much disparity in what the components of Mission statements ought to be (e.g., “key assets and skills”). Yet, there are also commonalities in what ought to be the components of a Mission statement (e.g., the product / business the company is in). However, whatever are the components that are to be included in a Mission statement, there is general agreement that the Mission statement be simple, concise, not overly broad or narrow in business scope (Lasher, 1999), brief, understandable, and verifiable (such that success in Mission
attainment can be determined) (Angwin, et. al., 2007).

In the next section, the mission statement of Arnoff Moving & Storage, Inc. is analyzed and the included components are identified. As will be demonstrated, that Mission statement fulfills the three key purposes of Mission statements identified above, provides for identifying the key components to be included in a Mission statement, and is effectively and efficiently written.

### Arnoff Moving & Storage Inc.

Arnoff Moving & Storage (“Arnoff”) is headquartered in Poughkeepsie, New York, U.S.A. The Mission statement of the firm, which is found on the reverse side of a business card given to the author by a Senior Vice-President of the firm, is:

“**Arnoff** is a worldwide logistics management organization with a highly motivated team determined to exceed customer expectations, continue to improve quality and safety to ensure exceptional growth and profits.”

An analysis of this Mission statement, in a sequential manner, suggests six critical components. The first component answers the question - what business(es) are you in? (e.g., what product / service / technology / ....)? Arnoff is in the ‘logistics management’ business. This business definition is deemed sufficiently narrow to provide clear strategic direction for the firm, yet sufficiently broad to provide for growth and expansion opportunities into, for example, related diversification areas. To illustrate this point, hypothetically consider two attractive, alternative investment opportunities, one a farm for sale that could be developed into a shopping center, and the other a limousine company (e.g., transporting business persons to/from airports). The business definition strongly suggests that the latter alternative should be given priority for consideration.

That is, in part, the business definition is a critical component of the Mission statement in that it acts as a strategic making criterion. Consider, it is likely very difficult to make effective decisions about business opportunities in the absence of knowing what business the firm is in and/or wants to be in the future.

The second component answers the question - what is your geographical scope? Arnoff’s geographic scope is ‘worldwide’. Note that Arnoff does not explicitly state that it has worldwide presence. Rather, it indicates that the firm has the capability to move, say household furniture, worldwide - Arnoff may not necessarily do the actual move themselves (they may subcontract to another firm for part of the move), but they will handle the ‘logistics management’, consistent with their business definition. While geographic scope is included here, it is unclear whether this component of the Mission statement is as crucial as the first. For some businesses it may be desirable to specify the business geographic scope, especially to communicate to the potential customers if that geographic scope is narrow (e.g., focused on serving customers in a restricted geographical area). Similarly, if the firm can service a geographic area much larger than the perception of the firm indicates, the firm may wish to indicate that expanded geographic capability, as Arnoff does. Thus, for this component, it may be desirable to include it in the Mission Statement, but only if it would make a difference (to the Mission purposes of decision making criteria, communication strategic change, and/or motivation) whether it is omitted or specified.

The third component answers the questions - who are your primary stakeholders (and, as appropriate if there are multiple stakeholders mentioned, their relative importance) and how do you address them? As stated in Arnoff’s Mission statement, “... with a highly motivated team determined to exceed customer expectations ...” Both the firm’s ‘highly motivated team’ and the ‘customer’ are the key stakeholders, with the two stakeholders related by the attempt of ‘exceeding’ the customer ‘expectations’. Note that the focus is not on customer ‘demands’ or ‘needs’ or ‘preferences’, but rather ‘expectations’ (whatever they may be). Furthermore, the focus on ‘exceeding’ suggests the notion of striving for superiority of performance - it is inadequate to ‘meet’, ‘satisfy’, ‘reach’, ... customer expectations. As such, this component also provides for decision-making criteria. For example, an Arnoff employee faced with a choice of responding to simultaneous requests from a supplier and a customer should (ceteris paribus) choose to respond (in an either/or situation) to the customer first.

The fourth component answers the questions - what is the culture / are the primary values of the organization (and, as appropriate if there are multiple values mentioned, their relative importance)? Arnoff’s Mission statement answers this question in several places. One place is in the words “... with a highly motivated team determined to exceed customer expectations ...”. Here, the value of ‘teamwork’ is noted, as is ‘highly motivated’ and ‘determined’. The word ‘determined’ connotes such aspects as ‘direction’ and ‘purpose’, ‘concentrated attention’, and ‘to succeed’. Thus, for example, applicants for employment with Arnoff that strongly prefer to work alone, or are not / do not wish to be team players, or lack motivation to take initiative, are unlikely to be desired by the firm. This suggests that the human resources function in Arnoff has criteria for seeking, assessing, and selecting potential employees (decision-making criteria). Furthermore, as discussed in the third component above, there is the apparent culture of striving for superior performance within the firm.

Another place in the Mission statement where organizational culture / value are identified is ‘continue to improve quality and safety’. This suggests the notion of ‘continuous improvement’ which is consistent with the aforementioned concepts ‘highly motivated’ and ‘determined’. The idea of an organization that is ‘moving forward, ongoing, continually striving to succeed and
The fifth component answers the question - what are your core competencies / bases for competition? The Arnoff Mission statement contains ‘... continue to improve quality and safety ...’. This part of the Mission statement clearly identifies ‘quality’ and ‘safety’ as the firm’s competencies and bases on which the firm competes - a strategy of differentiation. This component provides a clear basis for strategic and tactical decision-making within the organization.

The sixth component answers the question - what are your measures of strategic success (and, as appropriate if there are multiple measures mentioned, their relative importance)? The Arnoff Mission statement explicitly states ‘... to ensure exceptional growth and profits.’ Clearly stated, Arnoff measures strategic success in terms of both ‘growth’ and ‘profits’. This provides clear criteria for assessing the performance of the overall firm and the strategic decisions made. If the order of the performance measures indicates their relative importance, then, should there be a required tradeoff between the two, the likelihood is that growth would be preferred to profits (i.e., there is an implied willingness to, if necessary, sacrifice profits for growth).

These six questions have been answered by the Arnoff Mission Statement in a very clear, concise, and direct manner (one sentence, twenty-nine words, average word length of six characters). The words, their sequence, and syntax appear to have been very carefully chosen in order to increase the effectiveness and efficiency of the message (for example, not 'meet' but 'exceed' customer expectations). The Arnoff business cards provided to the author had the Arnoff mission statement imprinted on the back.

Discussion / Conclusion

This paper sought to understand the nature, purposes and components of organizational Mission statements. It was argued that Mission statements are a part of the hierarchy of an organization’s strategic intent and are essentially operationalizations of organizational Visions. Mission statements are formulated to provide criteria for strategic decision-making, a means of communicating strategic change, and to motivate stakeholders.

The analysis of the Mission statement of Arnoff Moving & Storage, Inc. identified six components as being crucial in the creation of a well-crafted Mission statement. These six components, presented in the form of questions, are linked to the foregoing discussions of the purpose and components of organizational Mission statements: what business(es) are you in? (cf., Aaker, 2001; Haines, 2000; Lasher, 1999); what is your geographical scope? (cf., Lasher, 1999; Rouse, 1998); who are your primary stakeholders and their relative importance? (cf., Haines, 2000; Robert, 2000; Rouse, 1998); what is the culture / are the primary values of the organization and their relative importance? (cf., Aaker, 2001; Barney, 2006, Haines, 2000; Rogers, et. al., 2007); what are your core competencies / bases for competition and their relative importance? (cf., Aaker, 2001; Barney, 2006; Robert, 2000); what are your measures of strategic success and their relative importance? (cf., Lasher, 1999; Rogers, et. al., 2007).

For practitioners, the findings presented in this paper suggest that the six questions may be employed in the formulation of an organizational Mission statement that promotes the inclusion of the important ingredients to operationalize the Vision by fulfilling the three identified purposes of a Mission statement. In addition, practitioners need to exercise care in the crafting of the Mission statement to ensure that the statement is also clear and concise.

In conclusion, while this paper has presented a framework for the formulation of organizational Mission statements, more work needs to be done to understand the effectiveness and efficiency of the resultant statement. For example, the following may be potential subjects for future study as related to Mission statement effectiveness / efficiency: the relative sequences of the components; the comprehensiveness of the description of the components; the length of the statement; the relative degree to which the components address the Mission statement purposes; the relative degree of specificity of the components; and so forth.

References


The paper aims at establishing the present status of the auditing profession in Egypt. The research is guided by four prevailing questions. They are: (1) do the Egyptian auditors have preferences? (2) what strategies do Egyptian auditors follow? (3) which tools do they use? and (4) to what extent are they supported by information technology (IT)? The general answer to these questions is that the auditors believe that a knowledge-based system (KBS) could be used for training purposes to overcome the lack of experience and expertise. However, our research also showed that significant differences exist regarding the shortage of experience and expertise, the lack of professional ethics, and the auditor’s role in relation to the expected role of IT support. Assuming that this is indicative for developing countries too, we formulate three specific recommendations.

Introduction

The objective of the paper is to explore the current auditing framework in Egypt and to investigate the challenges and the possibilities of support by information technology (IT). The most far-reaching idea is to develop a knowledge-based system (KBS) to formulate the auditor’s report on financial statements (cf. Wahdan et al., 2005b). Of course, this idea is rather ambitious. Although we would like to develop theories on the use of IT in all developing countries, we will start by one country. We have chosen as representative country, the Arab country Egypt, since we believe it may give indicative results based on its history and developments in the world of auditing.

The research problem on establishing the present status of the auditing profession in Egypt can be defined by answering four questions: (1) do the Egyptian auditors have preferences? (2) what strategies do Egyptian auditors follow? (3) which tools do they use? and (4) to what extent are they supported by information technology (IT)? So, the objective of this paper can be formulated as follows in four subgoals: (1) to determine to what extent the preferences are felt by the auditors (we distinguish between auditors with an academic degree and practitioners), (2) to determine to what extent the two groups of auditors are following a special strategy in their daily practice, (3) to determine the expectations of the two groups with respect to the (future) development of KBSs, and (4) to make a thorough analysis of the different perceptions of the IT support by members of the two groups (i.e., auditors in Egypt).

Auditors in Egypt

As shown above we take Egypt as country of research in our investigations. In Egypt, it is allowed for the accounting and auditing professors to work as external auditors. One might start with the belief that the auditors with an academic degree will provide knowledge that is more integrated (i.e., has a rich information density and is up to date knowledge) than the practitioners, since the academics have access to theoretical and practical knowledge. However, empirical research proved that expert auditors might make similar assessments on similar inputs. The differences, if they exist, depend mainly on human decisions, human knowledge, human interpretation (O’Leary, 2003), and/or human motivations; i.e., it depends on the accountability and the rewards structure in the audit environment (Libby, 1995). Based on the Libby and Luft (1993) model, we expect that the varied background knowledge and experience between those two groups would lead to differences in their opinions and judgements (Libby, 1995). Therefore, we will test whether there is a (significant) difference of perceptions by auditors with an academic degree and practitioners, regarding the current auditing framework and challenges in Egypt. To accomplish the objectives of the paper, a questionnaire was presented to the two groups of auditors; thirteen auditors with an academic degree and nineteen practitioners.

Outline of the paper

The outline of the paper is as follows. Section 2 describes the background of the current auditing framework. Section 3 presents the research method. Section 4 provides an overview of the auditors’ challenges. Section 5 gives the origin of the auditors’ challenges. Section 6
discusses the role of a proposed knowledge-based system. Section 7 provides our main conclusions and formulates three specific recommendations.

The legal framework in Egypt

As for the current auditing framework we start to discuss the legal framework in Egypt, i.e., the Egyptian governmental efforts to restructure (1) the financial reporting, (2) the disclosure requirements, and (3) the accounting and auditing standards. As part of the restructuring efforts, company law, banking law, and capital market law were modified. In addition, a central auditing organisation was established, and a new accounting practice law was drafted (cf. Wahdan et al., 2005a). Here we remark that in Egypt, there is no effective code of ethics for professional accountants and auditors. The audit practitioners are not required to follow any modern code of ethics in line with the IFAC code. In practice, there is little awareness among many practicing auditors of international best practice concerning conflicts of interest and auditor independence (Rahman, Msadek, & Waly, 2002). In addition, with regard to the professional standards for accountants and auditors, the educational quality suffers from a lack of a modern curriculum and from a teacher/students squeeze (cf. Rahman et al. (2002). With respect to interviews for an apprenticeship, application letters and employer’s letters are usually not subject to verification. This is generally accepted even though all the major international audit firms have a presence in Egypt in addition to well-established local audit firms of which clients include listed companies.

In 2002, Egyptian auditors have accepted twenty-two Accounting Standards and six Auditing Standards (cf. Wahdan et al., 2005a). The Egyptian Standards on Auditing only deal with the reporting issues and ignore the other areas of the ISA (Navady, 2001). Egyptian Standards on Auditing particularly handle the auditor’s opinion on financial statements, which enhances the form of a report without covering the entire audit process (Ministry of Foreign Trade, 2003). In the absence of an Egyptian standard regarding a specific treatment, the ISA are applied. In addition, the Egyptian Society of Accountants and Auditors (1998) has issued auditing standards, which constitute a translated copy of the ISA.

Moreover, there are three types of non-compliance with the Egyptian accounting and auditing standards. First, a lack of knowledge and guidelines on the application of Egyptian and international standards restricts ensuring sound accounting and auditing practice (Aly, 2001). Second, the quality of the audit process is influenced by assigning, or changing, auditors. Management usually assigns, or changes, auditors. This practice forces auditors to comply with the wishes of the top management affecting the level of compliance with the accounting and auditing standards. Third, ineffective control mechanisms exist for imposing sanctions on public accountants and auditors who fail to comply with accounting and auditing standards.

Consequently, these practices mislead the users of financial statements. In conclusion, despite great efforts to comply with the accounting and auditing standards in Egypt, there is still a gap between the accounting and auditing standards and the actual practices. We remark that (1) the lack of qualification of those who prepare and audit financial statements and (2) inadequate regulatory enforcement mechanisms are considered the main reasons for the shortage in the compliance with accounting and auditing standards.

Research methods

To answer the four research questions, we performed some explorative investigations. They are based on a questionnaire and interviews. The questionnaire survey consisted (mainly) of questions requiring a response on a five-point Likert-scale (from 5 = strongly agree, to 1 = strongly disagree). The questionnaire was presented to two groups of auditors in Egypt; thirteen auditors with an academic degree and nineteen practitioners. The sample was selected from 17 auditing firms in Egypt (including international auditing firms with a local partnership, such as KPMG, Ernst and Young, and Deloitte Touche Tohmatsu) and two auditors from the Central Audit Organization. In addition to the questionnaire, interviews were carried out with the respondents. With regard to our analysis in which we use statistical means, all results are expressed as a weighted mean. Although the numbers are small, we tested the differences between the views of the two groups with a Student’s t-test with a p-value of 0.05. The usual rule applies: if the p-value is less than the level of significance α, the null hypothesis can be rejected (Anderson, Sweeney, and Williams, 2002).

The auditors’ challenges

The topics of section 4 are: the shortage of experience and expertise (4.1), the lack of professional ethics (4.2), and the weak auditors’ judgements (4.3). All three topics support the need for a KBS to help auditors in formulating their opinions.

Shortage of experience and expertise

According to the Accounting Practice Law in Egypt, university graduates in the field of accounting are automatically registered as certified accountants. The law does not require that auditors who once received their licenses undertake regular training or continue professional education. Also, the Egyptian Society of Accountants and Auditors, which has established qualification examination requirements, does not require any continuation of
education for its own members. As a result, most auditors suffer from a lack of modern knowledge, experience, and expertise. Table 1 presents the responses of the two groups of auditors concerning the lack of experience and expertise, and the possible remedies. Our first observation is that the auditors agree per group as to (1) the lack of experienced auditors, (2) the low level of accounting education, and (3) the lack of training opportunities. However, there is a significant difference between both groups, the auditors with an academic degree are more strongly in agreement with these issues than the practitioners. Our second observation deals with the question what factors caused such a scarcity? The answers are not in Table 1, they follow below. According to the interviews, the scarcity of experienced auditors follows from five factors: (1) the long period required to develop experience with modern knowledge; (2) the lack of feedback information needed to develop experience and improve the judgements accuracy; (3) the decreasing numbers of auditees in each audit firm; (4) the short training time available to novices; and (5) the lack of education and training requirements. We suggested four remedies (indicated by (4) to (7) below) for these five factors to improve the situation. The responses in Table 1 show that a clear agreement exists with respect to the use of (4) high salaries, (5) incentives and reward systems, (6) improving the quality of education and training, and (7) promoting an auditor to partnership status as strategic remedies.

### Table 1: The lack of experience and expertise and auditor’s retention.

<table>
<thead>
<tr>
<th>Question</th>
<th>Mean Score</th>
<th>Auditors</th>
<th>Practitioners</th>
<th>Total</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>To what extent do you agree that the lack of experience and expertise in Egypt follows from:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. lack of experienced auditors?</td>
<td>4.31</td>
<td>3.53</td>
<td>3.84**</td>
<td>0.049*</td>
<td></td>
</tr>
<tr>
<td>2. low level of education?</td>
<td>4.38</td>
<td>3.58</td>
<td>3.91</td>
<td>0.032*</td>
<td></td>
</tr>
<tr>
<td>3. lack of training?</td>
<td>4.23</td>
<td>3.58</td>
<td>3.84</td>
<td>0.085*</td>
<td></td>
</tr>
<tr>
<td>To what extent do you agree that the following strategies are applied by audit firms in Egypt to achieve their auditors’ retention:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. high salaries?</td>
<td>4.23</td>
<td>4.35</td>
<td>4.30</td>
<td>0.645</td>
<td></td>
</tr>
<tr>
<td>5. incentives and rewards?</td>
<td>4.31</td>
<td>4.29</td>
<td>4.30</td>
<td>0.959</td>
<td></td>
</tr>
<tr>
<td>6. improving the education and training?</td>
<td>4.46</td>
<td>4.65</td>
<td>4.43</td>
<td>0.888</td>
<td></td>
</tr>
<tr>
<td>7. promoting auditor as a partner?</td>
<td>4.46</td>
<td>4.47</td>
<td>4.47</td>
<td>0.974</td>
<td></td>
</tr>
</tbody>
</table>

Values are presented as a weighted mean of each sample and of the total.

**Weighted mean of question 1 (total) =[(10*5)+(13*4)+(4*3)+(4*2)+(1*1)] / 32 = 3.84 for example.

* There is a significant difference between the perceptions of the two groups of auditors, p < 0.05, question 3: T=1.78 > 1.701

**Lack of Professional ethics**

As a result of the limited legal requirements for mandatory audits, smaller firms are usually not engaged in auditing. We have observed that many companies switch auditors from time to time on a purely subjective basis. This behaviour leads to instability of the auditors’ position with respect to audit engagements. Moreover, the auditor’s independence is strongly affected by the preferences of the family-owned companies (Hudaib and Haniffa, 2005).

The main reasons for the preferences are that the majority of stockholders, the Board of Directors, and the companies’ management are usually the same. The instability is further aggravated by a lack of separation between auditing service and consulting services provided by the auditor to the auditee. Moreover, in most companies, accounting for the purpose of tax minimisation takes precedence over the sound application of accounting principles. As a result, the auditor’s independence is affected and the auditor’s opinion may be changed due to pressures from management. Some Boards of Directors invite the auditors to attend the regular board meetings and by the end of each meeting, the auditors receive compensation for their attendance as members of the Board (from personal communications with auditors). All these factors negatively affect the fairness of the auditor’s opinion. Moreover, the lack of separation between the auditing service and other services provided by auditors affect the auditor’s independence. Table 2 presents the results of the survey regarding the lack of professional ethics. Although the sample is rather small (32 persons), we apply our statistical mechanisms as explorative means for the forming of future hypotheses.

The results indicate that auditors agree as to the presence of all these gaps and their negative impact on the profession and its ethics. However, the results also indicate that there is a significant difference between the two groups’ perceptions; the auditors with an academic degree perceive the presence of these challenges more strongly than the practitioners. Indeed, the auditors with an academic degree have a score between agreement and strong agreement, while the practitioners’ range is between neutrality and
agreement. Here we remark that the prevalence of closely held companies was focused upon as a cause of these gaps.

Table 2: The lack of professional ethics.

<table>
<thead>
<tr>
<th>Question</th>
<th>Mean Score</th>
<th>Auditors academic</th>
<th>Practitioners</th>
<th>Total</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>To what extent do you agree that the lack of a code of Professional Ethics in Egypt follows from:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. misunderstanding of relationship between an auditor and auditee?</td>
<td>4.46</td>
<td>4.31</td>
<td>4.31</td>
<td>4.15</td>
<td>0.032*</td>
</tr>
<tr>
<td>2. auditor's switch because of disagreement with managers and/or shareholders?</td>
<td>4.31</td>
<td>3.53</td>
<td>3.84</td>
<td>0.037*</td>
<td></td>
</tr>
<tr>
<td>3. prevalence of closely held companies?</td>
<td>4.31</td>
<td></td>
<td>4.11</td>
<td>4.19</td>
<td>0.275</td>
</tr>
<tr>
<td>4. issuance of a clean opinion to retain the auditee?</td>
<td>4.15</td>
<td>3.35</td>
<td>3.70</td>
<td>0.084*</td>
<td></td>
</tr>
</tbody>
</table>

* There is a significant difference between the perceptions of the two groups of auditors because p < 0.05, question 4: T = 1.79 > 1.701

Weak auditors’ judgements

Auditors frequently arrive at their decision by a personal-judgement approach used throughout the audit. So, the outcome may differ from one auditor to another in estimating the audit risk, the extent of disclosure, and the type of the opinion. Of course, these differences may be caused by the existing range in the auditor’s experience and expertise, but more importantly, they may also be caused by the relationship with the client, which may lead to personal bias and/or misleading judgements. Table 3 presents the results of the survey on the variation of judgements.

The responses indicate that both groups of auditors agree that the variations of the auditors’ judgements in Egypt follow from the differences in experience and expertise. They also agree somewhat on the fact that introducing and maintaining high-quality auditing would be a good competitive policy. Again, both groups appear to be neutral (the practitioners) or close to neutrality (the auditors with an academic degree) as to the need to issue a biased opinion in order to satisfy the auditee. It is expected that most auditors are unlikely to admit such a fact. In general, the results support the fact that a gap exists as a result from a lack of experience and expertise. In addition, the quality improvement is not viewed as a likely alternative in supporting the competitive position.

Table 3: The variation of the auditors’ judgements.

<table>
<thead>
<tr>
<th>Question</th>
<th>Mean Score</th>
<th>Auditors academic</th>
<th>Practitioners</th>
<th>Total</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>To what extent do you agree that the variations of the auditors’ judgements in Egypt follow from the differences in experience and expertise?</td>
<td>4.15</td>
<td>3.53</td>
<td>3.78</td>
<td>0.200</td>
<td></td>
</tr>
<tr>
<td>To what extent do you agree that the following competition policies are prevailing among the audit firms in Egypt:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. the policies maintaining a high-quality auditing?</td>
<td>3.54</td>
<td>3.29</td>
<td>3.33</td>
<td>0.499</td>
<td></td>
</tr>
<tr>
<td>2. the policies resulting in issuing a biased opinion to satisfy the auditees?</td>
<td>3.46</td>
<td>3.00</td>
<td>3.20</td>
<td>0.246</td>
<td></td>
</tr>
</tbody>
</table>

There is no significant difference between the perceptions of the two groups of auditors because p > 0.05.

The origin of the challenges

Four factors contribute to the shortage of experience and expertise: (1) legal and organisational gaps; (2) the auditor’s role; (3) competition and auditing fees; and (4) the IT audit environment. The factors are discussed below. The purpose of this section is to present the responses of the two groups of auditors to these issues.

Legal and organisational gaps

Above we noted that there exists a gap between auditing standards and actual auditing practice. At present, we see a lack of understanding, resulting in non-compliance or partial-compliance with auditing standards. This is a challenge faced by many auditors, who are not part of the international accounting firm networks. The gap results (1) from the fact that the Egyptian standards on auditing are insufficient for performing all auditing tasks and (2) from the complexity of the audit environment.

Table 4 presents the results of the survey of the two groups of auditors with respect to the legal and organisational gaps existing in Egypt. It was found that auditors (both academic and practitioners) somewhat agree on the gaps associated with (1) the lack of auditing standards, (2) the shortage of laws and regulations related to acquiring the auditees (3) the limited legal requirements of mandatory audits, and (4) the automatic registration of auditors, (see Table 4), albeit that there is a small but definitive distinction between the academic auditors and the practitioners. Furthermore, the auditors have a certain level of neutrality regarding the complexity of the audit environment. In summary, the results indicate that there is no significant difference between the two groups’ perceptions with respect to these challenges.
The auditor’s role

An audit expectation gap exists when there is a difference in belief between the auditors and the auditees about the duties and the responsibilities assumed by the auditors and the messages conveyed by the auditor’s opinion (McEnroe and Martens, 2001). In this subsection, the results of the interviews, concerning the duties and responsibilities of the auditors as perceived by the auditors, are presented and compared to the results of earlier studies on users’ satisfaction.

Table 4: Legal and organisational auditing gaps.

<table>
<thead>
<tr>
<th>Question</th>
<th>Mean Score</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>To what extent do you agree that the following five legal and organisational gaps are existing in Egypt:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. lack of auditing standards?</td>
<td>3.69</td>
<td>3.42</td>
</tr>
<tr>
<td>2. no rules for acquiring clients?</td>
<td>3.46</td>
<td>3.89</td>
</tr>
<tr>
<td>3. limited legal requirements of mandatory audits?</td>
<td>4.08</td>
<td>3.58</td>
</tr>
<tr>
<td>4. automatic registration of auditors?</td>
<td>4.15</td>
<td>3.63</td>
</tr>
<tr>
<td>5. complex audit environment?</td>
<td>3.15</td>
<td>3.67</td>
</tr>
</tbody>
</table>

There is no significant difference between the perceptions of the two groups of auditors because \( p > 0.05 \).

In earlier studies on users’ satisfaction with the auditors’ performance, users stated their discontent so as (1) to ignore sufficient disclosure, and (2) to report on the management’s compliance with laws and regulations, and (3) to report on the disposition of assets. Furthermore, they noted that the unavailability of the audit information during the annual stockholders meetings and the absence of disclosures on the going concern of the audited companies were real items. Apparently, based on the results of earlier studies, there is a clear gap between the auditor’s actual performance as seen by the users and the users’ perception of the auditors’ role, duties, and responsibilities (Aly, 2001; Manson and Zaman, 2001). In Table 5 we show the outcome of our explorative survey.

Table 5: The auditor’s role.

<table>
<thead>
<tr>
<th>Question</th>
<th>Mean Score</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>To what extent do you agree that the auditing profession has a role in the following four areas in Egypt:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. introduction of guidelines for investors?</td>
<td>4.31</td>
<td>4.79</td>
</tr>
<tr>
<td>2. evaluation of the companies’ performance?</td>
<td>4.62</td>
<td>3.89</td>
</tr>
<tr>
<td>3. prediction of the companies’ bankruptcy?</td>
<td>3.15</td>
<td>3.42</td>
</tr>
<tr>
<td>4. selection of the optimal allocation of the resources?</td>
<td>4.62</td>
<td>4.47</td>
</tr>
</tbody>
</table>

* There is a significant difference between the perceptions of the two groups of auditors because \( p < 0.05 \), question 2: \( T = 2.04 > 1.701 \).

Competition and auditing fees

At the start of this century, it has been noted that competition among audit firms in Egypt to attract and retain auditees has been increasing (Aly, 2001). Owing to competitive challenges, many managers try to minimise auditing fees for their firms. In response, several audit firms have applied cost-free auditing for the first year, and charged their clients an audit fee from the second year. As a result, audit firms have been suffering from low auditing fees, which would ultimately decrease the quality of their audits and may also result in an unfair opinion on the financial statements. This has been aggravated by the fact that high quality university graduates refuse to join the public accounting profession. They do so since the rewards and fees are not competitive. Table 6 presents the results of our explorative survey regarding the competitive policies and the auditing fee of the auditing profession.

The results show that the two groups of auditors agree that a severe competition exists to attract and retain auditees. The competitive policies include: using personal...
relationships, introducing additional services to the clients, and decreasing the auditing fees. There are no significant differences between both groups on these issues. In fact, the interviewees emphasized that good personal relationships and helping clients to obtain loans from banks are considered key elements in attracting and retaining the auditees. However, auditors did acknowledge the presence of “fee competition” with the possibility of resulting in low auditing fees. Needless to say, all these factors, in particular when combined, may ultimately influence the quality of the audit and the independence of the auditor.

### Table 6: The competition and auditing fees.

<table>
<thead>
<tr>
<th>Question</th>
<th>Mean Score</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>To what extent do you agree that the following five features exist in Egypt:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. keen competition to attract the auditees?</td>
<td>4.23</td>
<td>4.05</td>
</tr>
<tr>
<td>2. keen competition to retain the auditees?</td>
<td>4.30</td>
<td>4.11</td>
</tr>
<tr>
<td>3. decreasing auditing fee as a competitive policy?</td>
<td>4.00</td>
<td>3.71</td>
</tr>
<tr>
<td>4. introducing additional services as a competitive policy?</td>
<td>4.23</td>
<td>4.06</td>
</tr>
<tr>
<td>5. using personal relationships as a competitive policy?</td>
<td>4.62</td>
<td>4.18</td>
</tr>
<tr>
<td>Auditors academic</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Practitioners</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>4.13</td>
<td>4.19</td>
</tr>
<tr>
<td>P-value</td>
<td>0.594</td>
<td>0.539</td>
</tr>
</tbody>
</table>

There is no significant difference between the perceptions of the two groups of auditors because $p > 0.05$.

### The IT audit environment

In this subsection, we focus on the auditors’ perceptions in relation to four aspects: (1) the performance of IT audit; (2) the degree of reliance on IT audit output as audit evidence; (3) the auditing programs used in the audit firms; and (4) the auditing areas in which auditors use these programs in Egypt. There is no doubt that the use of IT for processing data has complicated the audit environment in Egypt. Audit firms have responded to this complexity in different ways. Below we provide two distinct cases: (1) large firms have acquired IT audit programs and hired staff consisting of system designers and specialists; in addition, a number of large audit firms have joined service-oriented multinational companies to provide high-quality services in accordance with international standards on auditing; (2) smaller firms have applied parallel auditing by simultaneously using both the IT audit program and manual auditing.

Within large audit firms in Egypt, (1) auditing around the computer, (2) auditing through the computer, and (3) auditing using test data (the most common supporter of an IT audit) are used. The responses of Table 7 indicate that the two groups of auditors agree on the lack of experience regarding the IT audit. However, the responses exploratively indicate that the auditors with an academic degree are more strongly in agreement with this issue. As a result, there is a slight but significant difference in the perceptions of the two groups. On the one hand the lack of experienced IT auditors results in higher auditing costs, but on the other hand experienced IT auditors would command higher salaries and benefits due to their skills. So, in this case the amount of money is not a discriminating factor.

### Table 7: The lack of IT auditors.

<table>
<thead>
<tr>
<th>Question</th>
<th>Mean Score</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>To what extent do you agree that the lack of IT auditors in Egypt follows from a lack of education and training regarding IT audit?</td>
<td>4.62</td>
<td>3.95</td>
</tr>
<tr>
<td>Auditors academic</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Practitioners</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>4.22</td>
<td></td>
</tr>
<tr>
<td>P-value</td>
<td>0.073*</td>
<td></td>
</tr>
</tbody>
</table>

* There is a significant difference between the perceptions of the two groups of auditors because $T = 1.86 > 1.701$.

### The role of a KBS

Several auditors in Egypt have stated that a Knowledge-Based Systems (KBS) in auditing would be helpful in (1) training auditors, (2) standardising the audit procedures and reports, (3) filling in part of the noted shortage in experience and expertise, and (4) the application of auditing standards. The questions in Table 8 are an intrinsic part of our explorative research on the use of IT support, and in particular intelligent IT support. The questions are designed to elicit the auditors’ expectations of the benefits of a proposed KBS. Responses to the questions indicate that there is a strong agreement that a KBS will (1) help educate and train novices and (2) provide a theoretical and practical basis for formulating the auditor’s opinion on the financial statements.

Moreover, the results show that there is a clear agreement that a KBS will help decrease the audit expectation gap, the auditor’s bias, and the reliance on personal judgement. There is also a general feeling that a KBS can help overcome the shortage of experience and expertise. However, despite the general feeling as to filling in the shortage of experience and expertise, there is a significant difference between the two groups: the
practitioners are less convinced of this issue. Some respondents believe that using a KBS to overcome the shortage of experience and expertise should be accompanied by a new and modern organisation of the profession and by using standard measures of audit quality. They agree that a KBS would provide practical and theoretical bases to formulate the auditor’s opinion on financial statements. Moreover, a KBS can decrease the auditor’s bias after setting up procedures to appoint, or change, the auditors and to enrich the auditor’s independence.

Table 8: The benefits of a KBS.

<table>
<thead>
<tr>
<th>Question</th>
<th>Mean Score</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>To what extent do you agree that a suggested KBS would:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. decrease the audit expectation gap?</td>
<td>4.46</td>
<td>4.21</td>
</tr>
<tr>
<td>2. decrease the auditor’s bias?</td>
<td>4.15</td>
<td>4.11</td>
</tr>
<tr>
<td>3. help in educating and training the novices?</td>
<td>4.62</td>
<td>4.47</td>
</tr>
<tr>
<td>4. help in filling in the shortage of experience and expertise?</td>
<td>4.54</td>
<td>4.28</td>
</tr>
<tr>
<td>5. provide theoretical and practical bases to formulate the auditor’s</td>
<td>4.62</td>
<td>4.42</td>
</tr>
<tr>
<td>opinion on financial statements?</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* There is a significant difference between the perceptions of the two groups of auditors because in question 4: T= 1.73 > 1.701

Given the presence of a general agreement for the need and benefits of a KBS, explorative questions were asked as to what audit assessments should be covered by a proposed KBS (Table 9). The responses indicate that a KBS for the auditor’s opinion would contain a large range of the audit assessments, viz. regarding the results of control examinations, the auditor’s compliance with applicable auditing standards, the auditee’s compliance with accounting principles, the fairness of representation of financial statements, the going-concern uncertainty, and the proper auditor’s opinion.

Table 9: The models of a KBS.

<table>
<thead>
<tr>
<th>Question</th>
<th>Mean Score</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>To what extent do you agree that a KBS to formulate the auditor’s opinion</td>
<td></td>
<td></td>
</tr>
<tr>
<td>on financial statements should include the following audit assessments:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. an assessment of the results of control examinations?</td>
<td>4.77</td>
<td>4.79</td>
</tr>
<tr>
<td>2. an assessment of the auditor’s compliance with applicable auditing</td>
<td>4.77</td>
<td>4.89</td>
</tr>
<tr>
<td>standards?</td>
<td>5.00</td>
<td>5.00</td>
</tr>
<tr>
<td>3. an assessment of the auditee’s compliance with accounting principles?</td>
<td>4.46</td>
<td>4.89</td>
</tr>
<tr>
<td>4. an assessment of the fairness of representation of financial</td>
<td>4.23</td>
<td>4.16</td>
</tr>
<tr>
<td>statements?</td>
<td>4.38</td>
<td>4.47</td>
</tr>
</tbody>
</table>

* There is a significant difference between the perceptions of the two groups of auditors because p < 0.05.

Finally, we remark that the responses on question 3 of Table (9) show that the audit assessments concerning whether the financial statements are prepared in accordance with accounting principles is most important. There is also a slight but significant difference between the two groups on the consensus that an assessment of the fairness of representation (question 4) should be performed before formulating the auditor’s opinion on the financial statements. Interviewed auditors suggested that an assessment of planned detection risk should be added to help deciding on the amount of substantive tests of transactions and balances of accounts. It is noticed that assessing detection risk has received little attention from Egyptian auditors in practice when planning the audit. In addition, the auditors suggested that a materiality-assessment threshold should be added to a proposed KBS to help selecting the amount of audit evidence.

Conclusion and Future research

The results of the study indicate that the two groups of auditors believe that the auditor’s work could be used as (1) a guide for investment, (2) a valuation of companies, and (3) sometimes as a mean in predicting bankruptcy. There is a general agreement between the two groups on the presence of variations among the auditors’ judgements. Obviously, they result from the differences in experience and expertise when performing the audit. Furthermore, the complexity of the environment in terms of a changing environment, and the challenges involved in the use of the current information technology (IT) in auditing have aggravated the variations of judgements in reporting. However, there is consensus between the two groups of the interviewees on the development of a KBS, that it can be used in formulating the auditor’s opinion on financial
statements. On a theoretical and practical basis a KBS would contribute to minimizing the variations of judgements as perceived by them.

This paper has shown that Egypt has still a long way to go before it may act on a par with established countries in the auditing domain. For instance, the Egyptian government has attempted to modify the law to achieve compliance with internationally accepted accounting and auditing standards. In the longer run the authors believe that the government will succeed. To investigate which recommendations should be implemented we scrutinized the Egyptian situation. The examination ranged from technical details to the potential use of modern means such as knowledge-based systems.

Conclusions
The two groups of auditors believe that the auditing profession has a central role in investment guidance, companies’ evaluation, and economic development. They agree with the presence of variations of auditors’ judgements, resulting from the differences in experience and expertise of performing the audit. The presence of high pressure on the auditors in terms of fees paid by the auditees, lack of protective regulations, lack of the professional standards, and weaknesses of the ethical standards in the profession are viewed as important factors at the origin of the challenges discussed.

Moreover, the results indicate that there is a scarcity of experienced auditors and a lack of competitive attitude of the auditing profession in Egypt. The auditors are not required to follow a code of ethics in line with the IFAC code. This deficiency is accompanied by a prevalence of closely held companies and the absence of rules in appointing (or changing) auditors. The auditor’s concern (and main priority) has been tax accounting rather than sound financial reporting. Additionally, there is a scarcity of experienced auditors in IT auditing in Egypt because of the lack of knowledge and skills required for such tasks. Despite this general agreement, significant differences are observed between the two groups as to the shortage of experience and expertise, the lack of professional ethics, and the importance of the auditor’s role in relation to the expected role of a proposed KBS.

Egyptian auditors are convinced that KBS might help educate and train novices and provide theoretical and practical bases for formulating the auditor’s opinion. The results indicate that there is a need for a KBS in formulating the auditor’s opinion on financial statements in Egyptian audit firms. Based on the respondents’ answers, it may be concluded that the construction of AREX (a KBS developed by the first author, see, Wahdan, 2006) will help overcome the lack of (Egyptian) auditors’ experience and expertise, by making the expert’s knowledge and experience available to the novice.

Recommendations
Proper accounting and auditing is an important issue that will play a part in every country all over the world. We would like to recall the incidents such as the PARMA case, the AHOEL case, the ENRON case, and the WorldCom case. Our first recommendation is to understand that the developing countries are yet in their infancy and therefore may serve as an excellent test bed on how to develop and use a proper KBS and in particular how to set up a proper IT audit environment. Our second recommendation is that, for the moment, other developing countries can learn considerably from the auditing development in the Arabic world, in particular in Egypt. The developments in Egypt may contribute to the process of becoming aware of IT programs in auditing. Our third recommendation is, more importantly, for the world as a whole. Since we see that a new era may start within the auditors’ world. we assume that the developing countries will learn from them. Therefore, we recommend collaboration and intensive exchange of information between developing countries and the rest of the world, so that after the upcoming twenty years the developing countries may act on a par with countries that are nowadays leading in the world of economy.

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The Impact of Leadership upon Employee Trust and Satisfaction: Outcomes of an Empirical Study in Suriname

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Beatrice I.J.M. van der Heijden, Maastricht School of Management, The Netherlands

The purpose of this study was to empirically test the impact of leadership upon employee trust and employee satisfaction. A multi-modal case study approach (Yin, 2003) has been adopted using both qualitative and quantitative data. Firstly, preliminary research based upon semi-structured interviews with eight subordinates was carried out. Subsequently, a quantitative survey was submitted to 67 subordinates, and dealt with their perceptions of the leadership style of the Managing Director. The survey study showed no statistical significant relationship between the leadership style and trust; neither did the study find a significant relationship between the leadership style and job satisfaction.

Problem Statement and Background to the Study

Suriname is one of the northernmost, and at the same time one of smallest countries, on the South American continent. Suriname has a relatively small mining-based economy, which makes the country highly vulnerable because of its dependency on international commodity prices. In Suriname, managers face same challenges intensified by Suriname’s accession to Caricom¹ that led to increased competition in the domestic market. Researchers and practitioners alike focus on the importance of leadership style to cope with market circumstances. One of the main responsibilities for organizational leaders is to motivate followers towards achieving organizational goals (Zaccaro & Klimoski, 2001). Cannella and Monroe (1997) indicated that transformational leaders form relationships with subordinates that facilitate them to convey and realize organizational goals. In this study, we examined how managing director’s transformational and transactional leadership styles are related to trust and job satisfaction across several organizational levels. Previously, authors (e.g., Avolio, 1999) have argued that transformational leaders articulate a strategic vision that helps to guide followers to focus upon and to learn what is essential to implement the vision and mission at their own hierarchical level, as well as at subsequent levels within the organization. They encourage followers to question assumptions, methods, and goals in order to discover better ways to understand and translate them into specific actions and deliverables (see also Argote & Ophir, 2002; and Finkelstein, 1992; and Flood, Smith, Turner, West & Dawson, 2000) who referred to the considerable impact of the managing director’s leadership style upon company performance.

Suriname was a late entrant to regional preferential trade agreements, having maintained development aid and migratory ties with its former colonizer, that is, the Netherlands. Inspired by the reality that supranational and transnational forces and organizations increasingly affect and lessen the ability of individual states to control events in their economic system, Suriname joined Caricom in 1995 and started to participate in its reciprocal arrangements. However, Suriname experienced isolation and the interaction with the other countries within the region was limited, probably given its different orientation as regards linguistic, cultural, educational, institutional and judicial systems based on extended periods of Dutch colonial integration. Some of the most pressing challenges Suriname faces at present are the reform of government institutions, and a redefinition of the roles of the government and private sector (due to the need to find an alternative for the depletion of traditional bauxite resources). Moreover, the relationship with the former colonizer, the Netherlands, must be redefined when the Treaty Funds will be depleted, and very importantly, the integration with Caricom must be deepened. (Van Dijck, 2001).

Given the multiplier effect of the construction industry, activities in this sector are considered an important economic indicator for the development of the country. This study was conducted in one major Surinamese industrial producer of concrete construction stones, experiencing significant losses for five consecutive years. While competitors renewed their production process, the organization under investigation lagged behind with the necessary investments. At the onset of his tenure the newly appointed managing director inspired his team’s involvement and participation in what he called their ‘mission’. He also introduced one-to-one talks with each of his subordinates.

¹ Caribbean Community and Common Market (Caricom) was formed by the Treaty of Chaguaramas in 1973, as a movement towards unity in the Caribbean.
This study is motivated by the fact that Suriname faces multiple challenges as a result of the increasing globalization and competition. At the same time Suriname’s position within Caricom after twelve years of membership is characterized as disadvantageous compared to the other member states (Country watch report, 2004). Suriname has been historically known for its multi-party, multi-ethnic governments that have thrived on patronage and an intricate balance of power system. The common leadership style in Suriname could be characterized as transactional. In order to incorporate transformational leadership competencies a multidisciplinary approach in which private sector organization leaders could play a vital role is needed as well (Brana-Shute, 1996). This implies that people-centered approaches that align human capital and the interest of the organization are advocated as they are an important source of competitive advantage that cannot easily be imitated (Pfeffer, 1998). Since the constructs under investigation are primarily developed in the United States, their applicability in a non-US setting should not be taken for granted (Walumba, 1999). Therefore, this study empirically tests our theoretical framework within a Surinamese context.

Theoretical Framework

Leadership research is mainly concerned with a better understanding of the style, personality and other characteristics of leaders and how these influence their followers. The purpose of the present study is to examine the relationship between leadership style and trust and satisfaction in a context of organizational change.

The Full Range of Leadership Theory (FRLT) Burns (1978) introduced the concept of ‘transforming leadership’. Bass (1997) building upon this concept eventually developed the Full Range of Leadership Theory (FRLT) which comprises transformational, transactional and ‘laissez-faire’ Leadership, and includes traditional charismatic leadership styles (Avolio, Yammarino, 2002; Downton, 1973; Zaleznik 1977, 1998; Burns, 1978). While Burns (1978) conceptualized transforming and transactional leadership at the extreme ends of a continuum of leadership behavior, Bass (1985) stated that transformational leadership adds to and builds upon the exchange nature of transactional leadership. The transactional process is seen as an essential component of effective leadership. Yet, by adopting transformational methods, a transactional leader can enhance the effectiveness of his or her leadership style, and represents the full range of leadership style behaviors and outcomes (Bass and Avolio, 1999). The essence of the FRLT pertains to the ability of every leader to display each style to a certain extent, depending on the circumstances. Each leadership style is assumed to have a direct effect on individual and organizational results. Bass (1985) argues that while we differentiate between more transformational and more transactional leaders, most successful leaders portray the full range of leadership styles. Transformational leadership does not replace the idea of the leader giving contingent rewards or punishments (Bass & Avolio, 1994). Rather, it adds to the transactional leadership style in that it impacts followers’ efforts, satisfaction, and effectiveness. Better leaders are both transactional and transformational depending on the situation. Moreover, the full range of leadership processes takes place at all levels of organizations.

Transactional Leadership implies that leaders and followers see each other as instrumental to the fulfillment of each other’s needs (contingent reinforcement (Bass, 1990). According to Bass and Avolio (1995) the impact of the reward or punishment depends on the follower’s significance of the anticipated effect, the need of the follower, the timing and the fairness of the reward.

The extensive interest in the construct of Transformational Leadership is the result of rapid changes in the business climate after the 1970s wherein business life became less stable and more competitive. Previously, under the ‘old’ leadership theories that were built around personal traits, the continuum of characteristics needed in a changing environment were not taken into account. In 1973, Downton conducted a sociological study named ‘Rebel Leadership: Commitment and Charisma in the revolutionary process’ and introduced the idea of Transformational Leadership. Burns (1978) was the first to propose the notion of transcendence of self-interest by leaders and followers. According to Burns (1978), transforming leaders have the ability to make sure that followers are consciously aware of the importance of goal and value sharing, and that they know how to achieve these goals. Bass (1985) expanded on Burns’ theory and developed a model of Transformational Leadership wherein the leader is defined in terms of values, motivation, wants, needs, aspirations and expectations. Transformational leaders are people with an entrepreneurial spirit that do not shy away from taking risks. They are likely to adopt effective ways to communicate important issues; they are leaders with a number of managerial skills and qualities, they demonstrate a positive attitude; they are respectful of others; they have coaching skills; they exert responsibility; they are cognitive team players; and most importantly, they instill trust in followers (see also Bennis, 2003; Yukl, 1987). The distinguishing attribute of transformational leadership comprises the profound personal impact this style has on followers’ values, aspirations, ways of thinking about work, and interpreting events (Yukl, 1999). Bass (1997) claims universality of the theory and argues that this emanates from the globalizing trends and the role of the Internet. Moreover, he stated that the inter-correlated components of transformational leadership have universal applicability, and have proven to be more highly correlated with effectiveness compared with other leadership styles.
(Bass, 1997; Kirkpatrick & Locke, 1996; Lowe et al., 1996). According to Bass (1997), transformational leadership is more likely to emerge in times of growth, change, and crisis. Transformational leadership practices move away from a command and control culture towards placing responsibility and accountability further down the organizational structure. Empirical research in a broad range or organizations has shown that transformational leadership correlates positively with outcome measures such as satisfaction (Avolio & Yammarino, 2002).

Transactional and transformational leaders differ primarily in terms of the style used to motivate followers, and the type of goals set. Transactional leadership is assumed to result in expected performance, whereas transformational leadership results in team and unit performance beyond expectations. Otherwise stated, transformational leadership is characterized as an exchange relationship in which leaders motivate followers by providing them with rewards or punishments in return for follower effort or lack thereof. Bass and Avolio (2003) have developed the so-called Multifactor Leadership Questionnaire (MLQ) to measure the effectiveness of the Full Range of Leadership Theory. Continuity of every organization is dependent on leaders and followers, working harmoniously together. As long as followers have trust in their leaders, they maintain respect. Whilst effective leadership is vital to an organization, without motivated followers who trust their leader, no organization will succeed beyond expectation (Bennis, 2003). Empirical studies have indeed shown that transformational leadership highly correlates with trust (Dirks & Ferrin, 2002; Pillai, Shriesheim & Williams, 1999; Podsakoff, Mackenzie, & Bommer, 1996). Given the global competitive pressure, trust in one’s leader has become an even more important aspect of management. Leadership style is well known to influence job satisfaction as well. Many empirical studies have established positive associations between a transformational leadership style and job satisfaction. Also, meta-analytic reviews have reached consistent and positive conclusions regarding the value of transformational leadership in predicting job satisfaction outcomes (Bono & Judge, 2003; Lowe, Kroeck, and Sivasubramaniam, 1996). However, empirical evidence to cross-validate the theory within a Surinamese setting is lacking.

The resulting conceptual framework is depicted in Figure 1. In the following section our hypotheses will be grounded.

![Figure 1: Conceptual framework](image)

Source: adapted from Multifactor Leadership Questionnaire 3rd edition 2004

**Hypothesis 1a:** Transformational leadership is positively associated with employee trust.  

**Hypothesis 1b:** Transactional leadership is positively associated with employee trust.
Hypothesis 2a: Transformational leadership is positively associated with job satisfaction.
Hypothesis 2b: Transactional leadership is positively associated with job satisfaction.

Leadership Style and Trust

The literature identifies numerous definitions for the concept of trust. For this study Mayer’s (1995, p. 709) definition is adopted: “The willingness of a party to be vulnerable to the actions of another party based on the expectation that the other party will perform a particular action important to the trustor, irrespective of the ability to monitor or control the other party”. Trust is an important and powerful factor in human relations, and has to be created intentionally and structurally within organizations to develop the desired culture (Ciancutti & Steding, 2001). Bass (1998) argues that trust in leadership is required for the followers to identify with the organization and its values. They further argue that ‘such a leadership organization’ is a guarantee for organizational success, and will generate satisfied people resulting in improved performance (see also Dirks, 2002). The components of transformational leadership are oriented to follower needs and are expected to positively influence the development of trust. Avolio & Yammarino, (2002) argue that transformational leaders build trust by demonstrating individualized concern and respect for followers. Followers who are motivated and committed become key to the organizational performance, and are considered an organization’s assets who are difficult to duplicate, and, according to Pfeffer (1998), are capable of continuous improvement.

Leadership Style and Job Satisfaction

Job satisfaction is defined as “a pleasurable or positive emotional state resulting from the appraisal of one’s job experience” (Locke, 1976, p. 1304). The concept was introduced in 1935 by Hoppock who considered that job satisfaction was composed of what workers subjectively thought in relation to the work environment, and what would satisfy them both physically as well as psychologically (Tsai, Yen, Huang, Huang & Chung, 2007, p. 160) (see also Maslow, 1954 on his motivational theory). Whereas traditional leaders understand the strength of the lower level needs of their followers (to speak in terms of Maslow needs hierarchy), and know how to satisfy these needs, transformational leaders motivate them to become high performers who satisfy their own higher order needs as they grow. Empirical studies, mostly done in school settings, report that transformational leadership is positively related to job satisfaction (Leithwood, Tomlinson & Genge, 1996).

Method

Sample and Procedure

The leadership style of the managing director was studied at the plant of the organization in concrete construction stones production experiencing change. Individual interviews were held with eight subordinates. The second stage comprised the survey, which was completed by 67 subordinates working at the plant. Each subordinate was assured of the anonymity and confidentiality of their responses. Paper and pencil questionnaires based upon previously validated scales were submitted to the subordinates, and a return date was agreed upon. Each questionnaire was accompanied by a covering letter explaining the purpose of the study and the importance of completion.

All questionnaires had to be translated from English into Dutch for univocal understanding. The translation-back translation method has been used. (Hambleton, 1994)The final versions of the questionnaires (for the managing director, and subordinates) were pre-tested using a few non-participants from the company consisting of part-time workers. These individuals were not included in the final study. Qualitative comments regarding wording have been dealt with. Where necessary, inappropriate wordings have been adjusted. Five data gathering sessions were carried out with lower level production and technical staff, grouped in clusters of ten subordinates per session. The total number of respondents comprised 67 (response rate was 83%). 80% were male, and 20% were female. The age of the managing director was 57 years. The average age of the subordinates was 49 years. The managing director is male and his tenure was 2 years; and 77% of the subordinates are male. The average tenure of the subordinates was 22 years.

Measures

All subordinates rated the managing director as regards his leadership style, and provided self-ratings for trust and job satisfaction. All constructs were assessed using a five-point Likert scale.

Leadership style

The Multifactor Leadership Questionnaire (short form 5x) from Bass and Avolio (2003) was used, measuring the full range of leadership. This instrument is the most widely used measure of transformational leadership (Judge & Bono, 2000). Five subscales have been used to measure transformational leadership 1. Charisma or idealized influence attributes (4 items, Cronbach’s alpha was .75). A sample item: ‘Goes beyond self-interest for the good of the group’. 2. Idealized influence (4 items, Cronbach’s alpha was .67). A sample item: ‘Talks about their most important values and beliefs’. 3. Inspirational motivation (4 items, Cronbach’s alpha was .81). A sample item: ‘Expresses confidence that goals will be achieved’. 4. Intellectual...
stimulation (4 items, Cronbach’s alpha was .74). A sample item: ‘Gets me to look at problems from many different angles’ and 5. Individualized consideration (4 items, Cronbach’s alpha was .60). A sample item: ‘Treats me as an individual rather than just a member of the group’ (see Amelo, 2005 for a full explanation of the subscales). Three subscales have been used to measure the amount of transactional leadership: 1. Contingent reward (4 items, Cronbach’s alpha was .34). A sample item: ‘Makes clear what one can expect to receive when performance goals are achieved’. 2. Management by exception active (4 items, Cronbach’s alpha was .59). A sample item: ‘Directs my attention towards failures to meet standards’; and 3. Management by exception passive (4 items, Cronbach’s alpha was .55). A sample item: ‘Fails to interfere until problems become serious’. (see Amelo, 2005 for a full explanation of the subscales).

The scale anchors for all subscales, both for transformational leadership and for transactional leadership, range from (1) not at all, to (5) frequently, if not always.

Organizational outcomes

Employee Trust

The perception of trust was assessed using Ciancutti and Steding (2001) pre-validated trust questionnaire. 41 items were assessed measuring six key aspects of trust. 1. General, non-specific concept (13 items, Cronbach’s alpha was .40). A sample item: ‘There is an atmosphere of authentic mutual trust in our organization’. 2. Direct communication (12 items, Cronbach’s alpha was .68). A sample item: ‘You can get in trouble if you voice concerns in our organization’. 3. Commitment (3 items, Cronbach’s alpha was .67). A sample item: ‘I am confident that others will follow through on commitments they make’. 4. Speedy Resolution (3 items, Cronbach’s alpha was .78). A sample item: ‘A good job is done of addressing marginal performance’. 5. Responsibility (3 items, Cronbach’s alpha was .77). A sample item: ‘Everyone fully shares the risks of change within our organization’. 6. Closure (7 items, Cronbach’s alpha was .68). A sample item: ‘Our communications end in closure regarding next steps and what tasks need to be done’. The scale anchors for all subscales range from (1) strongly disagree; to (5) strongly agree.

Job Satisfaction

The Job Satisfaction Instrument by Schriesheim and Tsui (1980) uses six single items that describe overall job satisfaction and was used to measure job satisfaction. Sample items include: ‘How satisfied are you with the nature of work you perform’; ‘How satisfied are you with your organizational superior’; ‘How satisfied are you with the pay you receive for your job’; and ‘Considering everything, how satisfied are you with your current job situation’. Mean scores ranged from 1.6 (pay) to 3.5 (superior), Cronbach’s alpha was .63 for all 6 questions. This score is consistent with Schriesheim & Tsui. Ratings were completed on a 1-5 scale with 1 representing ‘Strongly Disagree’ and 5 representing ‘Strongly Agree’.

Results

The interviews confirmed that the managing director exerted a true motivational spirit. The leadership style was experienced as inspirational motivational and enriching. Some characterized him as “considerate of staff’s social and work-related problems and having an open ear”. His ‘open door policy’ was also appreciated. The eight interviewed subordinates expressed trust in the managing director as a person but lack trust in the intentions of the company with regards to its future. In fact it is safe to say that the trust in the managing director mitigates the harmful effects of the distrust in the intentions of the company. The findings of the study support empirically the applicability of Bass’ Transformational and Transactional Leadership paradigm in this specific setting based on the FRLT. The study supports the FRLT by revealing that the subordinates perceived their managing director as exerting both TL and TXL behavior.

Prior to the model testing, the means, standard deviations, Cronbach’s alpha coefficients and bi-variate correlations (including test-retest correlations) were computed (see Table 1). As can be seen from the table, most constructs that were assessed demonstrated good internal consistencies, except for Contingent reward and the general concept of trust. All variables had test-retest reliabilities of at least .6. The highest test-retest reliabilities resulted for Transformational leadership related variables followed by Trust related variables and finally by Transactional related variables. The relations between the variables in the conceptual model were examined with the Pearson’s correlation analysis (see Table 1).

The mean rating of each leadership factor was below the recommended value of 3 for Transformational leadership and 2.5 for Transactional leadership with the exception of Inspirational Motivation (M=3). However, transformational leadership noted higher values than transactional leadership in line with Bass’ findings (1998).

Subordinates thought quite positively about the trust factor with the highest score for direct communication, closure and commitment. As for Job Satisfaction, the lowest score for the item salary reflects the dissatisfaction with the level of financial reward at the time of the study.

The relations between the variables in the conceptual model were examined with the Pearson’s correlation analysis (see Table 1). The survey study showed no statistical significant relationship between the leadership style and trust; neither did the study find a significant relationship between the leadership style and job satisfaction.
Table 1: Means, Standard deviations, Reliability Coefficients (Cronbach’s alpha; on the diagonal), and Correlations between the Model Variables, N = 67 (respondents)

| Variable                      | M    | s.d  | 1   | 2   | 3   | 4   | 5   | 6   | 7   | 8   | 9   | 10  | 11  | 12  | 13  | 14  | 15  | 16  | 17  | 18  | 19  | 20  | 21  |
|-------------------------------|------|------|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| **Transformational**         |      |      |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 1 Idealized Influence        | 2.53 | 0.67 |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 2 Idealized Influence        | 2.70 | 0.71 |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 3 Inspirational Motivation   | 3.00 | 0.73 | 0.81|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 4 Intellectual Stimulation   | 2.64 | 0.80 | 0.75|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 5 Individualized             | 2.42 | 0.71 | 0.60|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| **Transactional**            |      |      |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 6 Contingent Reward          | 1.95 | 0.61 | 0.58| 0.34|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 7 Management by Exception    | 2.60 | 0.89 | 0.59| 0.59|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 8 Management by Exception    | 1.62 | 0.84 | 0.59| 0.59|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 9 Laissez-Faire Leadership   | 1.17 | 0.71 | 0.64|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| **Trust**                    |      |      |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 10 General Non-specific      | 3.44 | 0.68 | 0.68| 0.68|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 11 Direct Communication      | 3.76 | 0.47 | 0.68| 0.68|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 12 Commitment                | 3.73 | 0.71 | 0.78| 0.78|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 13 Speedy Resolution         | 3.60 | 0.64 | 0.78| 0.78|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 14 Responsibility           | 3.68 | 0.81 | 0.78| 0.78|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 15 Closure                   | 3.74 | 0.79 | 0.68| 0.68|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| **Job Satisfaction**         |      |      |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 16 Satisfied with nature of  | S.   | S.   | S.  | S.  |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 17 Satisfied with superior   | 3.47 | 0.61 | 0.68| 0.68|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 18 Satisfied with relations  | S.   | S.   | S.  | S.  |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 19 Satisfied with promotion  | 2.69 | 0.79 | 0.78| 0.78|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 20 Satisfied overall         | 3.74 | 0.79 | 0.68| 0.68|     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |

Discussion

The objective of this study was to investigate within a Suriname context whether leadership style is related to trust and job satisfaction.

The study did not support the hypothesized interrelationship between Transformational leadership and Trust; not with Job Satisfaction. Under the conditions depicted in the company this seems understandable. Despite the firm believes and confidence in the managing director, subordinates are well aware of the uncertain future of the company and moreover they are dissatisfied with their salaries. Their trust is scarred by the idea of termination of the operations.

Although the hypothesis could not be supported, the insight was gained that through the transformational leadership style; the leader is well appreciated by the subordinates. They trust the leader as a person but lack trust in the intentions of the company with regards to its future. In fact it is safe to say that the trust in the leader mitigates the harmful effects of the distrust in the intentions of the company. The findings of the study support empirically the applicability of Bass’ Transformational and Transactional Leadership paradigm in this specific setting based on the FLRT. The study supports the FLRT by revealing that the subordinates perceived their managing director as exerting both transformational and transactional behavior.

Prior research has looked at transformational and transactional leadership behavior, in relation to influence exerted on Trust and Job Satisfaction. However, none has examined these relationships in a Surinamese developing country setting. As such this study is unique in that it has helped fill this gap in an effort to improve our understanding of the potential of the FLRT. Understanding of this paradigm can help increase the formulation and implementation of meaningful leadership training programs. Taking into account that Bass’ model is related to a more effective leadership style, provides the opportunity to inform managing directors about the model. Individuals with the potential to become transformational must then be identified and trained. By training these individuals to exert the Full Range of Leadership styles, employees’ trust and job satisfaction may be enhanced.

Limitations

As our investigation was conducted within one single organization we do not know to what extent the data are generalizable. Nevertheless, we think that our results are noteworthy and provide good challenges for future research and cross-validation in different settings and countries. As such the study is significant and provides good challenge for future research. Further research is needed to investigate the extent to which our findings generalize to other organizations and to other Caribbean countries.

Future Research

Similar research could be conducted into a larger number of organizations and within different occupational settings in order to obtain a broader view of the impact of setting and country. As the hypothesized relationships were
not supported, future research is also needed to further examine the nature and strength of these relationships (Amelo, 2007 work in progress).

**Implications for practice**

The ability of management to fully display and implement a full range leadership style comprising both transformational and transactional leadership is largely determined by the structure of the organization they manage. To fully reap the benefits of the transformational leadership style, the organization should embark on the process of designing a new organization structure aimed at communication between all organizational layers. Transformational leadership can be taught and learned (Bass, 1998). Bass (1997) also found that the degree of transformational leadership behavior observed at a superior level was also reflected at the next lower level of management. Therefore an effective strategy of enhancing transformational leadership would be to provide leadership training to managers, who in turn, serve as role models for their lower-level subordinates, who in many cases have management duties themselves. In line with Senge (1994), we believe that in an increasingly dynamic, interdependent, and unpredictable world, it is simply no longer possible for anyone to figure it all out at the top. The old model, ‘the top thinks and the locals act,’ must now give way to integrating thinking and acting at all organization levels. The latter is more likely in a context of mutual trust and understanding, based upon a clear alignment of higher level organizational objectives and those of individual workers.

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The Needs of Contemporary Marketing: An Essay

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The author offers a personal judgment about the current status of marketing education and of marketers in business. In both, marketing is found wanting and facing an uncertain future. Then, ways in which the contemporary performance and the future prospects of the marketing profession might be enhanced, are identified. Recommendations include a much broader marketing education, deeply integrated with other management disciplines, including accounting. Marketing graduates would then possess broader perspectives, be able to fill a wider variety of jobs, able to cooperate more valuably with others, and be in a position to gain correspondingly greater respect from their peers.

Introduction

For those who believe the marketing world lacks self-confidence, this short essay offers some reasons and some remedies. It reflects some years of experience as a marketing manager plus additional years as a marketing academic. It is conceptual and speculative. It suggests ‘marketing’ as presented in textbooks and as taught in universities inadequately reflects the reality of business life. To the extent that this judgement is fair, it is assumed to be in the interest of both groups to make changes.

There are weaknesses and misconceptions on both sides of the academic-practitioner divide. In academe, where marketing is usually presented as managerial responsibility for the 4Ps, it is seldom emphasised that only one of these P’s, ‘promotion’, is primarily the responsibility of a manager with a marketing job title. The other 3Ps, are usually the collective responsibility of a number of managers, among whom marketing managers seldom play a leading role. In business, those identified as marketing managers are typically given responsibility only for marketplace communications, or, in really big consumer product firms, for brand management. In business, there is not really much recognition of the value of marketplace understanding in the related areas of managerial responsibility, such as pricing, logistics or, sometimes, even product management.

One academic weakness in the recent past was an apparent emphasis on the distinctiveness and separateness of marketing expertise, at the expense of ways to achieve its integration and utilisation by all managers in the business as a whole. Another was a bias in favour of the household goods sector at the expense of the much larger industrial goods sector. A similar bias, only partially redressed in more recent years, was the limited attention given to the marketing of services. Yet another bias in the universities, which largely remains, is disproportionate interest in statistically precise research investigations of an utterly trivial kind, usually of little or no commercial interest, often based on raw data of highly questionable quality. Lastly, but not least, there is an interpretation of ‘strategy’ which is so obviously limited to short-term tactical market responses that it leaves many senior, practicing, managers open-mouthed and disenchanted. At the same time, throughout, there tends to be the most cavalier treatment of costs and of the probability of benefits. Many of the weaknesses on the business side are found in academe also. For example, both sides are equally happy to pay lip service to putting the customer first, but neither side chooses to spell out precisely when and why this is not always done. Similarly, both groups acknowledge the salience of trust in sound business relationships, but neither gives rigorous, systematic attention to the building of trust.

All these issues have been inconclusively noted and debated down the years. Most are far from new. Yet they do show why it is that marketers, practitioners and academics alike, are mostly found in subordinate positions in today’s business environment. This essay offers a brief commentary on the situation, followed by a means of widening marketing perspectives which could in time lead to a re-positioning of the marketing profession.

Commentary

It has been argued in the past that ‘marketing’ is too important to be left to ‘marketers’; that a market orientation needs to be fully disseminated throughout the firm, reaching all activities and all levels, and not remain the preserve of a group of specialists. This is correct. The marketplace is the source of revenue for the entire firm, not just for the marketing department, if there is one. It follows that marketplace understanding and knowledge of buyers, though not uniformly distributed in a firm, is essential to the wellbeing of all. Consequently, the contribution of marketers ought not to be seen as a specialised function but, as Peter Drucker wrote long ago (1974), a distinguishing
feature of the business as a whole. In other words, marketing’s contribution is business-wide in its value and purpose. So, logically, those who practice marketing should view their role in business-wide terms. That is, marketers should view their managerial responsibilities in a holistic perspective.

There are important implications arising out of adopting a holistic approach to business. It follows directly that a prime responsibility of marketers is to foster market-oriented and customer-centric attitudes, business-wide. That is, they need to see themselves as general managers, not specialists. This means they should seek to foster a business organisation, a business culture throughout the firm, which can deliver an enticing value-proposition to buyers, efficiently and effectively. To do this well they will generally need to take full account of the costs and benefits of what they do, to the business as a whole. Nobody is better equipped to perform these tasks than marketers, but they need to be able to work towards these goals within budget and within all the other organisational constraints which exist. At the very minimum, this requires financial literacy. So it becomes apparent that a marketer must be more than just a marketer; he or she must possess business-wide knowledge and understanding to do their own job properly. In the opinion of the author, tomorrow’s marketer will be a multi-skilled, general, manager; able to hold their own with accountants, engineers, and others, without problem. Those unable to do this, may not survive for long.

A firm grasp of financials is most obviously needed for the detail of product and service costs, without knowledge of which marketers cannot negotiate effectively with buyers. Happily, with a good management-oriented information system, this is not difficult to obtain. Moreover the only problems for the marketing manager are time and inclination. The practical problem in business today is that marketers do not always have this inclination. Yet marketers do very much need financial information and the ability to understand it, to do their own job well.

The contemporary push for greater financial accountability by those responsible for advertising and other promotional expenditures should not cause surprise. Given increased competitive intensity, this pressure is exactly what we should expect. While the financial rewards of true innovation and creativity may never be estimated very accurately, there is much in day to day marketing which can be. Marketers need to be sufficiently on top of routine accounting systems to do this by and for themselves.

The implications for marketing education are twofold. First, as identified above, marketers need a solid grounding in the other business disciplines to do their own job. Marketing in a vacuum has no more value than a piston out of its cylinder. Second, what is taught has to be integrated with the diverse other managerial responsibilities, extending well beyond marketing activities alone. There is a logic in ensuring that those who may be called upon to ‘sell’, or, manage ‘selling’ are, equally, trained and equipped to ‘buy’ as purchasing managers. Knowledge of the one enhances understanding of the other. All students of basic marketing should take at least one course in purchasing.

In short, the foregoing is a view that marketing needs to broaden its horizons and become more ‘holistic’ in its view of business and in its functional role within business. However the idea of ‘holistic marketing’ is neither new nor uniformly interpreted. It was a central feature of one of Philip Kotler’s more recent books (Kotler et al., 2002) and, equally, has received attention from major corporations (eg. Stengel, 2004). For Kotler and his colleagues, the ‘holistic marketing concept’ represents a major new framework with which to integrate demand management with resource management and network management. Industry, on the other hand, often uses the phrase in a much more restricted sense, to refer to business need to integrate ‘traditional media’ communications with growing use of ‘the new media’. Holistic marketing as understood in this article is much closer to the former than to the latter; it is a focus on the business as a whole rather than on just one part of it, or, one function.

A quite different weakness of academic marketing, especially in its ‘consumer behavior’ guise, is its short-term focus. Despite the enormously frequent use of the words ‘strategy’ and ‘strategic’ in marketing texts, the reality is that truly strategic analysis or reasoning is rare. In particular, there is very little in most treatments of the 4Ps which is genuinely strategic. A few product-market matrices may also be provided but there is little more to stimulate the development of longer-term perspectives. In the ‘marketing mix’ context, it is really only with regard to ‘positioning’ and ‘image-building’ that marketers are commonly invited to think long-term. The most prominent element of conventional marketing teaching, which is truly strategic, is often ‘positioning’; be it of company, brand or product. Yet ‘positioning thinking’ is currently losing favour in business itself. Nevertheless, positioning, like strategy in general, is inherently long term in purpose and influence. The consequences of any given strategy, be they positive or negative, are likely to prove important for a period of years, perhaps many years. It is normally difficult, costly and risky, to seek to change an established marketplace strategy. Put differently, changing horses in mid-stream can prove dangerous.

Marketing personnel, being those in the company who should know most about customers and competitors, might be expected to contribute mightily to business strategy. Yet generally they do not. It appears to be the case that most truly strategic decisions are taken by CEOs with substantial input from CFOs. Despite some honourable exceptions, one
wonders why there is relatively little comparable input from top marketing managers. Some also wonder why there are relatively few marketing managers at board level. There are at least three possible explanations. One is that marketers are not judged to know as much about the marketplace as they claim. A second is that they lack sufficient knowledge of likely future developments within their own firm, or, industry, to contribute. A third, is that their judgements do not command respect among their colleagues. If any of these explanations are correct, one reason may be that they are more accustomed to taking short-term ‘marketing mix’ perspectives than strategic ones. None of these possibilities is flattering. Yet, if they contain some grains of truth, marketers do need to rise above them. The first two weaknesses can be overcome through deeper understanding of the marketplace and of their own business and industry. The third can be overcome by developing a strategic mindset. That is, by developing the ability to see the big picture while at the same time maintaining a sound sense of proportion. Obviously enough, marketing education could make a sizeable contribution to this. I wonder how many of us really believe we are doing so at present?

In a professional sense, marketers’ core responsibility is to look after the supplier-buyer relationship, including repeat purchase, to the satisfaction of the supplier, or, seller. This means, safeguarding the actual and potential revenue stream from the relationship. With product life-cycles in many sectors becoming shorter, more and more marketers are having to give considerable attention to the maintenance of revenue streams beyond one product generation to the next. This commonly demands assessment of the marketplace implications of completely new generations of product technology. This requires more detailed attention than classic, consumer-oriented, incremental, new product development decisions. It is self-evident if we think of sectors like telephony and consumer electronics. It is less evident, but even more important, if we think of the impact of the new materials coming on stream as a result of advances in nanotechnology. So, once again, we can recognise the desirability of those with close knowledge of the marketplace, the marketers, of being in a position to view their responsibilities in the context of the business as a whole. If we examine this reality more closely we can make even sharper statements. For example, certainty in the timing of the market availability of a new generation of cell phone, is quite simply essential for the marketer who has to plan and schedule its launch. At the same time, it remains necessary to safeguard the revenue stream from the existing generation of product, which is soon to be superseded. This marketer’s work has to be very closely integrated with the work of production managers, purchasing managers and outside suppliers. Put rather differently, the marketer benefits from viewing marketing’s contribution through the perspective of an industry value chain as a whole, rather than as a specialised business function. Marketing education needs to help develop this kind of mind-set.

It has already been noted above that marketers need a firm grasp of financials to do their job. Yet they are frequently criticised for lacking this. Marketing education should, therefore, adjust accordingly and remove this weakness.

This leads us to the most important marketing requirement of all, which is to be profitable. This is more than a statement of the obvious. Bland generalisations about ‘profit maximisation’ by economists become precise profit targets with timelines for marketers. Within this, there is nearly always a potential conflict between greater return in the short-term and greater return in the longer-term. This is why marketing plans, including marketplace profit objectives, have to be precisely integrated into the plans and objectives of the business as a whole.

Theoretically, marketing, like other activities can be made more productive in each of two ways: by cutting the cost of existing activities while maintaining them, and/or, adding buyer value without adding commensurate cost through new activities. We expect both. We also expect marketing managers to be as accountable in terms of their activities and their financials as are other managers.

Happily, over the past decade or so, a big step forward has been taken. This is the steadily increasing level of attention being given to marketing metrics. As a result, marketing metrics have been refined and their use greatly expanded. There is now easy access, for all, to coherent sets of marketing function metrics, though measuring the direct impact of marketing expenditures on reported profit remains as elusive as ever. Nevertheless, sophisticated treatments of the indirect linkages between marketing and profit have become available. One such, written by someone qualified as both marketer and accountant, is straightforwardly titled: “Marketing and the Bottom Line” (Ambler, 2000; 2003). However even this first-class summary of contemporary marketing metrics, generously illustrated with practical examples of current practice, may fail to please those still searching for a direct link between marketing and current quarter profit.

There are solid reasons for this. First, profitability necessarily reflects many factors outside company control, such as competitors, as well as marketing activities. Second, many marketing activities, like brand-building activities, focus on much longer time horizons than quarterly or annual earnings.

Yet the desire to relate marketing expenditures more directly to reportable earnings remains. Indeed, the Marketing Science Institute has given this quest priority for nearly a decade. Somewhat similarly, The Conference Board has established a ‘research working group on measuring and managing return on marketing investment’. The same is true of the Institute for the Study of Business Markets (ISBM) at Penn State University. Specifically, the ISBM’s ‘Trends 2010 Study’ (2008) finds that marketers want better marketing and accountability metrics. The Study finds this to be the fourth-ranked challenge facing
business marketers over the next three years. What they want, ideally, is a metric which identifies the direct, or, unique impact of marketing performance on financial return. In the words of The Conference Board: “executives are under increasing pressure to deliver more quantifiable results that are specifically tied to the financial objectives of their organization”. As indicated already above, this is hard to achieve. In any case, there is no agreement in sight on which measures are likely to prove best. Indeed, it begins to look as though we should be asking, and answering, rather more narrowly focused questions.

While at a practical level it is very hard to raise the productivity of marketing expenditures, at a conceptual level, some general statements can be made. First, cost-cutting is much easier than value-adding, but is generally of only one-off, short-term, value. In some industries cost-cutting is established routine, but cost-cutting, by itself, can never build a business. The latter requires inspiration; that is, invention, innovation or insight. All of these are non-routine and uncommon, but in them reside the large potential rewards of enterprise. Second, the diverse multitude of marketing activities can be divided into two more or less discrete categories: those with immediate impact and those with only longer term consequence. Only the first of these two categories, which includes factors like sales’ force intensity, can sensibly be expected to impact on current revenue and profit. Third, some activities, including any business conducted online, yield more timely and accurate data than others, such as enhanced training of sales’ staff. Finally, care always needs to be taken to exclude the impact of external factors, like interest rate adjustments and tax changes, which always lie outside business control. Only then, can the financial return on any marketing investment, or other company activity, be estimated.

Repositioning the Profession

It is rather frequently claimed that marketing and marketers are often marginalised; in their day-to-day responsibilities and in their prospects for promotion (Gronroos, 2003). Yet all freely recognise that shareholder value is ultimately earned in the marketplace from the customers of the firm, and this is precisely the arena about which marketers are supposed to be the best informed people in the firm. So, evidently, something must be wrong.

The foregoing suggests that marketers in their companies, and ‘marketing’ as a business responsibility, have the potential to advance if they make some adjustments. For a start, they could gain by acting and thinking as ‘general’ managers rather than as specialists. This implies a willingness to make ‘marketing’ a common property, freely and transparently available to all. However, to act and think effectively as general managers, marketers do need to be broadly informed and roundly educated.
achieved with jargon, hype or puff. As ever, the first requirement is good homework.

With all this done, marketing could be ‘solid’ and self-confident in substance. It could become ‘central’ rather than peripheral to management of the business as a whole. Not least, marketers would probably begin to appear indispensable rather than, as now, struggling against indifference to justify themselves. Overall, it would give scope to re-position marketing away from functional isolation towards strategic decision-making and centrality. This need not imply any weakening of traditional, functional expertise. Functional expertise just needs to be augmented with broader insight and strengthened with robust strategic thinking. As Gronroos has written (2003), once this is done, it becomes possible to shift the focus of marketing from ‘spending’ on the marketing mix alone to ‘investing’ in customers and future cashflow. In this way marketing can move from being a ‘cost’ responsibility only and become a ‘balance sheet’ matter as well. This does, however, require the capability to produce solidly-based estimates of return on marketing expenditures. This is not at all unreasonable. After all, marketing expenditures are commonly the second or third biggest outlay of companies, after payroll and supplies.

The implications for marketing education are twofold. First, marketers, as much as anybody, need a solid grounding in the other business disciplines to perform their own job well. Second, marketing education needs to emphasise that what is taught has to be integrated with diverse other activities, extending well beyond marketing activities alone. In other words, ‘internal marketing’ is very much part of the job; a requirement and not an option. In addition, there is a logic in ensuring that those who may be called upon to ‘sell’, or, manage ‘selling’ are, equally, trained and equipped to ‘buy’ as purchasing managers. Knowledge of the one enhances understanding of the other.

Conclusion

In sum, there are sound reasons to examine contemporary marketing critically and to consider how marketers and marketing might be made more effective and influential in today’s business environment. Not surprisingly, this carries important implications for contemporary marketing education. The suggestions outlined above are that marketing should get more ‘HIP’; that is, more:

- **HOLISTIC;** in perspective  
  [not just marketing communications; not just FMCG sector; but ‘whole-of-business’ vision]

- **INTEGRATED;** into business strategy  
  [truly ‘strategic’ rather than overwhelmingly short-term, as in the ‘marketing mix’ and most textbooks]

- **PRODUCTIVE;** in purpose and with numbers!  
  [with focus on efficiency, effectiveness & the metrics of accountability]

At least nobody should quarrel with the last of these. How to do it, can only be hinted at in this short essay. It is the challenge all marketers and marketing educators face.

So, save your profession: Get HIP!

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A Comparative Study of Benefits Sought by Consumers in USA, Europe, & Asia: Case of Fast Food Industry

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The present study compares the fast food benefits sought by consumers in the USA, Europe, and Asia to develop some insights into cultural differences and cultural similarities across countries in these world regions. The relevant literature pertaining to fast food consumer behavior, brand image and service marketing areas is reviewed and 16 brand attributes/benefits sought by consumers are identified. Marketing implications of this research and directions for future research are discussed.

Overview

American consumers spent $6 billion on fast food in 1970 and this spending increased to $110 billion in 2000 (Wikipedia, 2008) that is more than 18 times in 30 years. For 2004, the fast food spending in United States was estimated at $148 billion ranking United States as #1 and accounting for nearly two-thirds of $229.4 billion spent on fast foods by the top ten fast food nations of the world (Workman, 2007). Americans today spend more money on fast food than on higher education, new cars, or personal computers (Schlosser, 2001) and fast food accounts for more than 50% of food consumed in restaurants in United States (Wikipedia, 2008). However, Americans are not alone in their fast food fancy. The whole world seems to have fallen in love with the fast foods. McDonald’s, the #1 fast food company in the world operates more than 30,000 restaurants in more than 120 countries of the world and serves more than 54 million consumers every day worldwide (Wikipedia, 2008). The success of McDonald’s is captured in terms such as, “McDonaldization,” which is often considered synonymous to globalization. Parallel to the globalization trend, most of the fast food industry expansion has been in the emerging markets of Asia, Central America, South America, and Eastern Europe where factors like trade liberalization and fall of communism have opened these markets to foreign capital investment and international trade (Kaynak, Kucukemiroglu, & Aksoy, 1996).

The restaurant business, in particular global fast food business is complex because it includes both tangibles, i.e., food products and intangibles, i.e., services, which are marketed in a very dynamic and culturally diversified global environment. An understanding of consumer purchase motivations and benefits sought in the cross-cultural contexts therefore is critical to the success of this industry. Fast food industry and in particular McDonald’s has attracted the attention of researchers in the field of international business and marketing. The research includes single country studies (Eckhardt & Houston, 2002; Kaynak, Kucukemiroglu, & Askoy, 1996; and Rekom, Jacobs, Verlegh, & Podnar, 2006) as well as cross-national studies (Anderson & He, 1999; Cunnigham, Young, Uлага, & Lee, 2004; Gilbert, Veloutsou, Goode, & Moutinho, 2004; Lee & Ulgado, 1997; and Murase & Bojanic, 2004). These researchers have examined topics like brand meaning/brand essence/brand personality, marketing mix, product preference/evaluation, and service classification and satisfaction. While brand attributes/benefits sought by consumers have been included in past research, these studies have been conducted in specific country contexts and have addressed specific consumer behavior topics. As far as we know there is no research done till date that identifies an aggregate list of brand attributes and benefits sought across a wide range of countries and associated with a variety of consumer behavior domains. The objective of our research is to compile this aggregate information and develop insights into cultural differences and similarities in fast food benefits sought by consumers across the world. The research reported in this paper conducts this analysis across the USA, Europe, and Asia.

This paper is divided into four sections. The next section reviews research on brand attributes/benefits sought by consumers and behavioral consequences. In the section after that, we summarize the findings and develop some insights into cultural differences and similarities across the USA, Europe, and Asia in fast food benefits sought by the consumers. The last section of the paper discusses marketing implications of our research and direction for future research.
Benefits Sought by Consumers and Behavioral Consequences in USA, Europe, and Asia: Literature Review

In this section we discuss 8 cross-cultural research studies dealing with fast food benefits sought by consumers and behavioral consequences. These studies are classified into four categories – purchase behavior studies, consumer satisfaction studies, brand image studies, and service industry studies.

Purchase Behavior Studies

Based on their review of the past literature, Kaynak, Kucukemiroglu, and Askoy (1996) list the following 11 concrete and abstract attributes as the considerations used by consumers in their selection of fast food outlets: nutrition, price, taste, speed, delivery service, variety, seating capacity, location, novelties, friendliness, and cleanliness. This study was conducted in Turkey and the findings of the authors reveal that location, speed, price, service and taste were most important considerations for more frequent eaters whereas nutrition and novelties were considered most important by less frequent eaters. Seating capacity, variety, cleanliness, and friendliness did not significantly influence frequency of purchase. This study also found that frequent eaters were willing to pay less than less frequent eaters and preferred Turkish meat balls and gyros compared to less frequent eaters who preferred chicken sandwiches, pizza, and fish sandwiches. The authors conclude that the findings of their study make a case for need oriented type of marketing strategies rather than the belief that fast food markets have become a commodity market. Purchase frequency was also examined as one of the dependent measures in a cross-national study of fast food restaurants conducted in the Peoples Republic of China and the USA by Anderson and He (1999). These authors examined the effect of marketing mix and a variety of socio-cultural and demographic variables on purchase frequency and differentiation of segments. The findings of their study indicate that taste, price, brand image and convenience of location explain the differences in the fast food purchase frequency (operationalized as number of days per year) in China and price explains the purchase frequency differences in the USA.

Consumer Satisfaction Studies

A cross-national study measuring consumer satisfaction with the fast food industry in Jamaica, Scotland, USA and Wales by Gilbert, Gilbert, Veloutsou, Goode, and Moutinho (2004) included the following 17 variables: provider courtesy, timely service, competent employees, easy to get help, convenient operating hours, neat and clean place, treatment received, easy access to service, employee listens, security within the organization, security outside the organization, prompt help, reasonable service cost, fair treatment, organization delivers what it promises, helpful personnel, and organization backs up its promise. The authors identified two dimensions of satisfaction, that is, satisfaction from the personnel and satisfaction from the setting. The results showed that 13 out of 17 variables had a clear loading on either the personnel dimension or the setting dimension. The 11 variables that loaded consistently for four countries on the personnel dimension included provider courtesy, timely service, competent employees, easy to get help, treatment received, employee listens, prompt help, fair treatment, organization delivers what it promises, helpful personnel, and organization backs up its promise. The two variables that loaded consistently for four countries on the setting dimension included security within the organization and security outside the organization. The remaining four variables had conflicting loadings, that is, on personnel dimension for some countries and on setting dimension for others. Convenient operating hours was identified on setting dimension for Jamaica, USA and Wales but on personnel dimension for Scotland. Neat and clean place was considered a setting related attribute for Jamaica and Wales but for Scotland and USA, it was considered a personnel related attribute. Easy access to service loaded on the setting factor for Jamaica and USA but it loaded on the personnel factor for Scotland and Wales. Finally, reasonableness of service was considered a setting factor for Jamaica, USA, and Scotland but for Wales it was considered a personnel factor. The results of this study provide insights into cultural similarities and cultural differences in terms of what consumers view as a personnel factor and what they view as a setting factor, the two important components of fast food service.

Brand Image Studies

Three research studies dealing with brand meaning/brand essence/brand personality include Eckhardt and Houston (2002), Rekom, Jacobs, Verlegh, and Podnar (2006), and Murase and Bojanic (2004) respectively. The study of Eckhardt and Houston (2002) conducted in China using a scenario completion methodology reveals the cultural paradoxes typical of a society undergoing transition. Three aspects of the meaning of McDonald’s brand found to be paradoxical were its social space, otherness/foreignness and modernity and youth image. The social space dimension included attributes and benefits like method of food ordering and delivery, décor, noise level, and table set up. The otherness/foreignness dimension included McDonald’s being a symbol of the United States, that is its Americana appeal. The dimension of modernity and youth was reflected in attributes and benefits like cleanliness, sanitation, technology, brightness and newness. Three scenarios were presented to the participants, that is, family birthday party, dating, and eating lunch alone on a workday. The findings reported by the authors indicate that
the social space dimension was relevant for the birthday party and dating scenarios but not for the eating lunch alone scenario. In birthday party scenario, the social space image of McDonald’s including its publicness is viewed negatively because it does not allow people to display their rank and “gain face.” The same publicness is viewed positively in the dating scenario because by having them seen on a date the consumers “gain face.” As regards the second dimension, that is, otherness/foreignness, attributes and benefits sought like the standardization and price do not provide opportunities for “giving face” to the honoree in a scenario like birthday party and therefore McDonald’s is perceived adversely in this context. On the other hand, in the dating scenario, the standardization and price attribute/benefits help the man in “not losing face” because everyone orders pretty much the similar price items. Finally, the modernity and youth reflected in McDonald’s brand were found to have a negative effect in birthday party scenario because these were considered conflicting with the “traditional” multigenerational gathering like a birthday party. On the other hand, the youthfulness of the brand is found to be romantic by youngsters and has a positive image in the “non-traditional” dating situation. The findings of this study show that the consumption context and thus the availability/lack of opportunity for “face” play a critical role in the perception of the brand image in Chinese society.

The second brand image study by Rekom, Jacobs, Verlegh, and Podnar (2006) was conducted in Slovenia with the objective of identifying characteristics of McDonald’s brand that form its “essence.” These authors generated an overall list of characteristics by asking participants to give 10 key words – 5 describing McDonald’s as a person and 5 describing human characteristics associated with McDonald’s communications. The key characteristics generated using the methodology were open, communicative, sociable, young, happy, kind, fast, pushy. In addition to these, two other characteristics, that is, western and successful were also investigated by these authors. The findings of this study revealed that the characteristic “open” was considered to be the most important feature of McDonald’s brand followed by “sociable,” “communicative,” and “happy” in that order. These variables showed a high causal relationship with each other with “open” occupying a center position. The characteristic “Western” had a low causal meaning but was associated with characteristic like “fast” and “pushy.”

The third brand image study by Murase and Bojanic (2004) examined the brand personality of three American fast food restaurants, that is, McDonald’s, Wendy’s, and KFC between the USA and Japan. These authors used Aaker’s (1997) scale to investigate differences in brand personality. The scale consisted of five dimensions with a total of 42 traits. The “Competence” dimension included 9 traits, namely, reliable, hard-working, secure, intelligent, technical, corporate, successful, leader, and confident. The “Sincerity” dimension included 11 traits, that is, down-to-earth, family-oriented, small-town, honest, sincere, real, wholesome, original, cheerful, sentimental, and friendly. The “Excitement” dimension included 11 traits, namely, daring, trendy, exciting, spirited, cool, young, imaginative, unique, up-to-date, independent, and contemporary. The “Sophistication” dimension included 6 traits, that is, upper-class, glamorous, good-looking, charming, feminine, and smooth. The “Ruggedness” dimension included 5 traits, namely, outdoorsy, masculine, western, tough, and rugged. The results of this study indicated that Japanese consumers rated the three fast food restaurants to be more sophisticated and more rugged compared to American consumers. There were no significant differences in the perceptions of Japanese versus American consumers along the sincerity, excitement, and competence dimensions. Brand personality ratings of the three restaurants showed significant differences on the sincerity, excitement, competence, and sophistication dimensions but not on the ruggedness dimension. An examination of the brand personality jointly by country and restaurant showed that for McDonald’s and KFC brand personality scores for Japan were higher than for USA on each of the five dimensions and with the exception of sincerity dimension for McDonald’s, all other nine comparisons for McDonald’s and KFC were statistically significant. For Wendy’s brand personality scores were higher for USA on the competence, sincerity, and excitement dimensions and were higher for Japan on the sophistication and ruggedness dimensions. These findings are attributed by the authors to cultural differences as well as differences in the positioning strategies used by the three fast food restaurants.

Service Industry Studies

Lee and Ulgado (1997) compared consumers’ evaluations of service offered by McDonald’s in USA and Korea. Their research instrument comprised of 22 items measuring expectations along five SERVQUAL (Parsuraman, Zeithaml, & Berry, 1988) dimensions, three items dealing with expectations about food prices, service time and location convenience, two items measuring overall perceived service value, 22 items measuring performance along five SERVQUAL dimensions and three items dealing with perceptions of food prices, service time and location convenience. The five SERVQUAL dimensions are described as “Tangibles” - physical facilities and equipment, “Reliability” – dependency and accuracy, “Responsiveness” – willingness to help customers and promptness of service, “Assurance” – knowledge, courtesy and ability to inspire trust and confidence, and “Empathy” – caring and individualized attention to customers. The results of this study showed that the perceptions of overall value (direct measure), gap theory based measures of value (difference between expectations and performance) for each of the five SERVQUAL dimensions and for food prices,
service time, and location convenience were lower for Korean consumers than for American consumers. A stepwise regression done by authors for American and Korean samples indicated that to American consumers, “Low Food Prices” are the most important consideration followed by “Assurance.” In comparison, to Korean consumers “Reliability” is the most important attribute followed by “Empathy” and “Low food prices.” The authors explain the results in terms of cultural differences between American and Korean society, such as, individualism-collectivism and time orientation.

A study by Cunnigham, Young, Ulaga, and Lee (2004) compared consumers’ classification of services (including fast food and fine dining) in USA and France. These authors used 11 dimension to measure consumers’ perceptions as follows: physical product component, customer-employee contact, production-consumption separability, risk in selection of provider, ease of switching, service performed on a person or object, formality in provider-customer relationship, continuity versus discreteness of service delivery, customization, judgment involved in providing service, and convenience. These 11 variables loaded on two factors, that is, personalization versus standardization as the first factor and service performed on person versus object as the second factor. The main difference between MDS maps representing USA and France data was in the classification of the convenience attribute. For USA convenience was aligned along the personalization versus standardization dimension whereas for France, the convenience attribute was aligned along the person-object factor. The authors explain these results by suggesting that in the USA, convenience is considered to be an integral part of standardized service whereas in France, convenience is viewed to have a distinct object component to it apart from the individual receiving the service.

Discussion of Findings

The eight research studies dealing with brand attributes/benefits sought by consumers discussed in the previous section are summarized in Table-1. A total of 16 brand attributes/benefits sought were identified in these research studies. For each of the eight studies the table indicates the attribute/benefit variables which had significant results and those which did not have significant results as well as the variables which were not included in the respective research studies.

Our first observation is that the data is rather limited. With the exception of one, all other seven studies were conducted only in one or two countries. Only 3 out of 8 studies included 8 or more variables and some studies included just 2 or 3 variables. We clearly need to include more studies in our database. However, it seems there is not a whole lot of cross-cultural research studies covering a large number of cultures and a large number of brand attributes/benefits sought. It also seems that some brand image studies and service industry studies tend to use overall and general measures of consumer perceptions rather than specific brand attributes and benefits sought. Also, behavioral consequences are not specifically discussed in some studies. In any case, based on the current data some preliminary insights on cultural similarities and differences in attribute/benefits sought by consumers are drawn and discussed below.

A maximum number of studies (6 out of 8) found significant effects for the “service” variable, followed by “price” and “speed” (5 out of 8 for each) and “brand image” (4 out of 8). Significant effects on these variables were found for each of the three country/world regions, i.e., the USA, Europe, and Asia. The consumer behavior domains covered in the 8 studies include consumer perceptions, brand/service evaluations, consumer satisfaction and purchase related behavior, such as, frequency of purchase and purchase occasion. A larger database will allow us to conduct further analysis and provide insights into cross-cultural differences and similarities in the relationships between these attributes/benefits and consumer behavior domains.

Marketing Implications and Future Research

The research studies reviewed in this paper suggest that in Asian cultures and some European cultures as well, socio-cultural influences on fast food consumption behavior are much stronger compared to the USA. The collectivist nature of these societies and strong emphasis on quality of life explains why socio-cultural influences are so important. Brand attributes and benefits sought like atmospherics and friendliness, typically considered intangibles may be as significant, if not more, as tangibles like price. Also these high-context cultures of Asia differ substantially from low-context cultures of the West in terms of their treatment of time, place etc. These differences in turn have very useful global marketing implications for promotion and positioning strategies.

We are currently in the process of developing a typology for fast food consumption behavior, which will help in understanding of such cultural differences and similarities between low and high context cultures. We are also working on developing a comprehensive conceptual model identifying the cultural antecedents as well as behavioral consequences of benefits sought by consumers in their patronage of fast food restaurants. We also feel that there is a need for empirical research related to the effects of cultural and other environmental variables on consumer behavior to test these conceptual frameworks and theories.
Table 1. Benefits Sought by Consumers in Patronage of Fast Food Restaurants in USA, Europe, and Asia: Summary of Past Research

<table>
<thead>
<tr>
<th>Research Study</th>
<th>Countries</th>
<th>Nutrition</th>
<th>Novelty</th>
<th>Location</th>
<th>Speed</th>
<th>Price</th>
<th>Service</th>
<th>Taste</th>
<th>Seating</th>
<th>Variety</th>
<th>Cleanliness</th>
<th>Friendliness</th>
<th>Brand Image</th>
<th>Atmosphere</th>
<th>Technology</th>
<th>Security</th>
<th>Overall Value</th>
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Legend: ✓ significant results, X results not significant, -- variable not included in the study

References


Management and Organizational Communication Preferences:
Singapore

Sharaf N. Rehman, University of Texas at Brownsville, USA
William R. Kennan, Radford University, USA

The research reported here focuses on the management and communication behavior reported in 106 organizations in Singapore. The research was conducted to better understand the distinctive cultural features of organizational management and communication in order to highlight the issues associated with cross-cultural business. Next to Hong Kong, Singapore is the most important business center in Asia. Singapore is also unique in the sense that it is a consciously and deliberately blended culture of Chinese, Indian, and Malaysian peoples grounded in, developed, and maintained by governmental policy.

Review of Relevant Literature

Organizations and Their Cultures

The literature on organizational culture is a long-standing and well-developed area of inquiry. A summary of that work is well beyond the scope of this paper, however, it can be said that one prerequisite for superior performance is the presence of a well entrenched set of core managerial values (Peters and Waterman 1892; Tichy 1983; Deal and Kennedy 2000). Barney (Barney 1986) notes that it is precisely these core values (how to treat employees, customers, suppliers, and others) that sets the stage for the innovativeness and creativity that foster success.

The impact of national culture on organizations has also received considerable attention. Hofstede’s (Hofstede 1980; Hofstede 2001; Hofstede 2005) five dimensions of culture (power distance (PDI), individualism (IDV), masculinity (MAS), uncertainty avoidance (UAI), and long-term orientation (LTO)) have provided a system for scoring and locating various national cultures in relation to each other. Singapore’s ratings (Hofstede 1967-2003), for example, place it above the Asian norm on the power distance dimension (PDI score is 74), somewhat higher on the individualism dimension (IDV score is 20), higher on the masculinity dimension (MAS score is 48), much lower on the uncertainty avoidance dimension (UAI score is 8), and lower on the long term orientation dimension (LTO score is 48).

Comparison across particular cultures is also possible. For example, PDI (Singapore 74, USA 40, China 80, Malaysia 104, India 77), IDV (Singapore 20, USA 91, China 20, Malaysia 26, India 56), MAS (Singapore 48, USA 62, China 66, Malaysia 50, India 56), UAI (Singapore 8, USA 46, China 30, Malaysia 36, India 40), and LTO (Singapore 48, USA 29, China 118, Malaysia no score reported, India 61). The PDI scores suggest that Singaporeans perceive that power is distributed unequally in ways similar to China, Malaysia, and India but dissimilar to the USA. The LDV score can be interpreted to suggest that Americans are considerably more individualistic than their Singaporean counterparts who are more collectivistically oriented. MAS scores are relatively closely aligned. The UAI scores suggest that Singaporeans are less willing to accept uncertainty than any other culture listed above. Finally, LTO scores are lower for Singapore suggesting a shorter-term orientation (suggesting, among other things a respect for tradition and a concern for face-saving).

These results suggest that in terms of national cultures organizations may experience challenges conducting international business across the five dimensions. Hofstede is quick, however, to point out the difference between national and organizational culture. Cultures are constructions unique to organizations and are based on rituals, symbols, heroes, values, attitudes, etc. So, comparisons can be made across national cultures but the distinctions among organizational cultures within national cultures are difficult because of the unique characteristics that emerge within organizations.

Like Hofstede, Trompenaars (Trompenaars and Hampden-Turner 1998; Trompenaars and Hampden-Turner 2004; Trompenaars and Wolliams 2004) aligns national cultures primarily across five dimensions (universalism versus particularism, communitarism versus individualism, neutral versus emotional, diffuse versus specific, and achievement versus ascription). He also, like Hofstede, sees the difference between national and corporate cultures and

1 The comparisons were chosen because: 1) the USA is a major trading partner and 2) Singapore is composed of three primary cultures Chinese (76.8%), Malaysians (13.9%), and Indians (7.9%).
argues that particular cultures are oriented collectively by individualistic dimension based on Hofstede’s work. He divides culture primarily along a collectivistic versus hierarchical and person versus task. Triandis (Triandis 1972; Triandis 1988; Triandis 1993) advances a four-category system of organizational cultures (incubator, guided missile, family, and Eiffel tower) distributed spatially across two dimensions egalitarian versus hierarchical and person versus task. This body of work has given rise to a limited body of research on Singapore. Ang and Kuo (Ang and Kuo 2002/2003), for example, specifically consider Singaporeans with regard to the connection between individualism and collectivism, gender, and refusals. Their findings suggest an interaction between gender and individualism/collectivism. Of particular interest here, the authors also suggest that patterns of behavior with regard to gender and individualism/collectivism are culture specific limiting the ability to generalize beyond the immediate cultural environment.

Singelis, Triandis, Bhawuk, and Felfand (Singelis, Triandis et al. 1995) added to the individualism/collectivism continuum by suggesting a vertical/horizontal dimension. This notion adds a consideration of equality, e.g., the extent to which individuals perceive themselves to be equal to those in their group. Soh and Leong (Soh and Leong 2002) seek to validate these dimensions by including and comparing 184 Chinese Singaporean students with 180 white American students. The important findings for this paper are that the factor structure remained in tact but with significant differences between the two cultural groups.

The net effect of this tradition of cross-cultural psychological research is to suggest that cultural differences can be identified in both national and organizational cultures. These differences are not insignificant and a clearer understanding of them can add to our understanding of the potential difficulties that may be encountered where individuals attempt to conduct business across these divisions. Further, this research points to significant differences in both managerial approach and communication behavior.

Management Styles

The discussion of management styles begins with the earliest writings on management roles and responsibilities. What is often referred to as the classical school draws from the work of Frederick Taylor (Taylor 1911), Henri Fayol (Fayol 1984), and Max Weber (Weber 1947) although others clearly contributed to this tradition. The classical tradition emphasizes scientific analysis of work, rewards analysis, managerial control, decision-making, and bureaucracy among other concepts. What emerges is a managerial vision where decisions are made by a highly trained and professional managerial class who then communicates these decisions and the required information to those who need to know. The communicative implications reflect a primary concern for downward communication, clarity, and work instructions and it largely ignores the need for the employee class to communicate their experiences except with regard to work and only through defined lines of authority.

The human relations approach, most often attributed to Elton Mayo (Mayo 1933; Mayo 1945), begins with the centrality of the scientific analysis of work but evolves into a concern for the impact of the group and its norms on work efficiency and productivity. Mayo’s work, and that of his colleagues, points to the impact of person oriented issues as the focus of managerial concern. Communicatively, managers focus on the individual as a living breathing human motivated by various concerns who lives and works within a group that through its interaction produces a set of understandings about work which, in turn, affects the very nature of the work enterprise itself. Hence, the focus of management changes from a control, analysis, and decision-making orientation of the classical school to the management of humans as individuals and their personal understandings and needs.

The human resources tradition (Likert 1961; Blake and Mouton 1964; Likert 1967; McGregor 2005) marks an emerging awareness of the value added nature of human knowledge and skill (human capital). It sees organizational members as valuable assets capable of adding, through their knowledge and experience, to the overall success of the enterprise. Management’s portfolio changes from control, analysis, and decision-making to the human motivation and understanding of a facilitation model. In this tradition the role of management is facilitation of human assets and attributes so that those characteristics can be leveraged on behalf of organizational goal attainment. From a communication perspective, managers become leaders and facilitators who make sure that organizational members are educated and trained and that this knowledge and experience becomes available to enhance organizational effectiveness.

The systems tradition (Katz and Kahn 1966; Bertalanffy 1968) sees organizations as organic totalities that interact dynamically with their relevant environments in an effort to maintain their status as open systems. Management’s role in this vision becomes one of scanning various relevant environments to detect threats and opportunities. In doing so communication becomes a distinguishing feature of a detect and respond posture designed to produce effective environmental adaptation.

The collective impact of these traditional managerial orientations and styles is to give rise to a veritable onslaught of contemporary definitions, categories, and
prescriptions for both research and applied needs that extends well past the original formulations. Senge (Senge 1990), for example, follows in the human resources model to highlight the role of human skill and knowledge. Building on the systems tradition Wheatley (Wheatley 1992) integrates chaos as a normal, valuable, and energizing organizational process that has its roots in traditional discussions of entropy.

**Singapore, Management, and Communication**

A number of studies exist which provide more detail with regard to managerial and communication behavior in Singapore but there is little that bears directly on either. For example, recent comparative study of Australian and Singaporean health managers (Braithwaite, Westbrook et al. 2007) found that Singaporeans reported greater pressure from their superiors regarding people, customer, process and quality management than Australian managers. The authors report that both samples experienced similar pressures regarding financial, organizational, data, planning, and external relations management. Finally, Singaporean respondents indicated more pressure from their co-workers in all categories.

Bjerke (Bjerke 1999) provides a comprehensive review of literature on Chinese management. He summarizes his review by suggesting that Chinese management can be understood along the following dimensions: philosophy, strategy, and future; autocracy and tradition, power and materialism; sales and quick return; familism; Guan-xi; face and prestige; superstition and daring; and localism. His general conclusions are that the Chinese belong to an old civilization that preserves many core traditions, there is a sense of optimism where they operate, they are accustomed to difficult and challenging times, they are good negotiators, they are good at networking, they have a strong sense of identity, and they are philosophical. These are, of course, broad generalizations given the complex cultural makeup of Chinese peoples living in both the People’s Republic and in other locations.

While the literature on culture, organizational culture, management style, communication, and Singapore in particular highlight the unique characteristics of organizations in this nation, there is little direct analysis of these topics, focused on Singapore, as has been noted. This study provides and descriptive analysis of the following research questions.

- **R1**: What traditional management styles are characteristic of Singaporean organizations?
- **R2**: What general approaches to organizational communication content are characteristic of Singaporean organizations?
- **R3**: How does communication flow in Singaporean organizations?
- **R4**: Which communication channels are preferred by Singaporean organizations?
- **R5**: Which communication styles are preferred by Singaporean organizations?

**Method**

**Sample**

One hundred and sixteen seniors enrolled in an upper-level Organizational Communication course in Singapore were assigned to spend a day at a local organization of their choice. Each student was required to interview one person from the top management and one person from the workforce. The students were to observe/study the organization’s management style and the process of communication at work. Data were gathered from 116 organizations. Ten organizations were dropped from the study due to insufficient information. The data reported here was gathered through interviews and observation methods.

Organizations were classified based on three criteria: (1) sector, i.e., nature of an organization’s business, (2) size of organizations and (3) age of organizations and then were divided into three sectors: retail, service, and manufacturing. Table 1 presents the sector breakdown of the organizations.

**Table 1: Business Sectors Represented in the Sample**

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<thead>
<tr>
<th>Sector</th>
<th>Frequency</th>
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<td>Service</td>
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<td>Retail</td>
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</tr>
<tr>
<td>Manufacturing</td>
<td>20</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>106</strong></td>
</tr>
</tbody>
</table>

The service sector included organizations such as banks, insurance agencies, software development companies, hospitals, hotels and restaurants, airlines, and health and fitness gyms, etc. Retail outlets and department stores were treated as retail sector. Construction companies and organizations that produced physical goods were clustered as manufacturing sector.

Based on the size of the workforce, the organizations were classified as small, medium and large. Since the focus of this study is management, we opted to use "number of people" as an indicator of size rather than sales volume or profitability. Companies with 50 or fewer employees were classified as "small", companies with 51 to 100 people were labeled "medium", and companies with more than 100 people were identified as "large". Table 2 shows the size breakdown for the 106 organizations.

Organizations in the study were also divided into three groups based on their age, i.e., the number of years in operation. Organizations that had been in operation for 10 years or less were classified as "young" organizations; companies that had been in business for 11 to 20 years were
labeled as "established" organizations; companies that had been in business for 21 years or longer were classified as "mature" organizations. Table 3 presents the age breakdown for the 106 companies.

Table 2: Organizational Size

<table>
<thead>
<tr>
<th>Size</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small Size Organizations (1-50 people)</td>
<td>67</td>
</tr>
<tr>
<td>Medium Size Organizations (51 - 100 people)</td>
<td>12</td>
</tr>
<tr>
<td>Large Size organizations (101 people or more)</td>
<td>27</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>106</strong></td>
</tr>
</tbody>
</table>

Table 3: Organizational Age

<table>
<thead>
<tr>
<th>Age</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Young Organizations (1-10 years)</td>
<td>28</td>
</tr>
<tr>
<td>Established Organizations (11 - 21 years)</td>
<td>23</td>
</tr>
<tr>
<td>Mature Organizations (21 years or longer)</td>
<td>54</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>106</strong></td>
</tr>
</tbody>
</table>

Results

R1: When top management was asked to describe their management style, nearly all identified one of three familiar approaches (Classical, Human Relations, Human Resources). Table 4 presents the distribution of styles identified by respondents.

Table 4: Management Style

<table>
<thead>
<tr>
<th>Style</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Classical</td>
<td>29</td>
</tr>
<tr>
<td>Human Relations</td>
<td>29</td>
</tr>
<tr>
<td>Human Resources</td>
<td>44</td>
</tr>
<tr>
<td>Systems</td>
<td>2</td>
</tr>
<tr>
<td>Hybrid</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>106</strong></td>
</tr>
</tbody>
</table>

R2: To understand the nature of communication in the 106 organizations, four dimensions of communication were studied: content, direction, channel, and style. In classical management, the content of communication is mostly related to duties, work, and tasks. Further, classical managerial orientations involve a concern for control of key processes with management seen as the source of leadership and innovation. In a human relations approach communication content is concerned with social interactions as well as tasks with some organizations emphasizing personal relationships as a mechanism for producing motivation and hence increased performance. The human resources approach to management also encourages initiatives and innovations from the workers. It tends to view organizational members as assets whose knowledge and skills (human capital) can and must be leveraged to power organizational attainment. In considering communication it must be acknowledged that these traditional managerial approaches constitute an approach to communication. Hence the communication content is a mixture of task, social interactions, and innovations. Table 4 presents the content of communication in the organizations in Singapore.

Table 5: Communication Content

<table>
<thead>
<tr>
<th>Communication Content Type</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Task</td>
<td>32</td>
</tr>
<tr>
<td>Task and Social</td>
<td>44</td>
</tr>
<tr>
<td>Task, Social, &amp; Innovation</td>
<td>28</td>
</tr>
<tr>
<td>Task &amp; Innovation</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>106</strong></td>
</tr>
</tbody>
</table>

R3 & R5: In organizations using the classical style of management, the flow of communication is usually from the management to the workers, i.e., from top to bottom – or vertical and downward. In Human Relations style of management the communication not only flows from top to bottom but also horizontally among the workers. In Human Resources style of management the communication flows from top to bottom as well as from bottom to the top. In other words, the vertical flow is both upward and downward. Additionally, communication also flows horizontally. Table 6 presents the observed and perceived flow of communication in the organization in the present study.

Different management styles employ different channels of communication. Managers in the Classical tradition prefer written instruction, memos, and email. Managers in the Human Relations approach rely on face-to-face communication or a combination of written and face-to-face communication. Table 7 presents the different channels of communication used by different organizations. Style of communication can vary from extremely formal where people address each other by their family names to informal where members or management and the workforce are all on first-name bases.

Some organizations may maintain a formal structure between the management and the workforce, and an informal style among the similar ranks. Table 8 presents the styles of communication in the 106 organizations in Singapore.
Table 6: Communication Flow

<table>
<thead>
<tr>
<th>Flow/Direction of Communication</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Downward</td>
<td>20</td>
</tr>
<tr>
<td>Vertical and Horizontal</td>
<td>35</td>
</tr>
<tr>
<td>Multi-directional</td>
<td>45</td>
</tr>
<tr>
<td>Downward &amp; Upward</td>
<td>2</td>
</tr>
<tr>
<td>Horizontal</td>
<td>2</td>
</tr>
<tr>
<td>Vertical</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>106</strong></td>
</tr>
</tbody>
</table>

Table 7: Communication Channels

<table>
<thead>
<tr>
<th>Channels</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Written only</td>
<td>9</td>
</tr>
<tr>
<td>Written &amp; Face-to-face</td>
<td>27</td>
</tr>
<tr>
<td>Face-to-face</td>
<td>36</td>
</tr>
<tr>
<td>Face-to-face &amp; e-mail</td>
<td>16</td>
</tr>
<tr>
<td>Written, face-to-face, &amp; e-mail</td>
<td>13</td>
</tr>
<tr>
<td>All channels</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>106</strong></td>
</tr>
</tbody>
</table>

Table 8: Communication Style

<table>
<thead>
<tr>
<th>Style</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal</td>
<td>19</td>
</tr>
<tr>
<td>Informal</td>
<td>48</td>
</tr>
<tr>
<td>Formal &amp; Informal</td>
<td>39</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>106</strong></td>
</tr>
</tbody>
</table>

Discussion

During the past 50 years, while Singapore’s neighboring nations such as Indonesia, Malaysia, and Thailand, concentrated on manufacture of electrical appliances and garments, Singapore focused on high-end technology and electronic equipment for computers and telecommunications. Not unlike the United States of America and the Western European countries, Singapore, in the past three decades, has moved away from manufacturing and moved into service industries. Even though Singapore is popularly known as shopper’s paradise, the main thrust of business in this city is that of services – financial planning, banking, insurance, healthcare, higher education, hotels, and the industry leader in air travel service – Singapore Airlines (along with Tiger Airlines an aggressive discounter with a new terminal at Changi International Airport). It is not surprising that nearly 70% of the businesses included in the present survey fell in the service category.

As Table 2 suggests, nearly one-fourth of the businesses are large companies employing over 100 people. These are mainly multi-national financial, manufacturing, and construction companies. However, what is more typical of Singapore are smaller sized companies. Two thirds of the businesses included in the study have a workforce of fewer than 50 people. Many of these businesses are family owned and operated concerns where family members from two, sometimes three, generations are working together. The elderly have the managerial and decision-making positions and the younger employees are receiving training for more responsible roles in the future. Unlike the large companies, the smaller companies offer a better scenario reflecting the culture in Singapore.

Singapore gained her independence from the British rule and then from the Malaysia in 1965. In this regard, it is a very young country. However, some of the businesses from the days of the colonial era are still in operation. More than half of the businesses in Singapore have been around for more than 20 years; three-fourth of the businesses have been in operation for over 10 years. This is a reflection of both economic stability and continuity of cultural traditions.

Table 4 demonstrates that the business environment in Singapore mirrors the philosophy of “working together.” The human resources style of management emphasizes maximum creative input from all employees. A little over 40% of the businesses claim to employ this style of management. A closer analysis of these companies shows that 63% were in the service sector, 22% in the retail sector, and the remaining 15% were in the manufacturing sector. It was also noted that 63% of human resources management style companies were small in size (fewer than 51 people), 14% were medium size companies (51-100 people), and 23% were large companies.

The results suggest that the human resources style of management is the prevalent style of management in Singapore and that most of the businesses are within the service sector, most of the business are small size operations, and most of the businesses have been around for more than 20 years. These observations are indicative of two things: one, these findings attest to continuous economic stability in the country, and two, working together, respect for others, and family cohesion are important cultural driving forces in Singapore.

Communication in Businesses in Singapore

Organizations that favor the classical style of management use a vertical, downward flow of communication where the content of messages is task related. It is usually conveyed in writing through letters or email, and the style is formal. In Human Relations management style the communication flows from management to workers but also among the workers. Hence there is downwards as well as horizontal
communication. The content is not only task but also includes social interaction. Messages are transmitted in writing as well as in face-to-face interaction, and the style is informal. In the Human Resources style of management, the content includes task, social, and innovative input from the workforce. The communication flows in all directions, using all channels of communication and is mostly informal in nature.

References

Determinants of Customer Satisfaction and Country Effect on the Satisfaction Assessment: The Case of Mobile Communications Service

Jung-Wan Lee, Kazakh-British Technical University, Republic of Kazakhstan
Simon W. Tai, Bang College of Business, KIMEP, Republic of Kazakhstan

This study identifies determinant factors for customer satisfaction with mobile communications service and examines country effect on the customers' assessment of satisfaction. Empirical data was collected from two surveys in South Korea and Kazakhstan during 2006. Factor analysis, multivariate regression analysis, and analysis of variance have applied to the empirical data. The results of the study show that there exist significant country differences in determinants of customer satisfaction. This study concludes that the determinants of customer satisfaction vary widely by the factors of socio-culture and market development stage.

Parasuraman, Zeithaml, and Berry’s (1994) conceptual model suggested that customer satisfaction was influenced simultaneously by service quality, product quality, and price (see also Bei & Chiao, 2001, 2006). This study is to examine the influence of perceived service quality, product quality, and price benefits on customer satisfaction in mobile communications service industry. In addition, this study examines how perceived service quality, product quality, and price benefits differently influence customer satisfaction, owing to the moderating effect of the varying conditions of market development in different countries. The paradox in cross cultural consumer research is that, although worldwide consumers may be similar in many ways, there exists many attitudinal or behavioral differences that can be crucial in determining their satisfaction, and the current research may provide an opportunity for understanding consumers in terms of their cultural differences.

Since the late 1990s, many of Korean and Kazakhstani firms have found the mobile communications service market to be very attractive. After entering the market, many of these firms have found numerous significant differences among consumers in terms of their preferences and other demographical factors. For example, Korean and Kazakhstani young people prefer fancy and digital camera equipped handsets that differ significantly from aged people. Therefore, to examine the underlying values within consumers of mobile communications service markets of South Korea and Republic of Kazakhstan is important. What factors influence strongly customer satisfaction of the markets? What needs does a product satisfy for customers of each culture? There may be cultural bias in the evaluations of product quality, service quality and values, and their impact on customer satisfaction.

Accordingly, the objectives of this research are:

1. To examine relationship between customers’ perception of product attributes and customer satisfaction of mobile communications service industry.
2. To examine country effect on customers’ evaluations of satisfaction.

Market development of mobile communications service in Kazakhstan and Korea

In the time of information era, world economies are becoming more and more oriented toward information and communication services. Thus, electronic information, telecommunications and mobile services have been developing into one of the most important and fast growing industries since they are the bases for information generation, transmission, and sharing among countries. In the same token, the mobile communications service market is also becoming one of the fast growing industries in Kazakhstan.

The new subscriptions of mobile communications service in Kazakhstan have reached a fifty-sixty percent of annual growth, which placed mobile communications service industry in the top three of the most dynamically developing industries in Kazakhstani business market (Kazakh Telecom, 2006). Digitalized mobile communications service in Kazakhstan began when two Turkish companies (Turkcell & Rumeli Telecom) established their operations in 1998. Turkcell established GSM Kazakhstan as a joint venture with Kazakh Telecom (it created “K-cell” & “Active” brands) and Rumeli
Telecom established KarTel as a joint venture with Investel (it created “K-mobile” & “Excess” brands). They launched mobile communications network with the global system for mobile communications (GSM) standard, which makes international roaming very common between mobile phone operators and enabling subscribers to use their phones in many parts of the world. However, a third operator of mobile communications service in Kazakhstan, Altel introduced the code division multiple access (CDMA) standard, a digital cellular technology that uses spread-spectrum techniques, and is marketing new brand names such as “Dalacom” and “Pathword.” since December 2003.

GSM formats accounts for about 93% market share with additional opportunities for further market development as of the end of November 2005 (Kazakh Telecom, 2006). The two market leaders: K-Cell (58%) and K-mobile (35%), hold a total of 93% of the market shares in Kazakhstani mobile communications service market, see Table 1 for the details. A report by Kazakh Telecom (2006) indicated that the mobile communications service market in Kazakhstan continues to maintain its increment ratio of new subscribers at an average of 5% every month, and at this time, it is at a growth or diffusion stage of the market. Furthermore, Kazakhstani government is going to liberalize the mobile communications service market in order to increase competition.

Table 1. Market development of mobile communications service in Kazakhstan and Korea

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Technology standard</td>
<td>GSM</td>
<td>GSM CDMA CDMA CDMA CDMA</td>
</tr>
<tr>
<td>Service providers</td>
<td>Kazakh Telecom “K-cell”</td>
<td>KarTel “K-mobile”</td>
</tr>
<tr>
<td>Product brands</td>
<td>“Active”</td>
<td>“Excess”</td>
</tr>
<tr>
<td>Number of subscribers</td>
<td>3.1 mil.</td>
<td>1.9 mil.</td>
</tr>
<tr>
<td>Market share</td>
<td>58%</td>
<td>35%</td>
</tr>
<tr>
<td>Total subscribers (penetration rate)</td>
<td>5.4 millions (35%)</td>
<td>36.4 millions (86%)</td>
</tr>
<tr>
<td>Total populations</td>
<td>15.4 millions</td>
<td>42.3 millions</td>
</tr>
</tbody>
</table>

The mobile communications service industry has played a crucial role in generating added value for Korean economy, and because of the growth of its service market, the mobile communications service industry in Korea is considered as the top tier in the information communications technology (ICT) value chain. A report by National Computerization Agency of the Republic of Korea (2006) indicated that one of the major reasons for the rapid growth of the ICT service industry during the 1990s, 10% or even more annually, was that mobile communications service and the Internet service created new markets rather than replacing existing markets. In addition, the explosion of ICT service market has brought about a dramatic development of ICT equipment sector, and as the result, the overall ICT industry became a growth engine for the Korean economy during the 1990s. The mobile telecommunications service industry had signed up a total of 36.4 million subscribers at the end of 2005 (Ministry of Information and Telecommunications of the Republic of Korea 2006).

In Korea, three operators have shared the mobile communications service market: SK Telecom (it created “SKT011” brand), Korea Telecom (it created “KTF016” brand), and LG Telecom (it created “LGT019” brand). SKT011 is still the leading player of mobile communications service market in Korea with 18.7 million subscribers, which was about 51.3% of the total market share as of November 2005. At the same time, KTF016 had reached 11.7 million subscribers or 32.2% of the market share, and LGT019 had reached 6 million subscribers or 16.5% of the market share, see Table 1 for details. Currently, the mobile communications service market in Korea keeps its increment ratio of new subscribers at an average of 0.5% per month, and it is at the maturity stage of the market (Ministry of Information and Telecommunications of the Republic of Korea 2006).

Literature Review and Hypothesis Formation

Product quality

Past marketing studies have generally suggested that when customers provide higher product quality evaluations, their behavioral intentions towards the company and brand...
tend to be more favorable, and they are more likely to remain as customers. Because quality is positively associated with the degree of product/service success, managers must be able to successful implement those marketing strategies and activities so as to raise customers’ perceived quality to another higher level. More often than not, many customers use extrinsic characteristics to judge product quality. Dawar and Parker (1994) suggested that customers used brand name, price, company reputation, and physical appearance of products as signals of product quality.

Service quality is a major component of relative service advantage, and many empirical studies affirmed that service quality was highly related to product/service success (e.g., Chang & Wildt, 1994; Dawar & Parker, 1994). Similarily, higher perceived service quality and higher satisfaction tend to result in higher levels of purchase intentions and repeat actual purchases (see Zeithaml, 2000). Customers may rely on surrogate cues to evaluate service quality in those situations where they are unable to compare competing services side-by-side as they do with competing products. Moreover, since the actual quality of services can vary from customer to customer and from region to region, marketers should try to standardize their services in order to provide consistency of service quality. In addition to the vast amount of support in the service quality literature concerning a link between customer interests and future purchases (e.g., Boulding, Kalra, & Staelin, 1999; Zeithaml, Berry, & Parasuraman, 1996), the idea that customers prefer greater service quality is intuitive, particularly if price and other cost elements are held constant.

It is very likely that mobile communications service quality is of special importance to customers who want to value product quality or service quality over price. Therefore, the following hypothesis is formed:

**Hypothesis 1:** Customers’ perception of product (communications) quality has an effect on the assessment of their satisfaction with mobile communications service.

**Price**

Many of past studies (Chang & Wildt 1994; Sinha & DeSasbro 1998) had found that customers rely on price as an indicator of product quality and that customers attribute different qualities to the identical but different price products. In addition, such customer characteristics as age and income affect the perception of value. Liechtenstein, Ridgway and Nitemeyer (1993) suggested that customers using a price-quality relationship are actually relying on a well-known brand name as an indicator of quality without actually relying directly on price. According to Brucks and Zeithaml (2000), customers use price and brand to evaluate the prestige of the product but do not generally use these cues when they evaluate the product’s performance.

Typically, the effect of price on customer satisfaction has been considered after the relationships among service quality and customer satisfaction in service industries (Athanassopoulos, 2000; Varki & Colgate, 2001). Still, it has been suggested that perceived price benefits play an important role in customer satisfaction and retention (Varki & Colgate, 2001). As to the relationship between price and customer satisfaction, research has shown that price was one of the determinants of customer satisfaction (Anderson, Fornell, & Lehmann, 1994; Zeithaml & Bitner, 2000). When customers were asked about the value of services rendered, they consistently considered the price charged for the service (Anderson, Fornell, & Lehmann, 1994). Price benefits must have an influence on customer satisfaction (Parasuraman, Zeithaml, & Berry, 1994) as well as on behavioral intentions (Varki & Colgate, 2001).

Applying the above findings, the authors infer that customers make use of price to evaluate the quality and performance of mobile communications service in satisfying their needs. Therefore, the following hypothesis is proposed:

**Hypothesis 2:** Customers’ perception of price has an effect on their assessment of satisfaction with mobile communications service.

**Corporate image and pioneering brand**

Quite a few marketing managers have argued that customers make their purchasing decision based on the benefits they received rather than on product features and/or company image. However, firms enjoying favorable images generally find that their new products are more readily accepted than products from those firms who have less favorable images. Past studies (Alden, Steenkamp, & Batra, 1999; Alpert & Kamins, 1995) have found that customers tend to have favorable perceptions of pioneer brands, which are the first in a product category, even after many more follower brands become available. Pioneering brands or the first brands to enter a new market often enjoy a long-term customer preference advantage over follower brands. This preference advantage, known as the pioneering advantage, has been observed in a variety of product markets that include growing markets, mature markets, and markets with low brand-switching costs (Gurumurthy & Urban, 1992; Urban, Carter, Gaskin, & Mucha, 1986). The pioneering brand is novel and interesting, and tends to attract much more attention from customers than a redundant, less interesting, and copycat brand. Moreover, the phenomenon has very important implications for managers since it suggests that all firms should try the best to get their ICT products and services to the market as soon as possible.

Extending the above discussion to mobile communications service market, the authors hypothesize that customers apply their images of service operators to evaluate the mobile communications service quality and their satisfaction with these products or services. Therefore,
the following hypothesis is proposed:

*Hypothesis 3: Customers’ perception of corporate image has an effect on their assessment of satisfaction with mobile communications service.*

**Country effect**

Lefkoff-Hagius and Mason (1993) distinguished between product characteristic, beneficial, and image attributes that influence consumer behavior in preference and similarity judgment. The preference is defined in terms of the customer’s judged distance between an existing product and an ideal product, while similarity is defined in terms of the customer’s judged distance or proximity between products. The same researchers further proposed that what is important to the customers at the time when they judge the similarity of products does not necessarily match what is important to them when they evaluate products for purchase.

The ICT industries are becoming one of the most important industries since they are the bases for generating, transmitting, and sharing information in any country. The ICT industry therefore was defined as a strategic sector that plays an important role in the development of a country’s economy, especially in developing countries. That is, customers in developing countries may use price and brand image to evaluate the prestige of the product rather than to evaluate the product’s characteristic attributes.

Applying the above reasoning, the levels of customer satisfaction may vary with the different levels of economic development as well as the market development. Therefore, the authors formulate the following hypothesis:

*Hypothesis 4: Customer satisfaction of mobile communications service tends to vary with levels of economic development and stages of market development in different countries.*

**Methodology**

To measure the perceptions of service attribute variables, this study employed survey questions measured at an interval scale. Respondents are asked to indicate their degree of agreement on a symmetric scale (for example, 1=not agree, 7=strongly agree) for each of the twelve (12) items concerning their perceptions of each attribute and their degree of satisfaction with the service. For measuring customer satisfaction, this study uses a single item to measure customers’ overall satisfaction with the level of service rendered.

The first survey was conducted in Seoul, the capital city of the Republic of Korea, during the period from September to November 2006. The second survey was conducted in Almaty, the largest city in Kazakhstan, during the same period of 2006. A total of 636 usable questionnaires were obtained in Seoul and 813 usable questionnaires were completed in Almaty. In total, 1449 respondents were completed for data analyses.

Of the Korea respondents, 43 percent was female and the mean age of the sample was 24.7 years old. Of the Kazakhstan respondents, 58 percent was female and the mean age of the sample was 26.7 years. The Korea respondents were spending an average of 51 US dollars (Mean=$51.3, Standard Deviation =24.4) for the monthly expenses of mobile communications service and had an average of 6 years (Mean=6.2, S.D.=3.6) experience in using mobile communications services. The Kazakhstan respondents were spending an average of 31 US dollars (Mean=$31.3, S.D.=25.4) for the monthly expenses of mobile communications services and had an average of 4 years (Mean=4.2, S.D.=2.8) experience in using mobile communications service.

To find a variable reduction scheme that would result in the best linear combination of independent variables, the principal components analysis procedure was applied to transform the original variables (responses to the 12 items in the survey questionnaire) into the new set of linear combinations. To increase the interpretability of components and parsimony, Varimax Rotations with Kaiser normalization procedures were employed. From KMO and Bartlett’s Test, the surveyed data has obtained Kaiser-Meyer-Olkin measure of sampling adequacy of 0.834 and Chi-square statistic of 6087.066, degree of freedom of 78, with the significance of 0.000 by the Bartlett’s Test of Sphericity. After conducting the principal component analysis, the authors derived a three-component model in which each component is represented by the linear combination of multiple survey items that have the highest loadings (>0.500) with the component. These three components were named as “product quality,” “price” and “corporate image,” respectively. Results from the above analyses indicate that the total variance of the model explained by rotation sums of squared loadings has the cumulative value of 56.752%.

A reliability analysis of the measurements and correlated items in this study provided the following results: the component of “product quality” obtained the highest reliability coefficients of Cronbach value and validity (Cronbach’s Alpha=0.781, Items=4); the component of “corporate image” achieved a reliability coefficients of Cronbach’s Alpha=0.746 with 5 items; and the component of “price” attained a reliability coefficients of Alpha 0.651 with 3 items, respectively, see Table 2 for details.
Table 2. Results of factor analysis and reliability test

<table>
<thead>
<tr>
<th>Items</th>
<th>Factor loadings</th>
<th>Eigenvalue</th>
<th>Extracted variance</th>
<th>Factor name</th>
<th>Corrected item-total correlation</th>
<th>Alpha</th>
</tr>
</thead>
<tbody>
<tr>
<td>Communication quality</td>
<td>0.840</td>
<td>2.739</td>
<td>21.073%</td>
<td>Product quality</td>
<td>0.686</td>
<td>0.781</td>
</tr>
<tr>
<td>Connecting speed</td>
<td>0.764</td>
<td></td>
<td></td>
<td></td>
<td>0.595</td>
<td></td>
</tr>
<tr>
<td>Area of coverage</td>
<td>0.738</td>
<td></td>
<td></td>
<td></td>
<td>0.574</td>
<td></td>
</tr>
<tr>
<td>Communication security</td>
<td>0.579</td>
<td></td>
<td></td>
<td></td>
<td>0.487</td>
<td></td>
</tr>
<tr>
<td>Number of subscribers</td>
<td>0.806</td>
<td>2.595</td>
<td>19.961%</td>
<td>Corporate image</td>
<td>0.552</td>
<td>0.746</td>
</tr>
<tr>
<td>Contents providing</td>
<td>0.697</td>
<td></td>
<td></td>
<td></td>
<td>0.598</td>
<td></td>
</tr>
<tr>
<td>Company image</td>
<td>0.655</td>
<td></td>
<td></td>
<td></td>
<td>0.456</td>
<td></td>
</tr>
<tr>
<td>Repairing services</td>
<td>0.624</td>
<td></td>
<td></td>
<td></td>
<td>0.477</td>
<td></td>
</tr>
<tr>
<td>Value added services</td>
<td>0.506</td>
<td></td>
<td></td>
<td></td>
<td>0.475</td>
<td></td>
</tr>
<tr>
<td>Hand-set subsidies</td>
<td>0.798</td>
<td>2.043</td>
<td>15.718%</td>
<td>Price</td>
<td>0.443</td>
<td>0.651</td>
</tr>
<tr>
<td>Discount offerings</td>
<td>0.626</td>
<td></td>
<td></td>
<td></td>
<td>0.456</td>
<td></td>
</tr>
<tr>
<td>Service charge tariff</td>
<td>0.565</td>
<td></td>
<td></td>
<td></td>
<td>0.482</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>56.752%</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Kaiser-Meyer-Olkin measure of sampling adequacy = 0.834
Chi-square = 6087.066, degree of freedom = 78, significance = 0.000 by the Bartlett’s Test of Sphericity.
Extraction method: Principal Component Analysis.
Rotation method: Varimax with Kaiser Normalization.

Results of Data Analysis and Hypothesis Test

Measures of association are numerical values that yield information about the relatedness of variables. The measure of association applied in this study is multivariate regression analysis, which is the process of determining a measure of the strength degree of relatedness between many independent variables and a dependent variable. A regression model is employed to explain variations of the customer satisfaction by perceptions of product attributes (mobile communications service). In order to assure that a set of variables can achieve its maximum explanation power under the condition of maintaining a parsimonious model, the sequential search method, which provides an objective method in selecting variables that can maximize the explanation power with the smallest number of variables, was employed. The partial correlation coefficients for these independent variables and the partial F value for the overall regression model were examined.

The obtained factor loadings of the three components and a dummy value for country effect were included in the independent variables, and overall degree of customer satisfaction was used for the dependent variable. Possible transformations of the data to remedy violations of various model assumptions, such as the normality on the shape of the distribution, homoscedasticity (the equality of variance dispersion), linearity, and the relationships between variables are examined. Scatter plot with residuals and normal p-p plot of regression standardized residual are employed to identify cases with particular influence on the result.

Regression coefficients are expressed in terms of the units of the associated variables, thereby making comparisons inappropriate. Since Beta coefficients in the regression model are the standardized regression coefficients that allow for a direct comparison between coefficients with respect to their relative explanatory power on the dependent variable, they were used for the direct comparisons of this study. The partial t-values were calculated and used to test the statistical significance of the independent variables in the regression model.

The “null hypothesis 1: customers’ perceived product quality has no effect on their assessment of satisfaction with mobile communications service,” was empirically tested by the survey data. The null hypothesis cannot be rejected by the statistical significant test, thus, the empirical data does not support that the customers’ perceived product quality is associated with the levels of customer satisfaction.

The “null hypothesis 2: customers’ perceived price have no effect on their assessment of satisfaction with the service,” was tested by the empirical data. The null hypothesis is rejected by the statistical significant test at
The result of the test shows that the perceived price of mobile communications service is negatively related to levels of customer satisfaction, see Table 3 for details. Therefore, the empirical data affirm that customers’ perceived price of mobile communications service has negative effect on the levels of customer satisfaction. For example, the higher the perceived price, the lower the levels of customer satisfaction with the service.

The “null hypothesis 3: customers’ perceived corporate image has no effect on their assessment of satisfaction with the service,” was empirically tested by the survey data. The null hypothesis is rejected by the statistical significant test at the 5% significant (t-value=5.661, significance=0.000). That is, customers’ perceived company image of mobile communications service providers has positive influences on the levels of customer satisfaction. For example, the higher the perceived corporate image, the higher the levels of customer satisfaction with the service.

Since empirical data were collected only in the two countries: Korea and Kazakhstan, the hypothesis-4 has to be modified accordingly. Therefore, the null hypothesis is stated as follows. The “null hypothesis 4: there is no difference in the levels of customer satisfaction with mobile communications service between the two countries of Korea and Kazakhstan,” was empirically tested by the survey data. The technique of a dummy value, in which a dummy independent variable is used for the multiple regression analysis, is applied in this study. The null hypothesis is rejected by the statistical significant test at the 5% significant (t-value=5.309, significance=0.000). This result affirms that Kazakhstani customers tend to evaluate higher level of satisfaction with mobile communications service than that of Korean customers in this study.

### Table 3. Outputs of regression analysis (by OLS) and hypothesis test

<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>Independent variables</th>
<th>Estimates (Standard error)</th>
<th>Standardized estimates</th>
<th>t-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>H1</td>
<td>X1: Product quality</td>
<td>0.009 (0.027)</td>
<td>0.009</td>
<td>0.364</td>
</tr>
<tr>
<td>H2</td>
<td>X2: Price</td>
<td>-0.091 (0.028)</td>
<td>-0.085</td>
<td>-3.239***</td>
</tr>
<tr>
<td>H3</td>
<td>X3: Corporate image</td>
<td>0.181 (0.032)</td>
<td>0.169</td>
<td>5.661***</td>
</tr>
<tr>
<td>H4</td>
<td>X4: Country effect: KZ</td>
<td>0.355 (0.067)</td>
<td>0.165</td>
<td>5.309***</td>
</tr>
</tbody>
</table>

Model: \( Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 \)

The dependent variable (Y): Customer satisfaction

A dummy independent variable (X4) has used for country effect (i.e., Kazakhstan=1).

\( R=0.315, R^2=0.099, Adjusted \ R^2=0.067, F=39.763 \) (sig. 0.000)

**p<0.05, ***p<0.001 statistically significant at \( \alpha=0.05 \) with 95% confidence interval

To examine details of the country effect, an analysis of variance (ANOVA) of the product attribute dimensions was applied to the two countries’ mobile communications services. As shown in Table 4, there are statistically significant mean differences at alpha=0.05 level of the mean values between Kazakhstan and Korea. The results of ANOVA affirm that there are significant differences in the mean values of “product quality” (F-value=7.859, significance=0.005), “corporate image” (F-value=544.736, significance=0.000), and “price” (F-value=110.130, significance=0.000) dimensions of the product attributes between the two countries.

### Table 4. ANOVA outputs of Mean differences of the two countries

<table>
<thead>
<tr>
<th>Product attribute</th>
<th>Levene Statistic</th>
<th>Sig.</th>
<th>Kazakhstan</th>
<th>Korea</th>
<th>Total</th>
<th>F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product quality</td>
<td>61.318</td>
<td>0.000</td>
<td>6.055(1.084)</td>
<td>5.772(1.459)</td>
<td>5.914(1.272)</td>
<td>7.859**</td>
</tr>
<tr>
<td>Price</td>
<td>3.080</td>
<td>0.079</td>
<td>5.803(1.232)</td>
<td>5.436(1.525)</td>
<td>5.619(1.378)</td>
<td>110.130***</td>
</tr>
<tr>
<td>Corporate image</td>
<td>6.436</td>
<td>0.011</td>
<td>4.196(1.506)</td>
<td>5.193(1.533)</td>
<td>4.695(1.519)</td>
<td>544.736***</td>
</tr>
</tbody>
</table>

**p<0.05, ***p<0.001 statistically significant at \( \alpha=0.05 \) with 95% confidence interval

N = 636 813 1449
Contrary to Korean consumers, a larger group of the Kazakhstani respondents concerns seriously “price” attribute, in which yield a mean value of 5.803 out of 7 point scale with the standard deviation of 1.232 in their perceptions. In particular, service charge had a mean value of 6.384 (S.D.=0.900) in their weights of importance. Possible reasons for explaining the above results are that the consumers’ perceptions towards mobile communications service tend to vary by a country’s market development stage and/or the economic development conditions of the country. This means that economic rationale is still most critical factor for customers’ evaluation of satisfaction with products or services in developing countries.

Managerial Implications and 
Conclusion

The results of this study affirm partly that customer satisfaction is influenced simultaneously by service quality, product quality, and price (see also Bei & Chiao, 2001, 2006; Parasuraman, Zeithaml, & Berry, 1994), and that customers’ assessments of products attributes tend to vary depending on market development stage and economic development conditions. Thus, determinant factors of customer satisfaction vary by countries and/or markets.

The results of hypothesis-4 test, in particular as shown Table 4, affirm that customers have a number of enduring perceptions that are particularly relevant to their satisfaction in service markets. In maturity market stage like the mobile communications service market of Korea, customers tend to use the service provider’s image attributes to assess the degree of their satisfaction with the service. Customers tend to use brand name, number of subscribers, repairing and after service, and a provider’s product reputation as signals of product quality and their satisfaction with the products or services. However, in market development stage or diffusion stage like that of Kazakhstan, economic rationale is still most critical factor for customers’ evaluation of satisfaction with products or services, in particular, in developing countries.

However, there is a subtle discrepancy: what is important to the customers when they judge the quality of products is not necessarily match with what is important to them when they evaluate their satisfaction with the products. Consequently, products or services with a well-known brand name or with a favorable corporate image are likely to provide customers with a sense of familiarity and security by leveraging positive attitude. In this situation, companies should keep their marketing communications and promotion open in order to increase their brand awareness or corporate image by reinforcing their product benefits instead of introducing price competition itself.

On the contrary, particularly in a growth or diffusion stage of the market, price benefit offerings should become a beloved marketing strategy for the success of products in today’s competitive marketplace. If the product satisfies the market with a price, it will enter a growth or diffusion stage, in which sales will start climbing quickly. The early adopters will continue to purchase, and even later adopters will start to follow their lead.

The mobile communications service market is increasingly complex. For example, the products have shorter life cycles, and the need for quicker decisions has been growing because of the increasing competition and continually evolving customers’ expectations from service providers. Companies that can get new and improved products to the market faster and sooner than other competitors often gain a competitive advantage. They can respond more quickly to emerging customer tastes. The results of the empirical testing imply that the product characteristic attributes alone might lead a marketing failure in ICT markets.

References


This paper examines telework as an alternative method of work organization. A literature review is presented of different aspects of the problem. In the first part of the paper theoretical discussion is presented concerning telework and the conditions for its successful implementation. In the second part of the paper, a real-life example of telework application in a Polish microenterprise is presented. Some identified advantages and disadvantages of telework are presented and discussed, as observed in the example.

A key factor in happening economic transformations is modern IT – communication technology. Its dynamic growth causes, in addition to social and economic progress, thorough changes in the structure and forms of employment. New data communication technologies make the notions of space and time acquire completely different meanings, and in the economic aspect the phenomenon of globalization of economies starts to function typical of the information society. The development of electronics, computer science and new technologies of information transfer and communication leads to movement of employment from agricultural and industrial sectors to the services sector. The passing from the industrial society to IT society in which the so-called new economics emerge with huge possibilities of economic growth, is not without effect on forms of work.

Under the happening virtualization of business operations, flexible forms of organization of work, which include, among others, teleworking, are more and more commonly used. Teleworking starts to shape the image of the contemporary organization coexisting with other symptoms of the information society in which new concepts are developed such as learning organization, knowledge or intellectual capital management. The development and popularization of this form of work organization carries along a number of consequences. It brings some economic benefits and organizational challenges. It creates also some social hazards.

In subject literature we may find a number of descriptions of teleworking created in different periods of development of this form of work organization. In the initial phase each form of replacing work-related commuting by IT technologies was considered as teleworking. The then IT level stimulated its perception first for all as a method of solving the problem of access to work, and not the form of work appropriate for a modern organization. It was no sooner than in 1987 under the effect of popularization of the notion of telecommuting, which means periodic work outside the main office, when it started to be examined as a form of work organization [Babik W., 1998]. Presently teleworking (telework, telecommunig, Telearbeit) is connected with the concept of virtual organization and is examined as a result of the evolution of information technology and the increasingly relative nature of the physical workplace, recognizing that this is a modern form of mental work organization, implemented outside the traditional workplace with the use of the latest means of IT-communication techniques and technologies.

According to S. Normann, primary features differentiating teleworking from other forms of mental work organization include workplace flexibility, flexibility in work time organization, high level of technical equipment and IT qualifications of the contractor [Normann S., 2000]. Teleworking should be perceived first of all in the context of the changing nature of work towards more flexible work, going beyond traditional forms [Depta R., http://www.idn.org.pl/]. Location of work is not the restricting factor anymore. Work, especially mental work becomes in a sense independent from the place of its execution. While in the industrial society industrial production requires that the employee reaches the place of work, in the information society data communication
networks deliver the production factor – information – to the person [Dziuba D., 1998].

The application of data communication technologies is sine qua non condition of teleworking. A common element of all kinds of teleworking, differentiating it from other works performed outside the traditional workplace is use of computers and telecommunication to implement specific tasks. Therefore it can be concluded that teleworking limits the scope of professions and work posts to those for which the main object of work is information. It requires not only a high level of instrumentation, based on the latest data communication technologies, but also appropriate, computer qualifications of contractors.

As a result, teleworking is not only a form of stimulation of the disabled or a way to restrict access to work, but becomes a pillar of the mobile information society, consolidating communication and accelerating the development of the IT sector.

Owing to some restrictions concerning the nature of work, required qualifications of contractors and access to new data communication technologies, teleworking should be perceived as a desirable, for economic and social reasons, supplement of traditional forms of work organization. The concept of global computer network operating on the basis of a uniform set of information transmission principles enables realization of principally all the activities comprising the information function [Rafa J., 1997]. Thanks to the data communications infrastructure, work at distance has become already reality in many countries.

Work performed in the system of teleworking may in practice take different forms. Their differentiation is made first of all with regard to the potential places of performing work assisted by IT networks. According to this principle U. Huws distinguishes its three categories, namely telehomeworking namely work performed only at home, multilocations teleworking, meaning performance of work partly in office and mobile teleworking (freelance teleworking and mobile working), including various kinds of works performed by employees of commercial services [Huws U., Korte W. B., Robinson S., 1990].

A similar classification is proposed by R. Depta, distinguishing telehomeworking, homebased teleworking being an equivalent of multilocations teleworking, nomadic teleworking, namely mobile work, performed mainly outside the offices of the company and ad hoc teleworking denoting support type services related to the idea of functional relocation and assuming implementation of services-oriented functions of a business at a distance by positions concentrated in one place [Depta R., http://www.idn.org.pl/].

An interesting perspective of classification is proposed by H. Dąbrowski. This author, taking account of the present kinds of teleworking, has distinguished its two functional types; the first one reducing commuting to the traditional workplace and intended for people strongly bound with home or the disabled, and the second one, determined by requirements of business operations and appropriate for the so-called mobile employees, for example agents, consultants etc. [H. Dąbrowski, 1999]. The first type of teleworking being supplement of traditional forms of work organization can lead to professional stimulation of social groups for which an open labor market would not be fully available. On the contrary, the second type is a form of work organization increasing the effectiveness of implementing these functions of a business where information plays a critical role.

By lifting restrictions related to time and place of work, teleworking imposes certain requirements on the organization. It is commonly believed that expectations from teleworking as a source of individual, business and social benefits in many cases have not been met not so much owing to technical and technological barriers, but due to inappropriate organisational solutions, and being more accurate, owing to failure to adjust the organization and the business management system to its requirements [Depta R., http://www.idn.org.pl/.., Dąbrowski H., 1999].

For this form of work to exist, and thereby for a virtual organizational to develop, it is necessary to enhance vertical and horizontal bonds between employees. Therefore, the application of data communication technologies is a sine qua non condition of teleworking, forcing specific solutions in the sphere of equipment of work posts.

According to T. Depta standard equipment of positions in the teleworking system includes, in addition to a computer with a modem, additional tools like e-mail and specialized software [Depta R., http://www.idn.org.pl/..]. An important condition for effective teleworking is to maintain the requirement of compatibility of the technical parameters of data communications software and hardware.

The traditional approach to teleworking examines it from the point of view of a single employee. In reality, teleworking should be perceived from the perspective of the whole organization. Teleworking is not only change of location of work, but, first of all, change of the management system and work organization. The essence of teleworking assumes development of informal contacts and increase in personal responsibility. Therefore, it requires change in the management philosophy and work organization methods, certain transformations in the culture of organization, changes in the style of management, shaping of proper relations between superiors, and subordinates, introduction of relevant systems of working time organization and reward.

Effective management in the system of teleworking is based on considerable decentralisation and delegation of rights, it demands precise determination of the tasks to be done and concentration more on the outcomes rather than on the course of work. Here management by tasks or results technique is preferred. The system of planning and control
is adapted to the nature of the tasks being implemented and the type of interdependencies occurring between them.

Here there are three types of dependencies of the tasks being implemented, namely unit, sequential and mutual interdependence determine the scope and intensification of the coordination function [Dąbrowski H., 1999]. The first assumes no interpersonal contacts. Tasks are a unique part of a more complex process, therefore, the coordination function is narrowed down. The second one envisages unidirectional flow of information, similar to the flow of semi-finished products in the conditions of assembly line production. And finally the last one assumes multiple information flows between employees, remaining in the cooperation relationships and demands efficient coordination.

High level of organizational culture and appropriate employee qualifications support and promote work flexibility, employee independence, trust and high importance of the need of accomplishments make traditional forms of control no longer popular in the system of teleworking. Current control over the course of the process is assumed by the contractor, while the manager performs periodic control over performance being achieved.

M. Pańskowska classifies control of outputs and effects, behaviors, social control and self-control, performed by teleworkers as primary methods of control in the system of teleworking [Pańskowska M., 1999].

Teleworking also carries the requirement of high and constantly developed employee qualifications, strictly related to the kind of the works being performed. The analysis of past experience lets us distinguish two categories of works being realized in the system of teleworking. The first one is formed by relatively simple works related to data gathering and processing, telemarketing, tele-translations or execution of non-complicated accounting activities. On the contrary, the second one includes analytical – conceptual works in the area of science and technology, computer science, engineering programming, technical engineering, banking, insurance, consulting [Depta R., http://www.idn.org.pl/, Dąbrowski H., 1999]. As a result a problem appears of determining competences of potential teleworkers. Taking account of the highlighted categories of works present in the system of teleworking one can identify desired employee qualifications (Table 1).

Table 1 Competence models of teleworkers

<table>
<thead>
<tr>
<th>COMPETENCE EVALUATION CRITERIA</th>
<th>CATEGORIES OF WORKS IN THE SYSTEM OF TELEWORKING</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formal</strong></td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>Medium complex works, partly standardized</td>
</tr>
<tr>
<td>Qualifications in computer science</td>
<td>Complex works, analytical-conceptual</td>
</tr>
<tr>
<td>Additional qualifications</td>
<td></td>
</tr>
<tr>
<td><strong>Behavioral</strong></td>
<td></td>
</tr>
<tr>
<td>Character traits</td>
<td>Ability to concentrate, divisibility of attention, self-discipline, sense of responsibility, mental resistance</td>
</tr>
<tr>
<td>Skills, attitudes and behaviors</td>
<td>Work organization and time management skills, loyalty, responsibility</td>
</tr>
<tr>
<td></td>
<td>Analytical thinking skills, communication, self-discipline, sense of responsibility</td>
</tr>
<tr>
<td></td>
<td>Work organization and time management, problem solving skills, readiness to learn, loyalty, responsibility</td>
</tr>
</tbody>
</table>

Source: prepared by the authors

Using a set of formulated criteria facilitates proper selection of employees for work in the system of teleworking. At the same time, it is worth noting the already occurring phenomenon of professional and economic polarization of teleworkers. Clearly, one may easily note that a side effect of the division of works in this system is not only diversity of competence, but also pay.

Flexibility of time and workplace, growth in self-reliance of employees and change in the way of implementing the control function, make it necessary to introduce certain solutions in the sphere of reward. Monthly pay related to time – bonus based form of reward is replaced with pay per task and for the achieved result. In some cases it is also justified to use team forms of reward. The threat of coming back to piecework forms of reward,
especially in the case of performing non-complicated repeated works can be reduced using suitable methods of planning tasks and quality oriented performance control. It would also be reasonable to introduce suitable forms of bonuses, in particular quantitative – qualitative and interdependent bonuses.

It is commonly believed that teleworking, by lifting restrictions related to time and workplace, will contribute to establishing a new labor market [Dałbowski H., 1999]. The modeling of a new labor market in an information society involves however availability of assets and information technology. Therefore, the first problem that is already present is the phenomenon of the so-called digital society divide.

A social and – economic phenomenon emerging as a consequence of teleworking is development of new professions. Here, reference is made particularly to the so-called IT occupations, namely specialists in the field of data communications technology such as for instance database administrators, systems designers and engineers, system analysts or computer programmers.

Teleworking also answers expectations of organizations aiming to minimize operating costs and improve work efficiency in the administrative sphere. Though it is necessary to sustain specific investment to develop appropriate data communications infrastructure, this is nevertheless compensated by a number of measurable and non-measurable economic effects. It is estimated that teleworking system efficiency grows from 20 to 40%, and its sources are sought in better organization of work and greater concentration of teleworkers and smaller number of interruptions in work [Depta R., http://www.idn.org.pl/, Dałbowski H., 1999, Pańkowska M., 1999]. The correct interpretation of teleworkers' efficiency improvements, and in particular its sources, is not that evident. Clearly, one may suppose that in some cases it derives from prolonged time of work.

In spite of that, one can share the view expressed by many investigators that the efficiency of teleworkers is determined by selection and compatibility of data communications technology, skill of work organization and time management, concentration on work outcomes, no factors disturbing the course of work.

The most important factors forming the economic effects of teleworking include apart from relevant competences and motivation of teleworkers - availability of appropriate informational resources, relevant compatible software on the home computer, fast data transfer, possibility to manage large applications remotely, costs settlement procedures in place, no interruptions in work at home [Depta R., http://www.idn.org.pl/, Kniaź A., Rzewuski M., 2001].

U. Huws claims that teleworking involves a number of benefits, but also threats. This can be a road to independence and satisfaction, but it can also be the means of social isolation and economic polarization [Huws U., Korte W. B., Robinson S., 1990]. A statement of its potential effects has been included in Table 2.

### Table 2. Statement of benefits and threats involved in teleworking

<table>
<thead>
<tr>
<th>AREA OF EFFECT</th>
<th>BENEFITS</th>
<th>THREATS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Employee</strong></td>
<td>possibility of performing work in home conditions, reduction of time of access to the place of work, possibility of planning rest according to one's own needs, improvement in family life.</td>
<td>social alienation, dehumanization of work, prolonged working time.</td>
</tr>
<tr>
<td><strong>Organization</strong></td>
<td>increase in efficiency of work in the administrative sphere, reduction in office costs, more flexible structure of organization, higher employee loyalty, lower employee absence, better use of electronic connections.</td>
<td>substantial financial investment in data communication networks, risk of loss of control over information resources, probability of breaking the hierarchy of authorities in the organization, difficulties in planning and control of work, risk of loss of corporate identity, return of piecework forms of reward.</td>
</tr>
<tr>
<td><strong>Professional stimulation</strong></td>
<td>professional stimulation of the disabled, improvement in interpersonal polarization,</td>
<td>digital divide of the society, professional and reward polarization,</td>
</tr>
</tbody>
</table>

102
Particularly alarming is the threat of social isolation of teleworkers. To prevent it, one should use, as proposed by U. Huws, various communication methods in particular remote consultations, daily contacts with managers through electronic mass media, cyclical inspections or periodic meetings of teleworkers [Huws U., Korte W. B., Robinson S., 1990].

The presented, selected aspects of teleworking are not exhaustive in view of its quite complex problems. Above all, they pay attention to the need to create appropriate conditions for implementing and development of this form of work organization. Irreversible tendencies to virtualize business operations indicate clearly that it will be an important supplement of traditional forms of work. Below an example has been presented of practical application of teleworking in a microenterprise in Poland.

**Teleworking in practice in a small company**

transmart.pl is a microenterprise offering translation services, acting mostly as a subcontractor for large translation companies. The company was established by its present owner in 2006. The company has its own unique translation support system, developed for many years by the owner. The system offers significant productivity improvements, drastically shortening translation times and improving translator's comfort at work as well as contributing to ensuring high quality and consistent translations.

The translations market in Poland is a very competitive market, where two groups of enterprises can be distinguished. One group are few large companies, specialized in performing large projects and serving large corporate clients. The other, much more numerous group are small microenterprises, offering services for small and medium enterprises and individuals. One of the reasons is that there are virtually no entry barriers to the market - practically everybody having appropriate qualifications and skills may begin offering services on the market. With so many entities, it is very difficult to successfully begin business on the market. Being aware of the situation, transmart.pl has opted for an aggressive pricing strategy. From the very beginning, the owner's vision was to utilize and take advantage of the benefits arising from the in-house developed technology. Therefore, the consequent market strategy was to offer translation services at very low prices in order to act as a subcontractor for other translation companies. In this way the company has intended to collect many orders from other translation companies, making use of the productivity improvements offered by its own unique technology, what would result in high turnover and profits.

The primary foundation of the business was the unique technology that the owner has been developing for years. The technology is based on the principle of combining and leveraging two main aspects: repetitions in language (in translations) and ergonomics. The company's system is divided into two elements. One element is the central translation support system, where most language processing takes place. The system processes text to be translated, based on unique algorithms, utilizing linguistic and statistical principles, and a huge database of translated texts. The central system generates files with multiple phrases, which are delivered for final translation to the translators. The translator uses the files with phrases to build the final text, picking most appropriate phrases, changing order of the words/phrases, or adding his or her own suggestions, if none of those proposed by the system is appropriate. At this stage, the translator uses the second element of the system - Input Panel client application, which has been designed to ensure as convenient and comfortable work to translators as possible, thereby shortening translation times. Translated text processed by the translator is then transferred back to the central system, which produces a document containing translated text, which, after formatting adjustments, is sent back to the client.

With such a structure of the system, teleworking has been selected as the main principle of operation. Although the possibility was considered to rent an office and employ translators for work at the office, the owner opted for teleworking, as the principal method of work for translators. This decision was mostly due to the business strategy, which, assuming low pricing, put pressure on cost reductions to ensure sustainable business.

One may distinguish two separate business processes in transmart.pl, whose participants are the organization and employees (translators). As the translators are working remotely, all these business processes are entirely virtual, and involve no direct contact between the business and the employees. The processes are:
- new translator recruitment and induction training process
- translation ordering and making process

<table>
<thead>
<tr>
<th>Society relations, lower environmental contamination, reduction in automobile traffic intensity, infrastructure cost reduction.</th>
<th>unclear differences between free time and working time, disappearance of social bonds.</th>
</tr>
</thead>
</table>

**New translator recruitment and induction training process**

The process begins with a candidate sending their CV to the company's email address. Since good translators as a rare resource, the company constantly posts employment offers on various career portals. Candidates for translators send their CVs to the company's email address. In reply, they receive a document with a number of short trial texts, which they have to translate to let the company evaluate their language skills. If their trial translations are regarded as good enough, transmart.pl qualifies them to the second step in the recruitment process. The company sends them an email with the following attachments:

- transmart.pl Input Panel application
- transmart.pl Input Panel user's manual
- 2 trial phrase files to be translated

In the email, candidates are instructed how to install and operate the program. They are supposed to translate the phrase files being sent - these are two texts, 5 pages each, already transformed to transmart.pl Input Panel phrase file format. The purpose of this stage in the recruitment process is to familiarize potential translators with the software and see how they manage with a longer, more homogenous texts, similar to those that they would expect in their future daily job. Also, they are verified in terms of how motivated they are to do this work (for some freelance translators it takes a long time to complete this stage). At this stage, the company is in touch with them to coach them in using the system. After sending the trial files back, transmart.pl provides feedback to the translator on the way the translations have been made. The comments sent to the translator are both of linguistic nature (common errors), as well as technical nature (how well the translator has coped with operating the Input Panel software). The next stage is signing of the contract, which is sent again by email. The translator sends the signed contract back by regular mail, the contract is signed by transmart.pl, and one copy is sent back by regular mail to the translator. For legal reasons, this is the only stage in this process that requires documents to be sent by regular mail.

**Translation ordering and making process**

The main process involving teleworkers in transmart.pl is the translation ordering and making process. After the central system has generated phrase files for the original translation order, the company selects one of the cooperating translators who have signed contracts with transmart.pl as the person to make the translation. In the central system, the translator is assigned to the document to be translated. Then, a special email is automatically generated by the system. A zip file with all phrase files is attached to the email. The email content includes a table with all necessary data concerning each of the phrase files being sent:

- deadline (by when the translator has to send the file back)
- size (how large is the phrase file)
- language code (languages of the original text and the translated text)
- credit points (number of credit points according to which each translator is remunerated; credit points depend on size of the file and qualification of the text to be translated; each translator has a rate per credit point individually fixed in their contract).

Along with the email, a notification message (sms) is sent to the translator's mobile phone. In this way, the company makes sure that the translator is almost immediately informed about the upcoming order. Now the translator has to confirm the order by replying to the email with an empty reply message. The message is received by the central system and changes the status of the order to 'confirmed by translator'. If the translator cannot accept the order for any reason, he or she sends a notification email/sms, or calls the company. When there is no feedback from the translator, transmart.pl contacts the translator after some time, and the duration of this period depends on the time remaining until the order deadline, so as to ensure that the order can still be sent to another person (maximum one day). As the conclusion of the process, the translator sends ready translation files back to the company.

A common feature of all the processes is their high degree of structuring. This is partly due to the requirements of the translation support system being the company's 'backbone'. Such structuring certainly assists in effective teleworking, as it greatly facilitates the company's contacts with cooperating translators. A disadvantage of highly structured processes involving teleworking is that the people involved may feel 'depersonalized'. They know that the emails they receive are standard messages, generated by a computer system.

**Advantages of telework in transmart.pl**

At transmart.pl, the main advantage of telework are certainly as low operating costs as possible. With such teleworking system up and running, the company bears virtually no fixed costs. Translators work at their homes and the company does not have to provide office space for them. At the present size of the company, it only needs to provide two working posts for office employees - one main translation manager (operating the system, contacts with translators) and one office manager (contacts with clients, client orders, accounting, etc.). It is not only office space that is saved but also equipment. Although nowadays computer hardware is not expensive, the company still saves money and, last but not least, maintenance effort by using translator's personal equipment. There is no need to care for hardware maintenance or computer network administration.
Flexibility is the second main advantage of telework in transmart.pl. The company orders as much as it receives from clients, and does not have to sustain costs, unless directly related to texts being translated. On the part of translators, they value flexibility in their work, since they do not have to begin or finish work at certain times, and can work as much as and when they feel like doing it. The only time-related restriction, which must be observed by the translators, is the deadline.

**Challenges of telework in transmart.pl**

Challenges related to telework begin at the stage of recruiting new translators. At the first stage, transmart.pl sends a set of short trial texts to potential candidates. Only one in five returns ready texts. With traditional face-to-face recruitment, if a candidate is not successful, there are more possibilities to see and examine the reasons for their failure (too difficult text, other reasons for resignation). In other words, when an appointment for a job interview is made, people seem to treat it more seriously than a situation where they are supposed to send back a short trial translation by email.

However, at transmart.pl, the greatest telework-induced problem is weak contact employer-employee. This issue is related to psychological perception of this relation, which for most people should involve personal contacts (both employee-employee and employer-employee). After a few months' work, many translators admit that they are tired of having no personal contact with people at work. Apart from financial compensation, there are practically no other elements allowing an employee to develop bonds with the company. To address this problem, transmart.pl considers organization of regular "real life" training to provide a platform for translators to meet together with the others and the company.

This problem of employee alienation is aggravated by the fact that translation orders are not very regular. Some days are busy, others are completely free. Translators find other ways to spend free time. As a result, they often refuse to make a translation, claiming that they have already planned other activities (have guests, go to the cinema, etc.), not expecting work to 'come'. On the other hand, the company is, obviously, sending orders to translators who are good and most available timewise. In this way, the group of permanent collaborators is shrinking, only because of this seamless process eliminating some translators who, however good they may be, find it difficult to effectively manage their own time and availability.

A significant problem raised by the owner is no feedback information from translators. In a traditional job, the manager sees people every days, talks to them, has an opportunity to see and early notice potential problems that may arise and affect their work. With telework, workers communicate their problems or decisions to the manager as late as possible, and, the manager has no possibility to see in advance any signs of an upcoming decision, as the group is not working personally together in one room. At transmart.pl, translators communicate information about their time availability at the very last moment, and thus it is very difficult for the company to plan people's availability ahead in time. One possibility examined by the company is to introduce in the future a system of credit points just for availability - translators declaring their time availability ahead would get financial compensation. Problems in planning future capacity contribute to the owner's cautiousness in extending marketing and promotion activities, as there is no certainty about the company's potential in the future.

All these factors express translators' weak identification with the company. They admit that they treat this work as a part-time, temporary job. The only thing that keeps them working is money, and they are still looking for other jobs, which might potentially give them more than just financial compensation. A result is relatively high employee turnover, and the need to constantly search for new staff.

The second large group of telework-related problems faced by transmart.pl are technology and infrastructure problems. One common problem is low general level of computer skills among translators. Often, they are language professionals, and some simple computer operations, such as simple installation of software (Input Panel) on a PC, create very basic problems, which they are unable to solve on their own. transmart.pl is therefore forced to provide technical assistance to them, in some cases going beyond remote phone or videoconference consultation and involving a visit at the translator's home. This problem is inherently bound to the fact of utilizing the remote method of work, and thus it is particularly difficult to solve. Related problems include hardware incompatibilities as well as insufficient or irregularly available Internet connection. In the past, transmart.pl made attempts to address these problems by buying laptops with mobile Internet connection cards and providing this equipment to translators in need. Given however the above outlined other problems, causing high employee turnover, this solution was not effective.

The development of telework requires appropriate technical and organizational solutions. First of all, it is necessary to provide access to technical communication media and build computer networks to remove the physical barrier of distance between the office and the employee. It is also necessary to popularize good employee professional development programs that might ensure supply of staff with required qualifications. The main condition for telework development is to build a management system, appropriate and adapted to the specific nature of telework, to reduce organizational and social threats.
The example of transmart.pl shows that, even with very sophisticated technology solutions, effective implementation of teleworking depends much on management solutions to address identified staff-related problems.

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Strategies of Companies in the Conditions of Globalization and Economic Transformation - the Example of Poland

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System transformation in Central and Eastern Europe created for countries of the region on the one hand opportunities of possible participation in globalization processes, but on the other hand, put those countries and their companies against the need for coping in new, turbulent terms with strong competition of great international corporations. Basing on the concept of Dawar and Frost it can be stated that strategies that Polish companies may use, for few of them it is the strategy oriented at improving their complexity, and thus of "a contender" and "an extender", according to the Dawar-Frost concept. For the majority of them more appropriate may above all be the strategy of vertical desintegration of activities, and basing on their core competences (reduction in complexity), which allows for operation within the global value chain and global network organisations (equivalent of the strategy of "a dodger" according to Dawar-Frost). The above mentioned empirical examples of such companies as: PKN Orlen, Kęty Group, Stomil Sanok, or Apteki Polskie, indicate that strategic orientation of Polish companies successfully operating on the international market is consistent with those proposed.

Introduction

Globalization, including globalization of operations of companies, is unquestionable, and at the same time - as is commonly considered - inevitable. The driving force behind globalization are the Triad countries, within which about 80% of the world's production is processed, in spite of the fact that the total number of people living in those countries constitutes only some 20% of the world's population1. This clearly proves how uneven the development really is in different parts of the world, and also how asymmetric are the benefits from globalization. Countries of Central and Eastern Europe, mainly for political reasons, did not contribute to a large degree in earlier stages of globalization. Only the radical change of the situation in those countries, being a consequence of the collapse of communism, and transformation processes taking place in them, on the one hand enabled them to participate in globalization processes, but on the other hand - contributing through their opening to the global economy to acceleration of the processes of globalization - put them, and especially their companies, against the need for coping in the new turbulent terms with strong competition mainly with great international corporations. Among the countries of the former communist block, which formally as of the date of 01 May 2004 were integrated into the EU, Poland definitely dominates in terms of both its area and population.

Taking this into account it appears justified to analyze the requirements created by globalization that companies must meet, as well as draw conclusions with regard to strategies allowing companies of the so-called emerging economies, including Polish companies, to survive, and especially, develop in the conditions of growing globalization.

Determinants of companies' operations in the conditions of the New Economy

Globalization processes increase the complexity of the determinants of running business operations, what is associated with the occurrence of many correlated factors. First of all, as a result of mass media influence, increase in customer's mobility, and standardization of educational processes, standardization of customer requirements occurred on the one hand, but on the other hand, as a result of the development of the consumer market, we are dealing with growing individualization of demand. These seemingly contradictory tendencies prove the growing market segmentation in different countries, with different segments being homogeneous globally. A basic characteristic of the world market is thus development of multiple market segments, scattered all around the world. These circumstances allow for considering the world market as one single market, with all its segments being similarly structured, allowing producers to make use of the experience effect by servicing selected segment(s) on the global scale. However, a decreasing volume of the demand within segments resulted in sharpening of competitive fight, and consequently, in increasing the importance of creativity and innovation. Although it was already Schumpeter who stressed the importance of innovation for enterprises, but this importance is particularly clear with

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1 Stonehause G., Hamill J., Campbell D., Purdie T., Globalizacja. Strategia i zarządzanie, Felberg SJA, Warszawa 2001, p. 27
regard to competition in the worldwide environment. This is proved by M. Porter's competition of nations model (diamond concept). Innovation is important both in the event when a company uses the cost strategy (acquisition of unique ability to costs saving), as well as differentiation (ability to generate long-term differentiation).

High dynamics, instability of the environment requires very high flexibility of organization, and makes strategic planning difficult, and often even impossible. The problem is to determine how, in this situation, an enterprise is supposed to survive, develop, achieve competitive advantage. In a situation of relatively higher stability in the environment, enterprises normally focused on their more "tangible" resources, providing direct source of competitive advantage (such as production scale, technology, or quality management).

And then, on this foundation, they formulated their mission, stating who is the client of the business and what needs should the enterprise satisfy. Turbulence in the environment also implies rapid changes of clients and their needs. As a result, the enterprise concentrates more on responding to the question about things in which it is able to perform better than others, particularly those that apply to the production of various articles and services or to services for various clients. Thus, the type of activity conducted by the enterprise does not change - only products and markets (clients) do. Such an approach implies much higher importance of factors / resources that are "softer", intangible, and therefore more difficult to identify, grasp and evaluate, and consequently - to transfer.

In conditions of such dynamic environment, a company may obtain long-term competitive advantage, if it has the ability to create unique competences, has unique knowledge and ability to its development, as well as the skill of natural protection against takeover or imitation, and the company may obtain knowledge both from internal sources as well as from the environment. Knowledge becomes the most important capital of the organization, the so-called intellectual capital, since it is knowledge that produces value and generates profits. To ensure long-term competitive advantage in the increasingly globalizing world, the enterprise should achieve the status of the "best

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3 Therefore, one may conclude that changes occurring in the global environment are logical consequence of the socio-economic development, providing evidence that a new era has started in this development, the era of knowledge-based society (A. Tofler's third wave).


The activity of international companies in Poland

In 1999 the share of international companies in revenues of all companies operating in Poland amounted to 31.6%. The highest share of foreign enterprises in total corporate revenue can be observed in the processing industry and in transport, communications and warehousing
(40-50%), proving that these companies are very important for the national economy. However, as much as some 80% of the value of that revenue came from sales on the Polish market. In spite of this, international enterprises operating in Poland are twice as much export-oriented as local enterprises.5

The greatest investment boom fell on the second half of the 1990s, when each year the value of foreign direct investments was clearly growing, and reached its apogee in the year 2000 ($9.34 billion according to the National Bank of Poland (NBP)); (10.60 billion USD, according to PAIIIZ; Since then, an interest in the Polish market decreased (no sooner than in 2004 a clear increase in the value of investment could have been noted ($6.29 billion according to the National Bank of Poland, $7.86 billion according to Polish Information and Foreign Investment Agency (PAIIIZ)), but this growth was not significant despite Poand's entering the EU). This can be explained both by slowdown of the privatisation processes, as well as lack of improvement in qualitative conditions of functioning on the Polish market (administrative impediments, gaps in the legislative system, ambiguity of tax regulations allowing latitude in their interpretation by treasury offices, inefficiency of the judiciary, lack of incentives by local governments, low level of development of communication infrastructure etc.).

At the end of 2004 there were some 51,500 companies with foreign capital participation registered in Poland, of which - according to Polish Information and Foreign Investment Agency (PAIIIZ) 6 only 1101 invested more than $1mln, and cumulated value of foreign direct investments until the end of 2004 was estimated at $80.7 bn (according to the National Bank of Poland foreign investors invested $56,4 bn altogether). This capital was mainly invested in the manufacturing business (about 40%), financial intermediation (about 23%), trade and repairs (about 12%), as well as transport, warehouse economy, and communication (approx. 10%).

The year 2006 may be considered as a breakthrough period, in which according to the data of Polish Information and Foreign Investment Agency (PAIIIZ) and the National Bank of Poland (NBP) the value of foreign direct investments in Poland amounted to 11 billion Euros (about $15 billion US), and thus it was as much as about 44% higher as compared to the previous year (7.7 billion Euro) and the highest of all of the so-called new members of the EU. Significant beneficial changes in foreign direct investments do not only relate to their size (value), but first for all domains in which the investments are made. There has been a significant shift towards sectors of new technologies, electronics, as well as automotive and service-oriented sectors (centres of services). The largest foreign investors in Poland in the year 2006 were the following companies: Bridgestone, Dell, Sharp, Toyota, and Toshiba. Such structure of investment may result in intensification of technological diffusion and modernization of the Polish economy, and hence growth of its competitiveness. In the case of Polish foreign investments their value amounted in 2006 to about 3.5 billion Euros.

**Determinants of operations and strategies of Polish companies**

After the early beginning of intensified system transition and opening of the economy to foreign investors at the turn of the 1980s and 1990s operating conditions for Polish companies were very unfavourable. This was partly due to relatively low level of economic development, lagging significantly behind TRIAD countries. The main factors that determined this situation included unfavourable structure of the national economy, which was not oriented to the development of information and knowledge-based sectors (new economy)that are so important for active participation in globalization. Apart from a low level of technological development and under-investment in science and research and development works, what greatly influenced the very unfavourable situation of Polish companies were low capital resources, smaller, as compared with world companies, experience in operations in the conditions of market economy, as well as abrupt sharpening of competitive fight caused by entering and expansion of foreign companies, especially of great international corporations, whose competitive advantage resulted additionally from global scope of their operations. For the purpose of identifying as well as proposing strategies of survival and development of domestic companies in the conditions of expansion of international corporations, the matrix prepared by N. Dawar and T. Frost may be useful as it shows possible strategies of local enterprises on the so-called "emerging markets" (which apart from countries of Central and Eastern Europe - in which system transformation takes place - also include rapidly developing countries of South-Eastern Asia).
Figure. 1. The Dawar and Frost matrix

<table>
<thead>
<tr>
<th>Pressure on sector globalization</th>
<th>Competitive strengths (core competences)</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>- strategy of a dodger</td>
</tr>
<tr>
<td></td>
<td>- strategy of a contender</td>
</tr>
<tr>
<td>Low</td>
<td>- strategy of a defender</td>
</tr>
<tr>
<td></td>
<td>- strategy of an extender</td>
</tr>
</tbody>
</table>


The authors of this matrix assume that in order to determine the proper strategy of a domestic business standing against competition with great international corporations, the following parameters must be above all considered:

- focus on the sector's globalization,
- core competences (competitive strengths), which the domestic company offers, as well as
- the possibility of them being transferred to foreign markets.

Having determined core competences of the company, the next step is to analyze them from the point of view of the other two parameters, what assumes the form of a matrix (fig. 1)

According to the presented matrix, companies have four basic types of strategies available:

- strategy of a contender,
- strategy of a dodger,
- strategy of an extender,
- strategy of a defender.

Two former strategy types are followed when there is strong pressure on sector globalization, and thus a global strategy may be necessary for enterprises. The other two cases are rather related to multilocational sectors.

Strategy of a contender concerns companies running rather in global sectors, whose key competences may be relatively easily transferred to foreign markets. These companies can follow particularly the internal development strategy through mergers, acquisitions and strategic alliances, regardless of whether they operate on the local market, or within a niche in the global market. This strategy normally means that the company's sensitivity to environmental effects is reduced through increased complexity.

PKN Orlen may be considered as a company using a strategy similar to the strategy of "a contender". According to the data from the years 2005-2006 this company possessed more than 1900 fuel stations in Poland (which comprised 26% of the market), 490 stations in Germany, and 310 stations in the Czech Republic. The development of the company was mostly conducted by means of mergers, joint ventures, acquisition, so mostly through external forms of development. Apart from refineries in Poland, the concern owns 3 refineries in the Czech Republic, from May 2005 is the owner of a majority shareholding of the Czech Unipetrol holding, as well as (since June 2006) of the refinery in Možėjki (Lithuania) along with 30 stations. Total production capacities of the refineries amount to 31,7 million tons annually.

The contender strategy under a global market niche can also be identified in the case of ATM, a company that exports their own technical know-how under their own brand, and is already present not only on Central and Eastern European markets, but also in Africa and Southeast Asia.

Strategy of "a dodger" concerns companies possessing competences specific for a given local market, but operating in sectors of large globalization pressure. In this situation, the enterprise may leave the sector or aim at cooperating with a global corporation, often as one of its value chain links, but this normally requires reorientation, "slimming", and focus on core competences only. This strategy corresponds to the aforementioned vertical disintegration strategy as a method of facing the environmental complexity.

Stomil Sanok company may be an example of the company using a strategy similar to the strategy of "a dodger". A long-term strategy of operation chosen by management of this company, was based on the belief that the company must be present on European markets, must export its products, and must be subjected to deep restructuring aiming at modernization and expansion of assortment of its production. This strategy was implemented multidiirectionally. Firstly, Stomil Sanok was developing production in its traditionally strongest area (namely the production of rubber mixes and rubber products for the automotive industry, self-adhesive tapes for
weatherstripping of windows, and fan belts for industrial machines of agricultural equipment). Secondly, the company chose as its main goal development and enhancement of its position as a supplier of sealings for household equipment for domestic and foreign recipients, as well as entering the new, dynamically growing production market of sealings for window woodwork, developed in Poland by Western manufacturers. The company also assumed the implementation of two new product line in automotive industry: sealings for car bodies and rubber-metal products for anti-vibration systems. In this regard the company undertook cooperation with the largest companies of the automotive sector. For example, the FIAT concern should be mentioned here, with which Stomil Sanok began cooperation as early as in the end of 1980s, and GENERAL MOTORS, from which the company was awarded the Q1 Ford prize in 2001 for no complaints throughout the whole year. Presently, the automotive business (sealings for car bodies and anti-vibration systems) constitutes about 45% of revenue of the company.

The result of actions undertaken by the management of the company, was improvement in financial performance, including a four-times revenue increase, and a five-times increase in net profit over the years 1993-2003, threefold increase in work efficiency, and significant reduction in employment, as well as acquisition of the market in new areas, and increase in export from 7 to 50% of sales.

Strategy of "an extender" refers to companies operating in sectors where strong pressure on globalization is not present, but which possess transferable core competences. In these conditions, the strategy should be focused on maintaining and consolidating the company's strong competitive position on the local market, and, with internationalized operations, on entering those foreign markets where similar business conditions exist - from the point of view of the business concerned. An example can be domestic products delivered and sold to emigration clusters.

Kety Group may be mentioned as an example of the company using a strategy similar to the strategy of "an extender". This company, as a result of the conducted restructuring, gained an increase in profitability and market position, and thereby the market value. Sales of the company almost doubled. In the years 1996-2002 it increased from 393 to 623 million zloty. This was an effect of: entering into more profitable market segments (packaging, aluminium fittings, aluminium facade systems), increasing the portfolio of customers by adding great corporations, building very good relationships with small recipients, and increasing the complexity of the offer. A significant cost reduction of its production should also be mentioned, as a result of modernization of the machines conducted by the expenditure of 335 million zloty, reduction in the level of administrative costs and doubling of work efficiency.

Strategy of "a defender" is present in the event when competences of the company are not transferable to other markets, but actually, this is not necessary, since the company operates in the sector in which strong pressure on globalization of operations is not present. In this situation, the enterprise should aim at maintaining and possibly improving its competitive position on the market and on consolidating its key advantages (competences) so as to make them difficult to be taken over (e.g. by consolidating customer loyalty).

Apteki Polskie (Polish Pharmacies) may be an example of the company using the strategy of "a defender". This company is the implementation of an enterprising, as far as the conditions occurring in Poland at the threshold of a new millennium, concept of creating a large and modernly managed network of pharmacies. In the year 2000 the Polish pharmacy market was already fairly expanded, but its consolidation and implementation of modern know how stagnated at the stage of wholesale turnover. The strategy of authors of the project was based on the following goals: building within eight years a network of three hundred pharmacies, taking over around 7-8% of the market, with an average margin higher by 2% than the market average. This concept assumed location of points of sale with the "Apteka 21" logo in the neighbourhood of clinics and hospitals, in commercial centres on the basis of exclusivity of operation, and on major streets of cities with big pedestrian traffic intensity. These assumptions were successfully realised. "Apteki 21" pharmacies were to reach its competitive advantage not only as a result of network operation (joint purchases, identical stock management procedures, etc.), but also due to organizational reasons, in particular due to rationalization of the policy of goods (management of stock and purchasing common to the whole network). Such approach enabled the implementation of the margin higher than average for the sector. The advantage which "Apteki 21" obtained in the field of marketing is also extremely important. Not only did they create the first brand network in the industry (with the use of the concept of visualization of its sites consistent for the whole network) and realized pioneering loyalty programs, but above all, conducted advertising campaigns and promotions in selling points together with wholesalers and manufacturers, using gains arising from economies of scale. The network focused on selling medicines without prescription, herbal pharmaceuticals, and cosmetics, what principally was supposed to produce a half of the overall sales value, implemented also within the then-novel concept on the Polish market of self-service sales. It is also worth consideration that implementation of the assumptions adopted by authors of the project, the Apteki Polskie company gained in 2001 revenues from sales at the level of 8,3 million zloty, while as soon as in the year 2003 the revenues amounted to as much as 109,1 million zloty.
Using the Dawar and Frost terminology it can be stated that in the outlined situation of considerable advantage of international corporations, a dominant kind of strategies of internationalization of Polish companies was the strategy of "a dodger". The companies that followed this strategy often act as subcontractors and their products are not sold on consumer markets under Polish brands. For instance, Ikea from Sweden, cooperates with over 130 Polish enterprises.

A similar situation can be observed in other industries, in particular in food, cosmetic, textile, home appliances sectors, where many Polish manufacturers sell their products on world markets under sellers' names. Applying this type of strategy can be regarded as an intermediate step, allowing the company to reappear later on the foreign market under a brand of its own.

In spite of those actions, none of the Polish companies found its place on the announced in the year 2003 by UNCTAD list of 20 largest in terms of the value of foreign assets transnationals based in Central and Eastern Europe. This may reflect still limited participation of domestic companies in the globalization processes.

**Summary**

The analysis conducted allows for observing that opening of the Central and Eastern Europe market caused the inflow of foreign direct investments, and the share of international corporations in creating gross domestic product is high. Nonetheless, this part of Europe is regarded by foreign enterprises mostly as a sales market. Any products manufactured in these companies' local branch units are mostly sold on the domestic market, and not exported. Furthermore, most of the foreign direct investments refer to sectors that do not belong to the so-called "new economy", do not increase the level of competitiveness of the Polish economy in the triad countries. This makes active participation in the benefits of globalization difficult for Poland. An appropriate state policy could counteract these tendencies, which would favours the development of new technologies, the development of society based on knowledge, and the development of sectors of the "new economy".

On the other hand, globalization and political transformation created for Polish companies an opportunity for the development of entrepreneurship and entry to the world's markets. These companies are in a far more difficult situation, owing to their development arrears and difficulties with access to capital, than international corporations, already experienced in operations on the world market. The basic ways of survival and for development in highly turbulent domestic markets and the global market is for few of them the strategy of increasing their complexity, what in accordance with the Dawar and Frost concept may conclude the form of the strategy of "a contender" and "an extender", or the strategy of vertical desintegration of activities and beign based on their core competences (reduction in complexity), which enables operation within the global value chain and global network organisations - the strategy of "a dodger".

In the authors' opinion, it is particularly functioning within the global network organisations, creating to the company the possibility of using and developing their core competences, which constitutes for companies from countries subject to transformation a chance for active participation in globalization processes.

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In the perspective of contemporary business and economic challenges, the basis for creating a knowledge-based economy is to offer life-long education to the society. The issue of life-long learning is becoming one of the most frequent matters related to contemporary education raised in debates. Possibility of expanding available knowledge on a permanent basis, is, therefore, not only a strive for self-improvement, but also a measurable contribution to the development of the resources of the organization.

Employers, noticing the benefits which result from personnel development, more and more often are willing to invest in human resources expecting that employees will use the newly acquired knowledge for the good of the organization. At the present time the most popular are postgraduate studies, however, MBA studies are considered to be more prestigious, and enjoy growing popularity in Poland. Nothing indicates that this trend will be reversed in the years to come, what is clearly indicated by the fact that Poland aims at building a knowledge-based economy.

Knowledge-based society as the basis for creating a knowledge-based economy

Economy based on knowledge may be examined in the macro and micro-economic aspect. The first definition was formulated in a report prepared together by OECD and the World Bank:

A knowledge-based economy is an economy "where knowledge is created, absorbed, transmitted and used more effectively by businesses, organizations, natural persons and communities, stimulating rapid development of the economy and the society. This definition does not concentrate attention only on narrow hi-tech industry or information and communication technology. This definition rather creates a framework for analysing the whole spectrum of options regarding educational policies and the policy in information infrastructure and innovation systems that promote KBE development. This definition also emphasizes the role of better coordination between activities of the government, private sector and the civic society – to enhance competitiveness and accelerate economic and social development."  

A. K. Kożmiński proposes the following microeconomic definition:

"Knowledge-based economy is such economy, in which many enterprises operate that rely on knowledge as the source of their competitive advantage." 2 This definition confirms the need to create common bonds between the scientific and business environment. Only as a result of cooperation, it is possible to create a knowledge-based economy.

Further development of the definition by A. K. Kożmińskiego introduces, however, distinct macroeconomic elements:

"Knowledge is this intangible and difficult to copy business resource, which includes any kind of useful information that others do not have and are not able to use. Knowledge is a result of the intellectual potential, and thus building a knowledge-based economy I will here define as development of conditions conducive to formation and success of enterprises that rely on knowledge as the source of their competitive advantage. Those entities may be, among others, the state, local authorities, businesses (especially from the financial sector), intellectual and academic groups." 3

The key role of life-long education in the contemporary world is most reflected by education aspects, highlighted in a report by the UNESCO International Commission for Education for the 21st century, contained in the following words:

- Learn to know,
- Learn to act,
- Learn to live together with others,

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1 OECD – World Bank Institute, Korea and the Knowledge Based Economy. Making the Transition. Paris 2000
3 Koźmiński A.K op.cit.
Learn to be.\(^4\) At the same time UNESCO postulates that it is nothing else but life-long education to become the key for new technologies. It is supposed to ensure access to knowledge, gathered and processed by the information society. It also permits selection of the most important information, ordering of it as well as use it in the right way. Reforms promoted by UNESCO assume that each man, regardless of age has the right to life-long learning, as a result obtaining of the graduation diploma will not have to be equivalent to the end of education.

Learning society is the basic determinant permitting formation of a knowledge-based economy. It must dispose of ample resources, skills as well as willingness and skill of long-term action.\(^5\) One should formulate a question what basic characteristics characterize a knowledge-based society? It seems that there are 3 basic components:

- It must be a competitive society, this means one that acknowledges the principle of competition as the underlying mechanism of organization of the society, economy and the state. Certainly, one has to interpret the principle of competitiveness not in terms of the 19th, but the 21st century.\(^6\)
- It must be an innovative society, this means one in which processes of creation, diffusion and absorption of innovation find a stimulating social climate. In subject matter literature, a distinction has been introduced between innovation prone and innovation averse societies, namely societies aiming at innovation and those in opposition, societies averse to innovation.
- This must be a society in which an effective system of life-long education is in place. Traditional views that the effort of multiplication of knowledge and skills is related only with some fragment of our life are false. The 21st century will be a century of life-long education systems from the cradle to the grave. Economy-based knowledge may be created only by people who understand the need for permanent remodelling of their knowledge resources and skills.

In order to adjust the Polish sphere of education to the challenges it faces "Education development strategy for the period 2007-2013" and "Directional strategy of development of IT introduction to Poland until 2013 and perspective forecast of transition to the information society until 2020" have been prepared. In these documents one may read, among other things: "Realisation of education strategy goals are pursued by actions congruent with three priority areas of the Lisbon strategy: increased access to education, support for openness of the educational system and improvement in the quality of education. These areas overlap with action directions in Priority "Knowledge and competences" of the National Development Plan for the period 2007-2013.\(^8\) And Lisbon Strategy establishing as the main purpose transformation of the European economy into the most competitive and dynamic knowledge-based economy in the world emphasizes the importance of education and professional education as a path to achieve it. In this way, it emphasizes the need to adjust European education systems to the requirements of a knowledge-based economy.\(^9\)

In Poland the education system includes the following education levels:

- Primary school (6 years)
- Secondary school (3 years)
- High school (3 years)
- University (2 level studies approx. 5 years)

Graduating from a university-level school and obtaining a Master's or engineer's degree (special case are titles of a medical doctor, dental surgeon or veterinary doctor), is the basis for beginning postgraduate study programs that are precisely determined by the Act of 27 July 2005 Law on higher education (Journal of Laws of 2005 no. 164, item 1365:)

"postgraduate studies – other than higher education and doctorate (PhD) studies form of education meant for people with a diploma of higher studies"

### History of postgraduate studies on Cracow University of Economics and Cracow School of Business

Cracow University of Economics, as one of the oldest economic universities in Poland, has been operating for over 83 years. Nowadays over 20 thousand students graduate the University each year. Polish educational...
system provides several levels of education, which enables young people to create their educational interests in many ways. Bologna process, introduced in Poland, divided previous educational system (which consisted of 5-year Master studies) into two levels – 3-year Bachelor studies (first degree) and 2-year Master studies (second degree). Both degrees are free of charge studies. Besides the basic degrees of education the University offers also doctorate (PhD) studies and different kinds of MBA studies on full payment basis. Those two tracks of Master studies graduates are popular among universities all over the world. What is interesting in the Polish educational system are post-graduate studies. These are one-year or two-years studies finished with a diploma of post-graduate studies.

On 1973 the University created an Improvement of Managerial Personnel College (SDKK), which was targeted in educating persons holding managerial positions. Later on, in 1989 a School of Managers was created under SDKK. The School offered services in managers education on the terms of full payment. In 1990 SDKK’s place took Cracow School of Entrepreneurship (KSP). The postgraduate studies were then still conducted on faculties under different institutes. A year later KSP was liquidated and Cracow School of Entrepreneurship and Management (SPIZ) took its place. In 2007 SPIZ changed its name to Cracow School of Business.

Cracow School of Business offers postgraduate (over 50 majors) and MBA studies, as well as all kinds as short-term and long-term courses, research, consulting and editorial operations. The School educates over 1700 people each year. Its offer is supervised by the Program Board, which consists of professors of councils of departments of Cracow University of Economics.

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of students</th>
<th>Number of groups</th>
<th>Number of supervisors</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>1026</td>
<td>30</td>
<td>14</td>
</tr>
<tr>
<td>2001</td>
<td>1033</td>
<td>29</td>
<td>15</td>
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<tr>
<td>2002</td>
<td>1037</td>
<td>36</td>
<td>19</td>
</tr>
<tr>
<td>2003</td>
<td>1397</td>
<td>44</td>
<td>18</td>
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<tr>
<td>2004</td>
<td>1380</td>
<td>44</td>
<td>27</td>
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<tr>
<td>2005</td>
<td>1332</td>
<td>46</td>
<td>26</td>
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<tr>
<td>2006</td>
<td>1626</td>
<td>46</td>
<td>26</td>
</tr>
<tr>
<td>2007</td>
<td>2031</td>
<td>50</td>
<td>30</td>
</tr>
<tr>
<td>2008</td>
<td>2485</td>
<td>52</td>
<td>30</td>
</tr>
</tbody>
</table>

As one may easily notice in the next figure, the growing number of fields of study is accompanied by the growing number of fields of study launched. This proves growing interest in continuous learning and gaining new skills.

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of fields of study offered</th>
<th>Number of fields of study launched</th>
<th>Number of cooperating institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>14</td>
<td>14</td>
<td>2</td>
</tr>
<tr>
<td>2001</td>
<td>23</td>
<td>15</td>
<td>4</td>
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<tr>
<td>2002</td>
<td>34</td>
<td>19</td>
<td>5</td>
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<tr>
<td>2003</td>
<td>33</td>
<td>20</td>
<td>7</td>
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<tr>
<td>2004</td>
<td>38</td>
<td>17</td>
<td>9</td>
</tr>
<tr>
<td>2005</td>
<td>47</td>
<td>22</td>
<td>9</td>
</tr>
<tr>
<td>2006</td>
<td>48</td>
<td>22</td>
<td>14</td>
</tr>
<tr>
<td>2007</td>
<td>51</td>
<td>29</td>
<td>15</td>
</tr>
<tr>
<td>2008</td>
<td>51</td>
<td>29</td>
<td>15</td>
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</tbody>
</table>

As visible on the next figure, Cracow School of Business prides themselves of having more students every year. The growing number shows that there are many candidates willing to broaden their knowledge and skills through postgraduate studies.

Cracow School of Business cooperates with many local institutions: local council units, companies, centres of culture, higher education schools and vocational colleges. It also cooperates with foreign units like Stockholm University School of Business from Sweden, St. Gallen Business School from Switzerland, ESC Clermont-Ferrand Graduate School of Management from France, and Grand Valley State University from the United States. The School was granted the prestigious AACSB International accreditation (Association to Advance Collegiate Schools of Business), which emsishes its high quality of teaching.
This is an accreditation held only by 455 institutions in the world.13

**Postgraduate studies in Poland**

Postgraduate studies are meant for graduates who have obtained a master's or engineer's diploma. A frequent practice is to admit graduates who have already got the certificate of completed studies and take an obligation to submit the master's diploma until completion of the studies. Bachelor diploma normally is not accepted, (although there are variations from this rule). Profile of the completed school normally does not have any importance. Unless having a special knowledge is necessary for active participation in the class program (e.g. on technical studies).

These studies are the most common way of gaining additional knowledge after graduating from a university-level school. One may attend them in more than 250 institutions in Poland, offering classes to expand knowledge in practically each domain. Last year 150717 people were attending postgraduate studies in Poland. Growth in the number of students in postgraduate study programs is presented on Fig. 3

**Postgraduate studies in the Cracow School of Business**

The Higher School Banking, for 16 years of operation, has grown its offer from initial 14 fields of study, to 51 being offered this year. Changes occurring in the Cracow School of Business are presented on Fig. 4

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of students</th>
<th>Number of field of study offered</th>
<th>Number of field of study launched</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>1026</td>
<td>14</td>
<td>14</td>
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<tr>
<td>2001</td>
<td>1033</td>
<td>23</td>
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<td>2002</td>
<td>1037</td>
<td>34</td>
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<tr>
<td>2003</td>
<td>1397</td>
<td>33</td>
<td>20</td>
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<tr>
<td>2004</td>
<td>1380</td>
<td>38</td>
<td>17</td>
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<tr>
<td>2005</td>
<td>1332</td>
<td>47</td>
<td>22</td>
</tr>
<tr>
<td>2006</td>
<td>1626</td>
<td>48</td>
<td>22</td>
</tr>
<tr>
<td>2007</td>
<td>2031</td>
<td>51</td>
<td>29</td>
</tr>
<tr>
<td>2008</td>
<td>2485</td>
<td>51</td>
<td>29</td>
</tr>
<tr>
<td>2009*</td>
<td>2393*</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>2010*</td>
<td>2797*</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>2011*</td>
<td>3254*</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>2012*</td>
<td>3764*</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

*data estimated on the basis of second level polynomial trend function.
X data not taken into account during estimation.

To encourage potential students, schools offer a wide offer of specialized fields of study, tailored to the needs of students. An education degree significantly affects the amount of earnings in Poland. Pay of graduates of higher education institutions is on average 55% higher than that of employees having only secondary school education15. One may at the same time note that in spite of the fact that the decision on starting postgraduate study programs normally is made by the employee, employers more and more often are willing to finance studies in the amount between 50-70%.

To facilitate distinction between different fields of study being offered, they have been systematized in 7 major groups:

- Company and market (7 fields of study)

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13 „School of Entrepreneurship and Management Cracow University of Economics”, School’s informational brochure, School of Entrepreneurship and Management, Krakow, 2007, pg. 13

14 Prepared by the authors on the basis of “Higher school and their finances in 2006”. (ed.) Alina Baran, National Statistical Office (GUS) 2007, Warsaw page 27

15 „OECD reports about higher education”, OECD 2007, France, page 68

16 Prepared by the authors on the basis of „School of Entrepreneurship and Management Cracow University of Economics”, School’s informational brochure, School of Entrepreneurship and Management, Krakow, 2007, pg. 22
MBA programs in Poland

MBA studies in Poland began in the early 1990’s, being very competitive from their beginning. In the first years of the existence of MBA programmes in Poland, Polish universities made use of their foreign partner universities experience, which supplied almost 100% of lecturers. Gradually this number was decreasing until it reached 50% of foreign and 50% of Polish lecturers.17

MBA studies are evolving and their shape becomes more attractive for students each year. The modules are concentrated on interactive classes, business processes simulations, managers laboratories and projects in cooperation with enterprises.

Polish membership in the European Union creates many possibilities for European or global career paths. This marks the markets opening for Polish managers, whose business possibilities are now broader than ever.

When Polish manager decides which Polish MBA program to start, he must take into consideration few important factors:
1. ranking of MBA studies in Poland (prepared by The Association of Management Education SEM FORUM or by one of the prestigious business newspapers)
2. foreign partner university (it’s rank, reputation, position in Europe and in the world)
3. accreditations obtained
4. number of class hours during the whole program
5. subject content
6. type of classes (theory, practical classes, case studies, laboratories)
7. language of classes
8. diploma obtained18

Association of Managerial Education FORUM has prepared a ranking of MBA programs in Poland. It has divided the programs in four categories: master, professional, standard and promising. The evaluation has taken many different criteria into account, among them one could find:
- the method of recruitment,
- the importance of the university and it’s partner,
- selection of lecturers and teachers,
- number of practitioners in business meeting with the program students,
- quantitative and substantive aspects of education process,
- final graduation conditions (thesis, business project etc.).19

In this ranking Executive MBA conducted on Cracow School of Business was classified in the master class (along with 11 other programs). Among the master programs there were mainly four scientific centres – Cracow, Warsaw, Poznań and Gdańsk. In the same ranking International MBA at Cracow School of Business has been classified, among 15 other programs, to the professional class.

Not only the Forum Association creates yearly rankings of MBA studies. “Wprost” weekly business and politics newspaper each year creates a comparison of the Polish MBA programs since 2002. For the past few years, as seen on the next figure, the Cracow School of Business has been heavily working on raising the significance and rank of its programs.

Fig.6 Cracow School of Business in the WPROST ranking in the years 2002–200720

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17 Orłowski W., Gazeta Finansowa 9-15 March 2007, pg. 11
18 Buła P., „Co trzeba wiedzieć zanim zdecydujemy się na studia MBA” Gazeta Finansowa 9-15 March 2007, pg. 10
19 „Rzeczpospolita”, 29 November 2006, suplement „Kariera” pg D1 – D4
20 Prepared by the authors on the basis of “WPROST” 27 May 2007, pg. 38 and http://szkoly.wprost.pl/
What is interesting in this figure is a leap in 2003 from 15th place to 5th place, and then in 2004 being assessed again on 14th place. According to the rankings, in 2003 most of the schools received relatively low number of points, which enabled the school to be classified on 5th place. The following year the school earned slightly less points, but in comparison to other programs, it was a number which drastically lowered school’s status.

As opposed to the USA or most countries in European Union, there is no research made yet on what is the difference in remuneration of a manager without MBA diploma, and remuneration of a manager who graduated MBA studies.

MBA studies on Cracow School of Business

Executive Master of Business Administration studies in Cracow School of Business are conducted from 1994. They were introduced as the first MBA studies in southern Poland. This intensive, international program was based on management and business studies. Executive Master of Business Administration is conducted in cooperation with Stockholm University School of Business. This program consists of modules: multifaceted business management, marketing, accounting, finance, international law, management psychology, multicultural issues, contemporary economic issues of the world and Central and Eastern Europe, as well as Business English course. The classes are by scientists from Cracow University of Economics, Stockholm University School of Business and practitioners involved in the given issues in their professional work. The program lasts five semesters and is finished with a diploma thesis. 70% of the classes are conducted in Polish and 30% in English. After graduation the graduate receives a diploma of the Cracow School of Business of Cracow University of Economics, diploma of Stockholm University School of Business and a Postgraduate Studies Graduation Certificate.

<table>
<thead>
<tr>
<th>Year</th>
<th>Students 1 year</th>
<th>Students 2 year</th>
<th>Graduates with diploma</th>
<th>Graduates without diploma</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>29</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>2001/2002</td>
<td>29</td>
<td>34</td>
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<tr>
<td>2002/2003</td>
<td>34</td>
<td>35</td>
<td>14</td>
<td>15</td>
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<tr>
<td>2003/2004</td>
<td>35</td>
<td>29</td>
<td>32</td>
<td>2</td>
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<tr>
<td>2004/2005</td>
<td>29</td>
<td>28</td>
<td>24</td>
<td>9</td>
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<tr>
<td>2005/2006</td>
<td>28</td>
<td>34</td>
<td>28</td>
<td>-</td>
</tr>
</tbody>
</table>

A better way to illustrate the amount of students attending MBA program would be a diagram showed below, illustrating in an accessible way the interest in the program (both for first and second year students).

Fig. 8 Executive MBA students in the years 2000 - 2007

International Master of Business Administration, European Multicultural Integrated Management Program, is a program introduced in 2006 in cooperation with St. Gallen Business School. This is a program designed especially for managers working in international environment. It includes: global management, investing and finance, controlling, leadership and multicultural team management, global organizations’ functioning. This program takes four semesters, finishes with a diploma thesis and is conducted in 100% in English. After graduation the graduate receives a diploma of the Cracow School of Business of Cracow University of Economics, diploma of Stockholm University School of Business and a Postgraduate Studies Graduation Certificate.

<table>
<thead>
<tr>
<th>Year</th>
<th>Students 1 year</th>
<th>Students 2 year</th>
<th>Graduates with diploma</th>
<th>Graduates without diploma</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006/2007</td>
<td>31</td>
<td>33</td>
<td>28</td>
<td>2</td>
</tr>
<tr>
<td>2007/2008</td>
<td>37</td>
<td>33</td>
<td>32</td>
<td>1</td>
</tr>
</tbody>
</table>

Fig.9 International Master of Business Administration students in years 2006 - 2008

The Cracow School of Business has initiated The Polish National MBA Congress in 2005. This undertaking was invented to exchange the experiences and integrate the graduates of MBA programs. It is addressed to managers

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21 Bulsza M., Adler D., Cracow School of Business, internal School statistics

22 Prepared by the authors

23 Bulsza M., Adler D., Cracow School of Business, internal School statistics
Cracow School of Business Continuously organizes many additional activities for its students – trainings, integration trips, meeting with representatives of business and politics. This creates an additional value given to all the people connected with MBA studies in the Cracow School of Business.

Conclusion

In Poland postgraduate studies diplomas are still very prestigious. Graduates of postgraduate studies or MBA studies are perceived by companies as desired employees who will have fast career paths. The most important aspect of postgraduate and MBA studies in Poland is the high quality of the programs and its relatively low price (in comparison to USA or EU countries). The quality of the programs is on one side adjusted to international standards, on the other hand to Polish economic reality.

What is easily observed is the growing popularity of this type of studies and growing willingness for constant education and life long learning. Polish higher education graduates continuously feel the need of skills improvement, broadening horizons, exchanging ideas, and first of all gaining knowledge and being up-to-date with events and trends in the modern economy.

The trends, that shows willingness of polish society for constant knowledge improvement is good projection for Poland aiming to reach knowledge-based society and for knowledge-based economy.

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24 http://kongresmba.pl/
25 „School of Entrepreneurship and Management Cracow University of Economics”, School’s informational brochure, School of Entrepreneurship and Management, Krakow, 2007, pg. 19
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Cracow School of Business, internal School statistics OECD – World Bank Institute, Korea and the Knowledge Based Economy™. Making the Transition. Paris 2000
http://szkoly.wprost.pl/
Social Challenges of Globalization: A Conceptual Model and Managerial Implications

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Lalita A. Manrai, University of Delaware, USA
Padmini A. Manrai, University of Delaware, USA

This research develops a conceptual framework identifying various adverse consequences of globalization, the globalization aspects/processes underlying these consequences, and the social challenges resulting from these consequences. A Socially-Responsible Globalization Strategy (SRGS) is proposed for businesses to deal with the social challenges of globalization. SRGS basically implies a long-term, societal-interest driven approach in the design & execution of global production/manufacturing and global consumption/marketing decisions.

Overview

Globalization is an extremely complex phenomenon and has been studied from a variety of perspectives—economic, social, cultural, political, etc. Zdravkovic (2007) compares globalization to the colonialism of the 1600s where balance of trade was achieved by the establishment of multinational corporations such as East India Trading company. However, unlike colonization, which employed use of military and political power by the dominant nation, globalization is based on a spirit of cooperation among nations (Zdravkovic, 2007). Two processes that have been acknowledged by researchers as precursors of globalization are trade liberalization and foreign capital investment (Kantor, 2001; Milanovic, 2005; Veen-Groot & Nijkamp, 1999). The removal of trade barriers and free flow of capital has integrated the world markets such that on one hand manufacturers have access to the raw materials, technology and manpower etc. from all around the globe and on the other, consumers worldwide have access to the global products. We live today truly in the “global village.”

Globalization affects are thus manifested in terms of both global production and global consumption processes.

Post World War II era, especially the later part of the 20th century is marked by shifting of industrial activity all over the world such that industries in the developed countries today primarily consist of high-tech products and services, and labor-intensive, relatively low-tech industrial activity is shifted to developing countries (Shrivastava, 1995, Veen-Groot & Nijkamp, 1999). Globalization of production process need not be done in its entirety. Buckley and Ghauri (2004) note that multinational corporations are increasingly splitting the production function and outsourcing the component activities to various locations optimizing production costs. Similarly these authors (Buckley & Ghauri, 2004) note that the ownership strategies represent a control matrix ranging from wholly owned subsidiary to market relationships such as subcontracting and joint ventures.

The second process representing the manifestation of globalization phenomenon is global consumption. Today frappuccino coffee is available at Starbucks in Mexico and the novels of Carlos Fuentes are available at bookstores in the United States (Cowen, 2002). While globalization has enabled cultural influences to permeate from developed countries to developing countries and vice versa, the influence of the developed countries on the developing countries has been greater. The changing consumption patterns and lifestyles in developing countries exhibit a strong American or Western influence, which is often captured in terms like “McDonaldization” or “Cocacolonization” of the world markets (Holton, 2000; Veen-Groot & Nijkamp, 1999).

Globalization is characterized by worldwide accessibility and cross-border flow of goods, services, money, manpower, technology etc. (Woodword, Drager, Beaglehole, & Lipson, 2001) and facilitating these movements are the developments in transportation, telecommunications, information technology, financial services etc (Shrivastava, 1995, Veen-Groot & Nijkamp, 1999). Figure-1 summarizes the four aspects of globalization discussed above i.e. two precursors—trade liberalization & foreign capital investment, and two manifestations—global production & global consumption.

In the next section of this paper we develop a conceptual model of the social challenges of globalization. In the section after that we propose a new concept of Socially-Responsible Globalization Strategy to deal with these social challenges. The last section of the paper consists of conclusions and directions for future research.
Figure 1. Globalization Processes: Precursors, Manifestations, Characteristics, and Facilitators

**Characteristics:** Worldwide accessibility and cross-border flow of goods, services, money, people, technology etc.

**Facilitators:** Developments in transportation, telecommunications, information technology, financial services, etc.

Social Challenges of Globalization: A Conceptual Model

While globalization has certainly led to an increase in economic output all over the world, there are several adverse consequences of globalization which lead to a variety of social challenges that global businesses must deal with. Figure-2 presents a conceptual model that identifies four major social challenges i.e. Economic Adversity, Environmental Degradation (including ecological damage and atmospheric pollution), Human Rights Violation (including health/safety risks in general, and to consumers and employees in particular), and Cultural Erosion resulting from the four processes of globalization discussed earlier i.e. Foreign Capital Investment, Trade Liberalization, Global Production, and Global Consumption. The model depicts various adverse consequences of globalization that mediate between globalization processes and social challenges of globalization. Various links represented in the model are discussed next.

Foreign Capital Investment and Economic Adversity

Foreign investment such as that by multinationals provides high wages & salaries to a select, small group of people thereby creating income inequalities and distorting class structure of the host country, concentrating land ownership, limiting wage potential of domestic labor, etc. (Kentor, 2001). Thus the dependence of a host country on foreign capital has adverse effect on its economy. Profits from foreign investment are typically repatriated rather than reinvested, thus formation of domestic capital is inhibited as well. Buckley and Ghauri (2004) list some of the complaints on this issue that were voiced at the 1999 meeting of the World Trade Organization (WTO) in Seattle. These include loss of jobs resulting from reduction of trade and investment barriers, greater insecurity of jobs resulting from technological changes and income inequalities both within and between countries.

Foreign Capital Investment and Ecological Damage

Dependence on foreign capital also suppresses adult wages and therefore necessitates participation of children in the workforce. Thus poor parents are likely to have more children to supplement family income. Since the earth’s natural resources are finite, population growth has an extremely damaging effect on ecology i.e. depletion of natural resources, damage to marine & wild life, deforestation, desertification, etc. It is estimated that at the most probable rate of growth in consumption, the earth’s natural resources including oil, natural gas, coal and all minerals will be depleted within the 21st century (Daly, 1977; McNeil, 1989; World Commission on Environment Development, 1987). Ecological Damage/Depletion therefore is a major component of the social challenge of Environmental Degradation.
### Trade Liberalization and Atmospheric Pollution

The second major factor contributing to Environmental Degradation is Atmospheric Pollution which in turn can be traced back to two other aspects of globalization i.e. Trade Liberalization and Global Production. Trade liberalization substantially increases the interactions between countries, which in turn increases the transportation flow between the countries of the world for movement of raw materials, manufactured goods, people, etc. Globalization thus leads to a substantial increase in transportation activities, which in turn leads to major atmospheric pollution problems like greenhouse effect/global warming, and ozone layer depletion (Veen-Groot & Nijkamp, 1999).

### Global Production and Atmospheric Pollution

Global production/industrial activity also leads to atmospheric pollution through environmentally detrimental effects like urban air pollution, smog, acid rain, and toxic waste sites. Shrivastava (1995) discusses that there were 30,000 documented uncontrolled toxic waste sites in USA and this number was increasing at the rate of 2000-3000 per year. Yet another issue related to industrial waste is the exploitation of poor, developing countries as dumping sites by rich, developed countries for their industrial waste (Clapp, 2002). Environmental degradation resulting from ecological damage and atmospheric pollution therefore is a major source of health & safety risks to the inhabitants of this planet.

A critical question in this context is why are the environmental protection laws in developing (host) countries not enforced? Christmann and Taylor (2001) summarize the arguments as follows. First, the host countries may on purpose choose to neglect enforcement of environmental regulations in order to lower production costs in those countries to attract foreign investment (Drezner, 2000). Second, governments in developing countries may want to but may not have financial and technological resources to enforce adequate environmental regulation and standards (Hettige, Huq, Pargal, & Wheeler, 1996) and multinational from rich, developed countries may take advantage of this situation and move their production operations to such developing countries (Leonard, 1988). Third, feeling the competitive pressure and worried about
the the “industrial flight” (Leonard, 1988; Low & Yeats, 1992) the developing host countries may even “race to the bottom” and become “pollution havens” for multinational companies looking for a home for their industrial activity (Walter, 1982). The problem of inadequate environmental regulation standards was also identified by Buckley and Ghauri (2004) as one of the concerns discussed at the WTO meeting in Seattle. Thus, on the overall, the problem of environment degradation resulting from globalization is more severe for developing countries.

Global Production and Health/Safety Risks to Workers/Employees

Besides harmful effects to health & safety caused by environmental degradation as a result of industrial pollution, global production/industrial activity also affects health & safety in two other & direct ways i.e. through Industrial Hazards and Poor Working Conditions as depicted in the conceptual framework. Industrial hazards include nuclear disasters like Chernobyl and industrial accidents like the one in Bhopal. Such hazards & accidents are a threat to the health & safety of the population in general. Poor working conditions and safety & health issues are also a very prevalent concern in global market based economies because countries & companies compete on the basis of cost-efficient production (Hogstedt, Wegman, & Kjellstrom, 2006). Such working conditions expose employees to an unsafe & unhealthy environment.

Global Consumption and Health/Safety Risks to Consumers

A third level of health & safety risk exists at the level of consumers based on consumption of unhealthy & unsafe products. Many of the products globally marketed today such as fast foods, tobacco etc have harmful consequences on health. The United Nations Environment Program (UNEP) has identified eight priority areas organizing the world’s environmental problems and this list includes protection of human health and quality of life as one of the priorities (Atchia, 1990).

Together these three levels of health & safety risks i.e. to the population in general due to industrial pollution & industrial hazards, to the workers/employees due to poor working conditions, and to the consumers due to harmful products constitute a threat to the Human Rights to health & safety. Berlinguer (1999) presents the issue of global health as a goal, responding to human rights and to common interests. The issue of human rights as depicted in the conceptual framework is linked either directly or indirectly to each of the four aspects of globalization and constitutes an extremely complex social challenge facing the global businesses today.

Global Consumption and Cultural Erosion

Yet, another effect of global consumption is Homogenization of Lifestyles. Cameron and Stein (2000) describe globalization as “…the set of processes that connect societies while fragmenting & transcending the social structure it confronts”. They further describe globalization as a “layered process such that some threads may thicken while others may thin out”. With the homogenization of lifestyles the threads of “global identity” strengthen while those of “national identity” thin out. Traditions & diversity are often lost in the pursuit of modernization and westernization. Many a times this Cultural Erosion comes back & haunts the global businesses. Globalization of taste often leads to nationalistic protectionist sentiments and attitudes (Buckley & Ghauri, 2004), which could be a major challenge global businesses must deal with. Understanding the stretching capacity of the cultural fabric is an extremely important skill global businesses must possess & constantly develop further. The forever ongoing issue of standardization versus customization (Kustin, 1994; Levitt, 1983; Szymanski, Bhardwaj, & Vardarajan, 1993; Whitelock & Pimblett, 1997) becomes an extremely critical balancing act to master. Businesses, which can critically distinguish cultural universals from cultural exclusives are the ones most likely to succeed in the global arena.

Social Challenges of Globalization: Managerial Implications

We propose a new concept of Socially-Responsible Globalization Strategy (SRGS) to deal with the four social challenges of globalization discussed above, i.e. Economic Adversity, Environmental Degradation, Human Rights Violation, and Cultural Erosion. SRGS is a long-term, societal-interest driven approach to the design and implementation of global production/manufacturing and global consumption/marketing. SRGS is based on the premise that the needs of the consumers and the goals of the businesses can be best met by serving the long-term needs of the society within which the consumers & businesses exist. SRGS requires the design and execution of the 4 P’s of marketing i.e. product, place promotion, and pricing to encourage a socially-conscious global consumption behavior. Similarly SRGS requires the design and execution of the 4 M’s of manufacturing i.e. materials, machinery, manpower, and money to conduct a socially-conscious global production activity. Table-1 summarizes the Socially-Responsible Globalization Strategy (SRGS) in terms of its two components, i.e., 4 Ms of Global Production/Manufacturing Strategy and 4Ps of Global Production/Marketing Strategy to handle four social challenges of globalization. Some examples are discussed next.
Managerial Implications: Global Production/Manufacturing Strategy

Production/manufacturing activity utilizing local raw materials and resources and generating primary, secondary & tertiary employment opportunities in the host countries will immensely help with the challenge of Economic Adversity. Pepsi Cola company made inroads into the large Indian market for its soft drinks in exchange for forming various alliances with the Indian government manufacturing snacks, fruit juices etc. which provided immense employment opportunities in India. To deal with the challenge of Environmental Degradation, consumer packaged good companies as well as fast-food multinationals will benefit immensely from initiatives such as biodegradable packaging and manufacturing processes & technologies that conserve resources & minimize pollution, for example the use of solar power. Use of manufacturing processes, raw materials and technologies that minimize/eliminate environmental degradation will also help the global businesses in dealing with the challenge of Human Rights Violation on account of health & safety risks. As regards the challenge of Cultural Erosion, a knowledge of local business cultures and cultural values will enable global businesses in successfully managing their dealings with business associates such as suppliers, distributors etc. as well as with their employees. One of the reasons for the problems Euro Disney faced early on resulted from their lack of understanding/appreciation of cultural values of their French employees. Culture plays a critical role in global business and culturally-sensitive business practices are essential for successfully dealing with the social challenges of globalization.

Managerial Implications: Global Consumption/Marketing Strategy

The long-term success of the global businesses will be sustained subject to their promoting a long-term, societal-interest driven consumption behavior. This orientation implies a rethink of and a shift in paradigm i.e. from a marketing concept to a societal marketing concept. To deal with the challenge of Economic Adversity, the global businesses will need to offer products that are useful, affordable and sustainable in the long-term. Such products may reduce the profit margins for the companies in the short-term compared to the wasteful, expensive products, however a long-term societal-interest driven consumption eventually is in the best interest of everyone. Environmentally-friendly consumption practices such as recycling, and use of larger size packing will reduce wasteful consumption and help with the problem of Environmental Degradation. In many European countries, McDonald’s charges a supplemental price for supplies and condiments like paper cups & ketchup, thereby discouraging wasteful consumption. Health & safety related concerns leading to the challenge of Human Rights Violation can be handled by encouraging consumption of healthy options and discouraging consumption of unhealthy options. In terms of the 4 P’s, this would mean that the global business should increase the variety, availability, advertising, and affordability of healthy options and decrease that of unhealthy options. As regards the challenge of Cultural Erosion, the most successful global businesses are the ones which are willing to adapt their marketing mix taking into account cultural differences. The most successful example of this adaptation is McDonald’s who introduces culture-specific variations in their product mix all over the world. Finally, consumer education websites, nutritional labeling, customer services etc are all beneficial in building mutual trust & long-term relationships between the businesses & the consumers.

Conclusions and Future Research

In conclusion, a Socially-Responsible Globalization Strategy comprising of a long-term, societal-interest driven approach to the design & execution of the 4 M’s of global production/manufacturing strategy and 4 P’s of global consumption/marketing strategy can help global businesses in dealing with the four social challenges of Globalization i.e. Economic Adversity, Environmental Degradation, Human Rights Violation, and Cultural Erosion.

The conceptual framework presented in Figure-2 covers several of the linkages connecting the four aspects of globalization, i.e. foreign capital investment, trade liberalization, global production, and global consumption to four social challenges of globalization, i.e. economic adversity, environmental degradation, human rights violation, and cultural erosion. Considering the complexity of the topic of globalization, some other possible linkages and interrelationships would be worth examining in the future research and will provide further insights into this extremely complex and at the same time extremely important subject.
Table 1. Socially – Responsible Globalization Strategy

<table>
<thead>
<tr>
<th>Social Challenges of Globalization</th>
<th>Global Production/Manufacturing Strategy</th>
<th>Global Consumption/Marketing Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Objective: Conduct Socially-Conscious Global Production Activity</td>
<td>Objective: Encourage Socially-Conscious Global Consumption Behavior</td>
</tr>
<tr>
<td>Economic Adversity</td>
<td>* Utilize local raw materials and resources * Generate primary, secondary and tertiary employment opportunities in the host country</td>
<td>* Offer products that are useful, affordable and sustainable in the long-term</td>
</tr>
<tr>
<td>Environmental Degradation</td>
<td>* Use biodegradable packaging * Use manufacturing processes &amp; technology that conserve resources and minimize pollution, e.g. solar power</td>
<td>* Encourage environmentally-friendly consumption practices such as recycling and use of larger size packaging to reduce waste</td>
</tr>
<tr>
<td>Human Rights Violation</td>
<td>* Use manufacturing processes, raw materials and technology that minimize environmental degradation to reduce health/safety risks</td>
<td>* Encourage consumption of healthy options by increasing their variety, availability, advertising, and affordability * Discourage consumption of unhealthy options by decreasing their variety, availability, advertising, and affordability</td>
</tr>
<tr>
<td>Cultural Erosion</td>
<td>* Learn local business cultures and cultural values to successfully manage dealing with business associates such as suppliers, distributors, employees, etc.</td>
<td>* Adapt marketing mix taking into account cultural differences * Build mutual trust and relationships through consumer education websites, nutritional labeling, customer service, etc.</td>
</tr>
</tbody>
</table>


Evaluating Reaction Learning Behavior and Results of an International Executive Development Program

Hamid Khan, Our Lady of the Lake University, USA

This is a proposed research in three stages of management development—needs analysis, program design, and evaluation. For the purposes of this study, the first stage of the research dealing with the needs assessment of global managers was completed and published last year in IMDA world congress. In the second stage, the measures of effectiveness in the form of correlates of learning styles and training needs are found and presented here. In the evaluation stage, the program was designed with the background variables and leadership profiles of global managers that were correlated with the training needs of these managers and an executive development program was delivered to nominated executives around the world. Evaluation at the three levels—Reaction and Learning, and behavior change have been summarized to portray the effectiveness of the weeklong program. The post study of Results will be reported in the next IMDA conference.

Introduction

In the IMDA conference of 2007 a two piece study of International Management Development was suggested and the Needs Assessment of such executives was studied. In this paper the design and delivery of the executive training program and its candid and detailed evaluation are presented in the Reaction and Learning level (Kirkpatrick’s four levels). Three and six month post training evaluations have not been concluded so far, for determining the change in executive behavior and the results that accrue on the job due to transfer of training.

Conceptual framework

Offerings of international executive development programs are few and far, and evaluation of such training programs are even rare. Literature is not replete with evaluation of executive program evaluation although there is much interest in spending millions of dollars annually for exposing executives to learn new skills of decision making and impart them with tools for organizational competitiveness.

Purpose of the study

The purpose of the study is to examine why executive development programs are not evaluated elaborately with respect to discrete learning outcomes in four levels as Kirkpatrick suggests – reaction, learning, behavior and results, in order to justify the organizational development expenditures in the return on investment (ROI).

Literature Review

The Executive Development Associates survey reported that management training programs were being more focused on strategy, productivity, leadership, and global competition. The merit of this report has prompted many university based management development programs to be tailored to the expressed needs of the managers. The Executive Program also was designed and focused on these dimensions. Four primary areas of management development was substantiated as shown below-- this led to participant's developing depth as well as impacting upon knowledge, skills, attitude and behavior.

Until the 1960s, the evaluation process developed by Tyler (1950) which focused on determining the congruence between learner outcomes and program objectives, was predominant. Nevo (1983) suggests that the Tylerian approach is one of the forty formal evaluation models. Grotelueschen (1980) has argued that some of these models are practical and applicable to evaluation practices. In continuing education the focus has been in the program evaluation for which Knox (1979) is credited for impact evaluation of training effort. But more recent evaluation literature reveals that Scriven and Stufflebeam and have significantly contributed to program evaluation.

Bolt (1989) states that according to Carlisle and Carter report in Business Horizons (March-April 1988), management development ranks third, even ahead of time-honored priorities as marketing and productivity studies. Evaluation of marketing effectiveness and productivity improvement were, at one time, considered to be crucial to a company's success.
But management development has become a priority for most effectively run companies now. The EDA report concluded that "the firm's survival and growth depends on capable management and orderly succession, and ... indication of concern for the future." (p.18)

The EDA study (1988) attempted to evaluate the types of activities that management development functions are engaged in. The types of activities are (a) Policies and Strategies (b) Planning and Needs Analysis (c) Program design and Development and (d) Learning Methods. The literature in program evaluation is quite occupied with many different forms of educational program evaluations. Stufflebeam (1971) showed that Context, Input, Product, and Process (CIPP) model can be effectively used for evaluation of educational outcomes. Guba and Lincoln (1982) have shown the use of epistemological and methodological bases for naturalist form of inquiry. Weis & Rein (1970) have used broad-based aims to evaluate educational programs, whereas Koppelman (1979) has used an anthropological approach. Spradley (1979) has used ethnography in participant observation. Scriven (1974) has widely disseminated various perspectives and procedures in educational evaluations. Lately his ideas have found a way to the internet where he moderates and discusses modern perspectives of educational and program evaluations.

However literature is not replete with industrial training programs evaluations. According to Kirkpatrick (1975), "Managers, needless to say, expect their manufacturing and sales department to yield a good return and will go to great lengths to find out whether they have done so. When it comes to training, however, they expect the return--but rarely do they make a like effort to measure the actual results. Fortunately for those in charge of training programs, this philanthropic attitude has come to be taken for granted. There is certainly no guarantee, however that it will continue, and training directors might be well-advised to take the initiative and evaluate their programs before the day of reckoning arrives" (p.1). There is an ongoing debate about the benefits of systematic evaluation of management development programs. Determining the worth of a program-- the definition of evaluation used here-- is such a fundamental necessity that it is done by all stakeholders eg. learners, instructors, and program planners. "Since all these individuals make judgments about the worth of all workshops, the issue is not whether workshops should be evaluated but to what degree evaluative information should be collected systematically." (Cervero, 1984) Cervero has provided a framework for the evaluation of workshops that allows researchers to consider the types of information that are required to make the desired evaluative judgments and to decide how that information can be collected.

Rationale for the Framework

Until the 1960s, the evaluation process developed by Tyler (1950) was predominant. Tyler's method focused on the congruence between learner outcomes and program objectives. Today, this process is one among possibly forty formal evaluation models. Most of these models have some applicability to the continuing education (Grotelueschen, 1980). Continuing educators have written extensively on program evaluation in context of program planning. Suchman (1967) wrote from the perspective of an evaluation specialist, Kirkpatrick (1967), Bennet (1975) and Houle (1980) wrote as continuing educators emphasizing in the fields of training and continuing professional education. Cervero's (1984) framework deals with seven categories of evaluation to collect information regarding workshop effectiveness: workshop design and implementation; learner participation; learner satisfaction; learner knowledge, skills and attitudes; applications of learning after the workshop; the impact of application of learning and workshop characteristics associated with outcomes (Cervero, 1984).

This framework should be viewed as a hierarchy only in the sense that evaluative information gathered at one level should not be used to infer success or failure at higher levels. For the management development workshop, the six categories of evaluation suggested by Cervero (1984) have been described in terms questions that can be asked. The following categories of evaluation have been examined for the management development program.

Training Design and Implementation

Workshop design and implementation category of evaluation includes factors related to quality, such as activities of learners or instructors, characteristics of the setting, and the nature of the teaching transaction. Evaluation in this category include: Was all the material covered? How much time was spent in each topic? Did the instructors follow the workshop design? How much time was allocated to participant discussion.

Participants, instructors, and program planners taken together as a group possess a unique vantage point on evaluative questions. With the use of several techniques like questionnaires, interviews, and observational rating scales, an evaluator can gather evidence on which to base judgments. These procedures have been followed for gathering evidence from participants, instructors and program planners for an effective evaluation of executive development program. So this executive program design and implementation followed the footprints of the findings of the literature review which stressed that for the effectiveness of the program a matrix of program offerings should encompass strategy, productivity, communication and global competition.

Findings from the Literature Review

Management development literature was studied with a selected review of the background and history of management development. Literature reveals that U.S. corporations recognize the development of managerial
resources for the organization's growth and survival. But with the harsh realities of global competition, they have been either forced to downsize or have decided to gain competitive advantage by strategic human resources effectiveness through a rigorous management development program.

Presently, management development programs were focused on strategy, productivity, leadership and global competition. The U.S. corporations are relying heavily on university sponsored programs for their managers for developing Engineering and Management effectiveness by participating in executive development programs to increase the effectiveness of managers in their present jobs, identifying future leaders, and to provide organizations with stimulus toward a more creative and innovative decision making.

**Methodology**

The Executive Development Associates survey reported that management training programs were being more focused on strategy, productivity, leadership, and global competition. The merit of this report has prompted many university based management development programs to be tailored to the above expressed needs of the managers. The University’s Executive Program also was designed and focused on these dimensions. Four primary areas of management development was substantiated as shown below-- this led to participant's developing depth as well as impacting upon knowledge, skills, attitude and behavior.

The executive development program consisted of four tracks running in parallel with sixteen faculty members. These four main tracks were Strategy, Productivity, Leadership and Global Competition. Each track had four relevant modules as shown below. Each module and its instructor were evaluated extensively for the desirable outcomes of the training program in Kirkpatrick’s four levels of outcome: Reaction, Learning, Behavior and Results of the training program.

**Results of the Program**

(enlarge the inset to read the data of evaluation in fifteen criteria of evaluation)
Specific details of the best module are described below.

The results of the best module shown above, with respect to different criteria are also depicted graphically.
<table>
<thead>
<tr>
<th>Module</th>
<th>Questions 1-15</th>
<th>Mean Score</th>
<th>Standard Deviation</th>
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<tbody>
<tr>
<td>Design for Manufacturing Module</td>
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<td>HRM Module</td>
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<td>Human Factors Module</td>
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<td>Designing Organization for Teams Module</td>
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<td>Negotiation and Dispute Resolution Module</td>
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<tr>
<td>Decision Analysis Module</td>
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<tr>
<td>Marketing for Technical Managers Module</td>
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<td></td>
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<tr>
<td>Managerial Accounting and Financial Analysis Module</td>
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<tr>
<td>Capital Investment Decisions</td>
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<td></td>
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<td>Career Management Module</td>
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</table>
Discussion of the Findings

The above results shown are very interesting and need to be discussed with a view to understand what happens to learning in such a unique environment when the participants have been recruited throughout the whole world. There were sixteen management development courses offered to the executives with fifteen criteria of evaluation.

Fifteen questions regarding the effectiveness of teaching of each of the sixteen modules and training professors were answered by participants using a scale of 1 (Strongly Disagree) to 5 (Strongly Agree).

Q1. My instructor displays a clear understanding of the course topics
Q2. My instructor has an effective presentations style.
Q3. My instructor seems well prepared for class
Q4. My instructor stimulates interest in the class
Q5. The objective of the course were clearly explained to me
Q6. This course contributes significantly to my professional development
Q7. My instructor develops classroom discussions skillfully
Q8. One real strength of this course is the classroom discussion
Q9. Assigned readings significantly contributed to this course
Q10. I highly recommend this course
Q11. My instructor motivates me to do my best work
Q12. My instructor explains difficult material clearly
Q13. Course assignments are interesting and stimulating
Q14. Overall this course is among the best I have ever taken
Q15. Overall this instructor is among the best I have ever known

The results of each trainer evaluation were combined and tabulated. Each instructor's evaluation is highlighted with mean score and standard deviation within a range from low to a high, with an intermediate medium score. The overall scores for all the questions are highlighted in the last column.

Thus teaching and course effectiveness were compared to strategic decisions regarding the most liked courses and the best instructor and the underlying systemic reasons. Competitive Advantage and Organizational Capabilities (CAOC) was unanimously voted as the best course by the participants. The mean satisfaction level in reaction and learning are toward the highest end in the fifteen criteria with very small standard deviations. These are highlighted in yellow for the CACC course in the overall cluster of sixteen modules and sixteen instructors. This course was considered as the best in six criteria of evaluation, the second best in four criteria and about third best in about five criteria. This benchmark will be used in determining the transfer of learning on the job in a three month and a six month post survey. The benchmarked criteria are summarized in the graph below.

MEAN SCORE AND SD OF TRAINING EFFECTIVENESS

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Hypermarkets and their Impact on Retail Structure: The Case of Indonesia

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Ronald S.J. Tuninga, Maastricht School of Management, The Netherlands

The increasing number of hypermarkets is a new phenomenon in developing countries. This rapid development in Indonesia is stimulated by its country’s economic growth after the financial crisis in 1997. Using Carrefour in Jakarta as a case, this article shows that modern retailers including hypermarkets negatively influence the retail sales of traditional markets. Almost fifty percent of Carrefour stores in Indonesia are located in Jakarta province and this number is increasing.

Introduction

Modern retailing internationalization, especially in the food retail sector, has shown substantial growth over the past decade. There are several factors that stimulate the dynamic growth of modern retailing internationalization; domestic market saturation, liberalization of worldwide trade (in Eastern European and Asian countries), regional integration, development of new technologies, company growth strategies, entrepreneurial behavior and managerial ambitions (Williams, 1992; Swoboda, Foscht, and Schwarz, 2004). Among some of the modern retailing institutions, Hypermarkets and Supercenters are the most important new retailing institutions.

The Asian financial crisis in 1997 changed the economic conditions of some countries in this region. Indonesia experienced the worst impact. Retail liberalization as part of Indonesia’s economic recovery program attracted some big foreign retailers to enter this market. In 1997, Continent and Carrefour introduced the hypermarket format in Indonesia followed by Wal-Mart in 1998. Wal-Mart closed its business after riots in the middle of 1998. Better economic conditions, partly as a result of the economic recovery program, have enabled hypermarkets to experience remarkable growth in the last ten years.

An AC Nielsen study (2007) showed that compared to other Asian countries, Indonesia continues to have a very strong growth of modern retailing, driven by the growth of hyper- and mini markets (Figure 1).

Figure 1. Share of Trade for Modern Service Outlets


The development of modern retailers, especially large format retailers such as hypermarkets and supercenters, has resulted in research focused on: indigenous retailers performance (Stone, 1995; Davidson and Rummel, 2000; Arnold and Fernie, 2000; Peterson and McGee, 2000; Farmhangmehr, et al., 2000; Arnold and Luthra, 2000; Seiders and Tigert, 2000; da Rocha and Antonio, 2002; Hernandez, 2003; Singh, et al., 2004), consumer preferences and shopping behavior (Seider and Tigert, 1997; Arnold, et al.,1998; Farmhangmehr, et al., 2000; Arnold and Luthra, 2000; Seiders and Tigert, 2000; Singh, et al., 2004), and social interactions within the place where this type of retailer exists (Arnold and Luthra, 2000).


Considering the rapid development of hypermarket in Indonesia, this study investigates the impact of hypermarket development on retail structure and Indonesia’s economic development.
Theoretical Considerations

Retail structure refers to the number and size of marketing intermediaries in the distribution channel. Retail structure has been measured by the number of employees, and the length of the channel (Olsen and Granzin, 1990); the number, kinds, and management of stores (Kaynak, 1985); store closures, redistribution of retail sales, and retail job creation/loss (Jones and Doucet, 2000); and ownership structure (Da Rocha and Dib, 2002). Some relate distribution channels to the stage of a country’s economic development process and give empirical evidence that economic development also determines the channel structure (Wadinambiaratchi, 1965; Mittendorf, 1978; economic development also determines the channel structure (Da Rocha and Dib, 2002). Some relate distribution channels to the stage of a country’s economic development process and give empirical evidence that economic development also determines the channel structure (Wadinambiaratchi, 1965; Mittendorf, 1978; Mallen, 1975; Olsen and Granzin, 1990; Ling Yi and Jaffe, 2007).

Along with the economic development process, Mittendorf (1978) discusses three stages of development in a country’s retail distribution structure. First, small retailers and hawkers are dominant players in the retail structure and one company performs both wholesaling and retailing activities. Second, the presence of well-established traditional wholesalers who perform important role in the distribution of fruit, vegetables, and fish to a large number of specialized retailers with a higher level of operation than in the first stage. Finally, there is development of integrated and associated food chains, which is associated with increased consumer income and GNP. At this stage fruit and vegetables are distributed directly to the supermarkets from a wholesale depot of food chains without passing through the wholesale market.

Market development changes retail structure in domestic market by attracting new entrants (Da Rocha and Dib, 2002). The entry of foreign large format retailers most likely influences indigenous retailers’ performances as well. Some of them experience losses in sales, employment and number of outlets. In order to compete and survive they need to improve services, apply differentiation, and some of them choose to have strategic affiliation with foreign retailers (Da Rocha and Dib, 2002; Jones and Doucet, 2000, Moreno-Jimenez, 2001).

According to Ling Yi and Jaffe (2007) economic development and government policy are important factors influencing channel structure. Economic development provides the need for a more efficient distribution channel, as more private-owned intermediaries enter the distribution system. Subsequently the number of channels is reduced as an effect of vertical integration and a shakeout of less efficient enterprises. To promote foreign direct investment and these developments, government policies have been formulated to open market policy in order to attract foreign firms to enter into the domestic market and to support distribution reforms. Ling Yi and Jaffe’s model shows that channel structure is a function of economic development, mobility and environmental variables (including urbanization and government policy).

Regarding the importance of the role of retailing on economic development, Anderson (1971) has shown that economic stability and growth significantly improved through a well-managed retailing and merchandising effort, financed by foreign retail institutions that have success in the retail trade. Government policy and regulations play an important role in stimulating this “retail pull” strategy. One success story of “retail pull” is Sears Roebuck in Latin America.

Modern Market Development in Indonesia

The first modern retailing format in the food sector in Indonesia was the supermarket introduced in the early 70s. However, due to poor economic conditions including high inflation, there was no growth in the number of supermarkets during the period 1970 – 1980. In the 80s, Indonesia had economic growth and increased income per capita. Followed by retail sector liberalization in 1998, foreign companies came into Indonesia and created a new competitive environment in the domestic retail market. The Indonesian supermarket sector grew rapidly during 1978-1997. (Natawidjaja, 2005).

During the worst time of the financial crisis (1997-1998), supermarket outlets decreased by 13% and recovered again within two years after the crisis. However, after 2001, the growth rate has started to decrease. Another format, the mini market was not negatively influenced by the crisis and it showed a remarkable growth during 1999 – 2001 and slowed down after that period (Table 1).

Table 1. Store Number Growth of Supermarket and Mini Market, 1997 - 2003

<table>
<thead>
<tr>
<th>Year</th>
<th>Supermarket</th>
<th>% Growth</th>
<th>Mini Market</th>
<th>% Growth</th>
<th>Total</th>
<th>% Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>442</td>
<td>0.00</td>
<td>290</td>
<td>0.00</td>
<td>732</td>
<td>0.00</td>
</tr>
<tr>
<td>1998</td>
<td>385</td>
<td>(12.90)</td>
<td>290</td>
<td>0.00</td>
<td>675</td>
<td>(7.79)</td>
</tr>
<tr>
<td>2000</td>
<td>494</td>
<td>12.27</td>
<td>552</td>
<td>75.24</td>
<td>1046</td>
<td>38.54</td>
</tr>
<tr>
<td>2001</td>
<td>538</td>
<td>8.91</td>
<td>730</td>
<td>32.25</td>
<td>1268</td>
<td>21.22</td>
</tr>
<tr>
<td>2002</td>
<td>573</td>
<td>6.51</td>
<td>858</td>
<td>17.53</td>
<td>1431</td>
<td>12.85</td>
</tr>
<tr>
<td>2003</td>
<td>599</td>
<td>4.54</td>
<td>972</td>
<td>13.29</td>
<td>1571</td>
<td>9.78</td>
</tr>
<tr>
<td>AverageGrowth</td>
<td>6.64</td>
<td>20.99</td>
<td>13.47</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Desk Research Indonesia, 2003.

The hypermarket was introduced in Indonesia in 1997 as Continent and Carrefour came into market. This format has shown substantial growth rates in the period 2003-2006 (Table 2). Carrefour is the leader with 33% of market share in 2006 (Figure 2).
Table 2. Indonesia Retail Structure – Store Number  

<table>
<thead>
<tr>
<th>Year</th>
<th>Supermarket</th>
<th>Mini Market</th>
<th>Hypermarkets</th>
<th>Warehouse Clubs</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>896</td>
<td>4,038</td>
<td>43</td>
<td>24</td>
<td>1,752,695</td>
</tr>
<tr>
<td>2004</td>
<td>956</td>
<td>5,604</td>
<td>68</td>
<td>22</td>
<td>1,754,397</td>
</tr>
<tr>
<td>2005</td>
<td>1,141</td>
<td>6,465</td>
<td>83</td>
<td>24</td>
<td>1,797,730</td>
</tr>
<tr>
<td>2006</td>
<td>1,311</td>
<td>7,356</td>
<td>105</td>
<td>26</td>
<td>1,857,676</td>
</tr>
<tr>
<td>Total</td>
<td>4,304</td>
<td>23,463</td>
<td>299</td>
<td>96</td>
<td>7,154,480</td>
</tr>
</tbody>
</table>

Figure 2. Hypermarket Market Share (%), 2006  

All of the modern format retailers such as Supermarket, Mini Market and Hypermarket are concentrated in big cities, in the Jakarta area. 58% of the hypermarkets are located in the Jakarta area known as Jabotabek (Jakarta, Bogor, Tangerang, and Bekasi) (Figure 3).

Figure 3: Hypermarket and Its Store Location, 2004  
Source: Natawidjaja, 2005.

This study examines and discusses the growth of hypermarkets in the DKI Jakarta area, with Carrefour as a case.

DKI Jakarta and Retail Structure

The DKI Jakarta province is divided into five municipalities and regency: South Jakarta, East Jakarta, Central Jakarta, West Jakarta, North Jakarta, and Kepulauan Seribu regency. Based on the National Socio-Economic Survey, the population of this province in 2006 was 8.96 million. With an area of 661.52 km², the population density reached 13.5 thousand/km² and is the most densely populated region in Indonesia.

Compared to other major provinces in Indonesia, DKI Jakarta has the highest Gross Regional Domestic Product (GRDP) and per capita GRDP (Table 4 and Table 5). In 2006, this province achieved 5.90 % economic growth. The per capita GDP of this province is higher than the country’s per capita GDP (Table 3).

Table 3. Indonesia GDP and Per Capita GDP at Current Market Prices, 2002-2006  

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP (billion US$)</th>
<th>Per Capita GDP(US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>204.24</td>
<td>969.18</td>
</tr>
<tr>
<td>2003</td>
<td>237.10</td>
<td>1,110.27</td>
</tr>
<tr>
<td>2004</td>
<td>251.27</td>
<td>1,161.22</td>
</tr>
<tr>
<td>2005</td>
<td>282.28</td>
<td>1,287.74</td>
</tr>
<tr>
<td>2006</td>
<td>366.83</td>
<td>1,652.03</td>
</tr>
</tbody>
</table>

Source: BPS (original data in Rupiah and converted into US$ based on the average of IMF currency rate).

Table 4: GRDP at Current Market Prices by Provinces, 2003-2005 (Million US$)  

<table>
<thead>
<tr>
<th>No.</th>
<th>Province</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>DKI Jakarta</td>
<td>39,365.51</td>
<td>41,103.37</td>
<td>44,217.59</td>
</tr>
<tr>
<td>2</td>
<td>West Java</td>
<td>32,164.96</td>
<td>32,944.30</td>
<td>39,261.42</td>
</tr>
<tr>
<td>3</td>
<td>Central Java</td>
<td>20,238.07</td>
<td>21,173.61</td>
<td>23,761.94</td>
</tr>
<tr>
<td>4</td>
<td>DI Yogyakarta</td>
<td>2,309.36</td>
<td>2,410.41</td>
<td>2,559.11</td>
</tr>
<tr>
<td>5</td>
<td>East Java</td>
<td>35,395.01</td>
<td>37,327.93</td>
<td>40,887.12</td>
</tr>
<tr>
<td>6</td>
<td>Bali</td>
<td>3,081.12</td>
<td>3,172.44</td>
<td>3,440.75</td>
</tr>
<tr>
<td>7</td>
<td>North Sumatera</td>
<td>12,174.89</td>
<td>12,925.52</td>
<td>13,876.27</td>
</tr>
<tr>
<td>8</td>
<td>South Sumatera</td>
<td>6,586.44</td>
<td>7,039.44</td>
<td>8,263.97</td>
</tr>
<tr>
<td>9</td>
<td>South Sulawesi</td>
<td>5,044.54</td>
<td>5,320.58</td>
<td>5,274.96</td>
</tr>
</tbody>
</table>

Source: BPS (original data in Rupiah and converted into US$ based on the average of IMF currency rate).
Table 5: Per Capita GRDP at Current Market Prices by Provinces, 2003-2005 (US$)

<table>
<thead>
<tr>
<th>No.</th>
<th>Province</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>DKI Jakarta</td>
<td>4,556.10</td>
<td>4,697.65</td>
<td>4,990.48</td>
</tr>
<tr>
<td>2</td>
<td>West Java</td>
<td>843.38</td>
<td>853.24</td>
<td>1,007.60</td>
</tr>
<tr>
<td>3</td>
<td>Central Java</td>
<td>628.99</td>
<td>650.54</td>
<td>743.07</td>
</tr>
<tr>
<td>4</td>
<td>DI Yogyakarta</td>
<td>719.11</td>
<td>747.76</td>
<td>765.36</td>
</tr>
<tr>
<td>5</td>
<td>East Java</td>
<td>975.88</td>
<td>1,023.19</td>
<td>1,126.54</td>
</tr>
<tr>
<td>6</td>
<td>Bali</td>
<td>916.23</td>
<td>933.82</td>
<td>1,016.90</td>
</tr>
<tr>
<td>7</td>
<td>North Sumatera</td>
<td>1,021.09</td>
<td>1,066.17</td>
<td>1,114.48</td>
</tr>
<tr>
<td>8</td>
<td>South Sumatera</td>
<td>1,009.94</td>
<td>1,062.01</td>
<td>1,218.45</td>
</tr>
<tr>
<td>9</td>
<td>South Sulawesi</td>
<td>690.09</td>
<td>719.05</td>
<td>702.42</td>
</tr>
</tbody>
</table>

Source: BPS (original data in Rupiah and converted into US$ based on the average of IMF currency rate).

As GRDP and per capita GRDP increase, the average per capita monthly expenditure for food of DKI Jakarta increased with 13.11% between 2002 and 2005 (Table 6).

Table 6: Average Per Capita Monthly Expenditure by Province

<table>
<thead>
<tr>
<th>Province</th>
<th>Total (US$)</th>
<th>Food (US$)</th>
<th>Total (US$)</th>
<th>Food (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>DKI Jakarta</td>
<td>53.99</td>
<td>21.88</td>
<td>66.77</td>
<td>25.19</td>
</tr>
<tr>
<td>West Java</td>
<td>23.44</td>
<td>13.87</td>
<td>30.03</td>
<td>15.14</td>
</tr>
<tr>
<td>East Java</td>
<td>20.93</td>
<td>12.11</td>
<td>25.66</td>
<td>13.02</td>
</tr>
</tbody>
</table>

Source: BPS (original data in Rupiah and converted into US$ based on the average of IMF currency rate).

It is clear that DKI Jakarta is a large potential market for retailers in the food sector. In 2003, DKI Jakarta had 12 hypermarkets, and 381 supermarkets and mini markets throughout the five municipalities (Table 7). A study by Visidata Riset Indonesia (2003) estimated this area’s increasing demand for hypermarkets (Table 8).

Table 7: Number of Hypermarket and Supermarket/Mini Market in DKI Jakarta, 2003

<table>
<thead>
<tr>
<th>No.</th>
<th>Area</th>
<th>Hypermarket</th>
<th>Supermarket/Mini Market</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Central Jakarta</td>
<td>3</td>
<td>59</td>
<td>62</td>
</tr>
<tr>
<td>2</td>
<td>South Jakarta</td>
<td>4</td>
<td>99</td>
<td>103</td>
</tr>
<tr>
<td>3</td>
<td>East Jakarta</td>
<td>2</td>
<td>80</td>
<td>82</td>
</tr>
<tr>
<td>4</td>
<td>West Jakarta</td>
<td>2</td>
<td>98</td>
<td>100</td>
</tr>
<tr>
<td>5</td>
<td>North Jakarta</td>
<td>1</td>
<td>45</td>
<td>46</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>12</td>
<td>381</td>
<td>393</td>
</tr>
</tbody>
</table>

Source: Desk Research Indonesia.

Table 8: Hypermarket Space Projection in Jabotabek (thousand m²)

<table>
<thead>
<tr>
<th>Year</th>
<th>Demand</th>
<th>Supply</th>
<th>Potential Demand</th>
<th>Additional Supply Plan</th>
<th>Plus/(Minus) Accumulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>202</td>
<td>188</td>
<td>14</td>
<td>22</td>
<td>8</td>
</tr>
<tr>
<td>2003</td>
<td>214</td>
<td>210</td>
<td>4</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>2004</td>
<td>226</td>
<td>218</td>
<td>8</td>
<td>0</td>
<td>(8)</td>
</tr>
<tr>
<td>2005</td>
<td>239</td>
<td>218</td>
<td>21</td>
<td>0</td>
<td>(21)</td>
</tr>
<tr>
<td>2006</td>
<td>253</td>
<td>218</td>
<td>35</td>
<td>0</td>
<td>(35)</td>
</tr>
</tbody>
</table>

Source: Visidata Riset Indonesia.

Hypermarkets and other modern retailers negatively influence the market share of the traditional markets. Figure 4 shows the decreasing market share of traditional markets in Indonesia. This is the result of changing consumer preferences (consumers who live in big cities prefer to buy groceries in modern retailers because of the convenience store environment, competitive prices, and one stop shopping concept).

Figure 4: Market Share of Modern Retailers versus Traditional Retailers in Indonesia


Carrefour Indonesia

Carrefour Indonesia opened its first store in October 1998 at Cempaka Putih-Jakarta. At the same time, another French hypermarket, Continent also opened its first store in Jakarta. At the end of 1999, Carrefour merged with Promodes making Carrefour the second largest retailer in the world after Wal-Mart.

Within ten years Carrefour established 40 stores in Indonesia, which are located in Jabotabek(25), Bandung (4), Yogyakarta, Samarang, Surabaya (5), Palembang, Medan, Makassar, and Denpasar (Table 9). With more than 10,000 employees, Carrefour focuses its operations on competitive prices, wide assortments, and services.
Table 9. Carrefour Store Location and Number in Indonesia, 2008

<table>
<thead>
<tr>
<th>City</th>
<th>Store number</th>
<th>Store location</th>
<th>Opening date</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>2. Pluit Mega Mall 15 Mar 1999 15</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3. Cempaka mas 14 Jul 1999 22</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>4. Duta merlin 24 Aug 1999 22</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>5. Ratu plasa 29 Jun 2000 12</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>6. M.T.Haryono 12 Jun 2002 14</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>7. Lebak bulus 14 Nov 2002 25</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>8. Puri indah 28 Sep 2004 26</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>9. Ambasador 22 Jun 2006 1 Nov</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>10. Grand ITC 15 De 2006 Pemata hijau 8 Sep 2005</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>11. Mangga dua 15 Feb 2008 12</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>12. Taman palem 14 Nov 2002 25</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>13. Taman mini 12 Sep 2001 26</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>15. Kelapa gading 30 Oct 1998 14</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>17. Daan Mogot 1 May 2005 8</td>
<td></td>
</tr>
<tr>
<td>Tangerang</td>
<td>3</td>
<td>1. ITC BSD 8 Dec 2005 3</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>2. Cikokol 3 Dec 2007 3</td>
<td></td>
</tr>
<tr>
<td>Bandung</td>
<td>4</td>
<td>1. Mollis 16 Jun 2003 14</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>2. Sukajadi 10 Oct 2007 5</td>
<td></td>
</tr>
<tr>
<td>Depok</td>
<td>1</td>
<td>Blue Mall 23 Nov 2007</td>
<td></td>
</tr>
<tr>
<td>Bekasi</td>
<td>2</td>
<td>Blue Mall 23 Nov 2007</td>
<td></td>
</tr>
<tr>
<td>Cikarang</td>
<td>1</td>
<td>Blue Mall 23 Nov 2007</td>
<td></td>
</tr>
<tr>
<td>Bogor</td>
<td>1</td>
<td>Blue Mall 23 Nov 2007</td>
<td></td>
</tr>
<tr>
<td>Yogyakarta</td>
<td>1</td>
<td>Blue Mall 23 Nov 2007</td>
<td></td>
</tr>
<tr>
<td>Semarang</td>
<td>1</td>
<td>Blue Mall 23 Nov 2007</td>
<td></td>
</tr>
<tr>
<td>Surabaya</td>
<td>5</td>
<td>Blue Mall 23 Nov 2007</td>
<td></td>
</tr>
<tr>
<td>Palembang</td>
<td>1</td>
<td>Blue Mall 23 Nov 2007</td>
<td></td>
</tr>
<tr>
<td>Medan</td>
<td>1</td>
<td>Blue Mall 23 Nov 2007</td>
<td></td>
</tr>
<tr>
<td>Makassar</td>
<td>1</td>
<td>Blue Mall 23 Nov 2007</td>
<td></td>
</tr>
<tr>
<td>Denpasar</td>
<td>1</td>
<td>Blue Mall 23 Nov 2007</td>
<td></td>
</tr>
<tr>
<td>Total outlets</td>
<td>40</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In 2006, Indonesia had both the highest growth of 27.20% on constant exchange rates compared to China and other Asian countries. Based on Carrefour’s Sales Report (Table 10), growth in Asia in 2006 and 2007 was 12.8% and 17.50% respectively, based on constant exchange rates and supported by contributions from new stores. In both years, Indonesia achieved the highest growth of number of stores opened among Asian countries, by opening nine hypermarkets in 2006 and eight hypermarkets in 2007.

Table 10. Carrefour Sales in Asia

<table>
<thead>
<tr>
<th>Sales</th>
<th>Like for Expansion</th>
<th>Total Ex.</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incl.VAT (m€)</td>
<td>(%)</td>
<td>(%)</td>
<td>(%)</td>
</tr>
<tr>
<td>Asia</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>China Total</td>
<td>2,482.00</td>
<td>8.00</td>
<td>16.40</td>
</tr>
<tr>
<td>Taiwan Total</td>
<td>1,391.00</td>
<td>-3.50</td>
<td>13.40</td>
</tr>
<tr>
<td>Indonesia Total</td>
<td>689.00</td>
<td>-3.10</td>
<td>5.10</td>
</tr>
<tr>
<td>Other Asia</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asia</td>
<td>6,052.00</td>
<td>2.80</td>
<td>14.70</td>
</tr>
<tr>
<td>China Total</td>
<td>2,964.00</td>
<td>8.00</td>
<td>16.40</td>
</tr>
<tr>
<td>Taiwan Total</td>
<td>1,391.00</td>
<td>-3.50</td>
<td>13.40</td>
</tr>
<tr>
<td>Indonesia Total</td>
<td>763.00</td>
<td>-3.10</td>
<td>5.10</td>
</tr>
<tr>
<td>Other Asia</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asia</td>
<td>6,052.00</td>
<td>2.80</td>
<td>14.70</td>
</tr>
<tr>
<td>China Total</td>
<td>2,964.00</td>
<td>8.00</td>
<td>16.40</td>
</tr>
<tr>
<td>Taiwan Total</td>
<td>1,391.00</td>
<td>-3.50</td>
<td>13.40</td>
</tr>
<tr>
<td>Indonesia Total</td>
<td>763.00</td>
<td>-3.10</td>
<td>5.10</td>
</tr>
<tr>
<td>Other Asia</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Carrefour

With Indonesia’s economic recovery from the crisis in 1997, it has become an interesting market. The Jakarta area (Jabotabek) is attractive and is a large market for large format retailers such as hypermarkets. With 17 stores in DKI Jakarta, 3 stores in Tangerang, 2 stores in Bekasi, and one store each in Depok, Cikarang and Bogor, Carrefour is still planning to open more new stores in these areas.

Carrefour stores in DKI Jakarta are located in five municipalities (Figure 5). There are 4 stores in Central Jakarta (Cempaka Putih, Cempaka Mas, Duta Merlin, Ratu Plasa), 3 stores in North Jakarta (Mega Mall Pluit, Mangga dua and Kelapa Gading), 3 stores in West Jakarta (Puri Indah, Taman Palem, and Daan Mogot), 4 stores in South Jakarta (MT. Haryono Lebak Bulus, Ambasador, and Permata Hijau), and 3 stores in East Jakarta (Taman 140
Central Jakarta, the center of the business district, has more Carrefour stores compared to North Jakarta and East Jakarta (Table 11). Although the population of Central Jakarta is the lowest compared to other areas, this area has the highest population density and highest per capita income. In February 2008, Carrefour opened new stores in East Jakarta and West Jakarta. East Jakarta has the largest population and number of households, while West Jakarta is the second largest in population size. (Table 11).

Table 11. DKI Jakarta Area and Population, 2006

<table>
<thead>
<tr>
<th>Municipality</th>
<th>Area (Km2)</th>
<th>Population (Person)</th>
<th>Population Density (Km2)</th>
<th>Households</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Jakarta</td>
<td>145.73</td>
<td>2,053,684</td>
<td>14,092</td>
<td>510,624</td>
</tr>
<tr>
<td>East Jakarta</td>
<td>187.73</td>
<td>2,413,874</td>
<td>12,858</td>
<td>616,640</td>
</tr>
<tr>
<td>Central Jakarta</td>
<td>47.90</td>
<td>891,778</td>
<td>18,617</td>
<td>226,800</td>
</tr>
<tr>
<td>West Jakarta</td>
<td>126.15</td>
<td>2,130,696</td>
<td>16,890</td>
<td>526,112</td>
</tr>
<tr>
<td>North Jakarta</td>
<td>142.20</td>
<td>1,452,285</td>
<td>10,213</td>
<td>357,696</td>
</tr>
<tr>
<td>Kepulauan Seribu</td>
<td>11.81</td>
<td>19,362</td>
<td>1,639</td>
<td>4,480</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>661.52</strong></td>
<td><strong>8,961,679</strong></td>
<td><strong>74,311</strong></td>
<td><strong>2,242,352</strong></td>
</tr>
</tbody>
</table>

Source: Based on 2006 National Socio-Economic Survey.

Conclusions

Shopping and buying preferences, economic development and retail structure changes have simultaneously taken place in Indonesia. Since 1997 the retail structure has changed substantially in Indonesia. Modern retailing formats such as hypermarkets and supermarkets have almost doubled their share of retail sales. This study shows that increasing GDP in Indonesia, especially in the Jakarta province, coincides with the increasing growth of the number of hypermarkets and other modern retail formats.

Previous research on hypermarkets entries and economic development show that as a country develops economically, it will attract foreign retailers to enter into the market. The presence of hypermarkets will change the retail structure in domestic markets and can change both consumer’s preferences and shopping behavior. Since 1998 Carrefour has established 40 hypermarkets in Indonesia. Most of these are located in the Jakarta province. Foreign hypermarkets like Carrefour have substantially changed shopping behavior and the retail structure in the Jakarta region.

References


Brand Loyalty as a Tool of Competitive Advantage

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Jan Napoleon Saykiewicz, Duquesne University, USA

Brand equity created by customers’ loyalty brings benefits not only to customers, but also to manufacturers, commercial intermediaries, society, and, of course, brand owners. Customers’ loyal support of a brand may contribute to the creation of competitive advantage for a firm. This type of competitive advantage based on brand equity may help many global firms overcome the fading country-of-origin effect.

Brand as a Resource of the Firm

The discussion of the brand concept in mainstream literature, in most of the cases, presents the brand concept from the demand side point of view and agrees that the real reason for brand existence is to enhance customer value (Aaker 1996; Keller 2008; Kotler, Keller 2009). This approach is in agreement with the old statement that a brand that is not recognized by a buyer is not a brand but just a marked product (Levitt 1980). In this statement representing the demand side approach, the importance of a buyer in the process of brand creation and brand strengthening is clearly emphasized with an inference that a brand mainly favors the customer. However, it is important to recognize that a brand adds value also to the supply side and this is underestimated or even neglected in brand definitions currently available. It would be interesting to pay attention to the fact that brand equity, in some cases, comprises a significant part of the value of a firm: 61% of the Kellogg company, 57% of Sara Lee, 52% of General Mills (Kapferer 2005).

The value of a brand may be the most significant resource of a firm. Ability to create value is a very important element of brand identity. Indication of a demand side factor in brand definition seems to be important because it brings to attention the entire process of brand creation. The reason for brand creation and promotion is to bring advantage to the firm otherwise the firm would not invest time and money just to respond to the demand side requests. Brand is a business tool and the ultimate objective of the process of brand creation is enhancement of value delivered to the firm and creation of a profitable firm (Kapferer 2005; Rust, Zeithaml, Lemon 2005). A brand may create value for the brand owner in a quantitative form such as monetary value, return on investment, income and profit generated by a brand, and also in qualitative form such as brand esteem, brand imagery, and brand loyalty.

Brand Loyalty

Brand loyalty is a very important component of brand value and it significantly contributes to the meaning of brand as a resource of the firm. There are various approaches to the concept of brand loyalty and what makes that the concept may have many different meanings. Sometimes the focus is on emotional ties between the buyer and the brand. In another approach, the focus is on the loyal behavior of the buyer of a branded product – buyer loyalty repeats purchase of a brand and is resistant to competitive promotion (Rudawska 2005). The most comprehensive approach presents brand loyalty as “a 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 having the potential to cause switching behavior” (Oliver 1999). This definition simultaneously addresses behavioral and attitudinal elements of the buyer’s reaction and brand loyalty emerges only in a situation when behavior is supported by attitude. On this basis, Chaudhuri and Holbrook developed the concept of purchase loyalty - understood as an interest in repeated purchase of a given brand and attitudinal loyalty understood as a degree of buyer’s emotional engagement in a brand (Chaudhuri, Holbrook 2001). Gounaris and Stathakopoulos added social influences as another dimension to the concept of brand loyalty and indicated four types of brand loyalty: premium loyalty, inertia loyalty, covetous loyalty, and no loyalty (Gounaris, Stathakopoulos 2001).

A no loyalty situation is the result of no purchase and also of total indifference to the brand. Inertia loyalty happens when a buyer buys the brand but has no emotional ties to it and a purchasing decision is not made under the influence of the brand image. This happens when a purchase is strongly influenced by price or there is no other alternative on the market. This type of loyalty is a very fragile because the buyer can easily switch to other brands. Covetous loyalty is related to no purchase of the brand, but there is a strong emotional relationship to the brand resulting from environmental/social pressure. In this
situation, it is difficult to expect loyalty because there is no personal experience with the brand. As opposite to other determinants of perceived brand value (brand awareness, brand image, and brand confidence), an earlier purchase and experience with the brand is necessary for loyalty to come into being. This often happens in the case of luxury goods. This situation, however, is advantageous for the brand owner because it contributes to the proliferation of the brand image and increases brand awareness. Premium loyalty refers to buyers having strong emotional ties to the brand, buyers who regularly buy the brand under social pressure situations, and even in the case of limited access to the brand, are still ready to search for it. This type of brand loyalty is the most desired as it creates the highest brand equity.

Keller (2008) distinguishes four levels of brand loyalty that are quite similar to the ones mentioned above:

1. Behavioral loyalty – this level refers to buyers purchasing the brand but having no special attachment to it. They buy often significant amounts of a given brand that represents a big lifetime value. In Gounaris and Statákopoulos’ system, this level is called inertia loyalty.

2. Attitudinal attachment – this level refers not only to a systematic purchase of the brand but also personal attachment by the buyer. Customers feel a high level of satisfaction and pleasure in purchasing this brand.

3. Sense of community indicates a specific level of loyalty related to buyer’s group. The customer feels a part of a particular group associated with the brand and develops a feeling of social belonging.

4. Active engagement with the brand represents “the strongest affirmation of brand loyalty, when customers are willing to invest time, energy, money, or other resources in the brand beyond those expended during purchase or consumption of the brand” (Keller 2008). Customers strongly attached to the brand organize themselves in fan clubs, are proud of the brand, and communicate the brand to outsiders. Harley Davidson or Mustang clubs are excellent examples of this type of behavior. This is the highest level of brand loyalty that brings unusual value to brand equity.

As previously mentioned in Oliver’s definition, a type of customer’s resistance to competitive promotional marketing effort was mentioned. A loyal customer remains loyal to his brand even if price changes, innovation, or special promotions. To be a loyal customer means that the brand represents the most attractive alternative in the eyes of the buyer. Loyal behavior is measured by checking if the customer who didn’t find his/her brand in the shop will purchase a competing brand.

For most of the 20th century in literature and marketing practice, a loyal customer was considered the customer who, in the shopping process, replaced or repeated purchase of the same brand. This type of behavior has been described as sole brand loyalty. However, recently the concept of share of requirement or share of wallet has been adopted. This means that most of the customer’s purchase, within a given product category, focuses on buying the same brand. This type of behavior is described as divided brand loyalty or proportional loyalty (Falkowski, Tyszka 2003, 169). The reasons for this behavior are mixed – variety seeking, quality conformity, and promotional influence. Some research indicates that brand loyalty is a phenomenon strongly related to product type and competitive effort in a given product category. For example, only selected brands of cigarettes or liquor enjoy a high percentage of loyal customers, others are subject to variety seeking behavior (Kall 2001, 102). Also, there is no agreement among researchers concerning brand loyalty among social groups. Jacoby and Chestnut noticed that housewives and older customers show stronger brand loyalty (Jacoby, Chestnut 1978). On the other side, Kall’s research showed that the highest propensity to brand switching exists among less educated, older and poorer customers (Kall 2001, 105).

In summary, one can make a statement that it is difficult to indicate a social group’s brand loyalty more than others. Also within a given product category, various consumer group brand loyalty is not close which indicates a variety of reasons for brand loyalty among customers (Falkowski, Tyszka 2003, 175).

Determinants of Brand Loyalty

The search for an answer as to why the customer feels attached to a particular brand and systematically purchases it is related to one of the fundamental issues of marketing management. Among academe as in business practice, there is an overwhelming agreement that among the most important determinants of brand loyalty is customer satisfaction (Oliver 199, 33). Customer satisfaction can be defined as a conclusion related to the use of a brand based on the difference of earlier expectations and perceived achievements after brand use (Suh, Yi 2006, 146). So, satisfaction is a result of an earlier experience with the brand and depends on a degree of expectations. Research indicates that only strong satisfaction may be converted into loyalty and mild feelings of satisfaction do not lead to brand loyalty (Chandrashekaran, Rotte, Tax, Grewal 2007). Not only meeting but exceeding customers’ expectations is the key to building emotional ties to a brand and creating loyalty. The relationship between loyalty and customer satisfaction, however, is not just a linear equation. Increased satisfaction is not enough to enforce loyalty and brand equity. The reasons are as follows:

a) Even satisfied customers switch brands. The reason may be brand indifference or conviction
that another brand equally or even better responds to customer needs.

b) Unsatisfied customers may stay loyal because it is their belief there is no better alternative on the market or making the decision regarding switching is too complicated.

c) Some customers, despite dissatisfaction, stay with the brand because the earlier brand relationship was important to them and they will give the brand another chance.

d) Formal restrictions, e.g. long-term agreement, discourage brand switch.

In all, one can make a statement that satisfaction makes a positive influence on customer attachment to the brand, makes necessary conditions to create loyalty, but it is not enough. An important determinant in this stage of loyalty is perceived superiority of a product or service resulting from the quality of the product, quality of service and quality of the marketing communication process.

A traditional approach to brand loyalty was product quality which was the major reason for brand loyalty (Oliver 1999, 38). Perceived high product quality often resulted from prolonged brand positioning based on quality associations. Also customer personality may contribute to brand loyalty, e.g. risk aversion discouraging new brands trials (Gounaris, Stathakopoulos 2004).

Other determinants of brand loyalty also play an important role. Oliver (1999) includes an individualistic determinism of a customer and also institutional or personal social attachment to the brand. An individualistic determinism of a customer means a degree of intensity with which the individual customer defends his own perception and resists competitive influence of marketers (Oliver 1999, 37). This is strong motivation to stay loyal to the brand. Brand confidence and attitudinal attachment are signs of the individualistic determinism and as such are accepted as determinants of brand loyalty (Chaudhuri, Holbrook 2001).

An individualistic determinism in its emotional part functions also in social dimension. It is related to the need of group belonging and sharing certain common behavior and consumption patterns. The practice of marketing management made an effort to institutionalize this need in a form of loyalty programs giving a loyal individual a feeling of belonging. Various frequent customer or preferred customer cards are aimed at increased frequency of purchase of a given brand, and frequent purchases are rewarded. Similarly, marketing clubs offer frequent customers various services and benefits not available to average customers. It is aimed at making a brand a part of an individual’s identity and organizes it into various forms of social existence. It emerges as fun clubs supporting sport, cultural and even political events. Loyal fans are ready to support their icons even in situations of defeat.

Effective management of brand loyalty requires proper metrics and systematic measurements. The measure of brand loyalty should take into consideration two factors previously discussed – attitude and behavior. Among behavioral measures the most important seems to be (Kall 2001, 101):

- percentage of repeat purchases (what percentage of customers repeat purchase of a given brand)
- percentage participation of a given brand in a product category purchase – share of wallet.
- number of brands purchased within a product category.

Some authors suggest a customer loyalty indicator which would give information about the intent to buy a particular product or service in relation to the total number of customers researched (Kozielski 2004).

When addressing measurement of attitudinal dimensions of brand loyalty, one can refer to the measurements of brand confidence, customer satisfaction, brand “likeness” or other measures indicating customers’ interest or even fascination with a brand. Attention should be focused on frequency of customer interaction with a brand, expression of opinions about a brand or even involvement in brand fun-club activities.

Brand loyalty creates a lot of advantages to the brand owner. All advantages such as increased market share, premium prices, higher margins and, finally, higher return on investment lead to the emergence of competitive advantage and even may be a barrier to entry of competitive brands. Considering the above, brand loyalty should be considered as a strategic asset of the firm; an asset that contributes to brand equity.

Table 1. Brand Loyalty as an Element of Competitive Advantage

<table>
<thead>
<tr>
<th>Brand Loyalty:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Lower marketing costs</td>
</tr>
<tr>
<td>o Higher effectiveness of marketing communication</td>
</tr>
<tr>
<td>o Guarantee of a right choice for new customers</td>
</tr>
<tr>
<td>o Favorable word-of-mouth</td>
</tr>
<tr>
<td>o Intensive purchase by existing customers</td>
</tr>
<tr>
<td>• Better access to distribution channels</td>
</tr>
<tr>
<td>• Better resistance to competitive moves</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Competitive Advantage</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Higher margins</td>
</tr>
<tr>
<td>• Increased market share</td>
</tr>
<tr>
<td>• Higher return on investment</td>
</tr>
<tr>
<td>• Entry barrier for rival competitors</td>
</tr>
</tbody>
</table>
Contribution of Brand Equity to Competitive Advantage of a Firm

Brand strategy is not the only strategy in product management. Many firms successfully apply generic (non-brand) product strategy which is effective especially when the product has a very weak emotional appeal or belongs to a product category that is difficult to differentiate. It refers to many agricultural consumer products, some industrial supplies or raw materials; however, in some cases one will notice existence of well established brands like Chiquita bananas or Del Monte pineapples. Generic product strategy allows for aggressive price competition since firms, in this case, do not invest in the brand building or brand strengthening process (Altkorn 1999, 55). Another reason for following generic product strategy may be because of low purchasing power of the population or fragmented economy. Consumers existing in this type of market, often in poor countries, are not ready to pay the cost of adding emotional value to products so an investment in brand building does not create additional value.

In developed countries with more sophisticated markets, firms decide to develop brands because brand equity building strategy is advantageous not only for the brand owner and buyer but also adds value in distribution and supply chain, i.e. business partners, suppliers, intermediaries, investors, and even society (creating the impression of a real or imaginary higher standard of living). Well recognized, strong brands followed by loyal customers contribute to and create benefits for various stakeholders in the business process, and ultimately help in the emergence of a competitive advantage for a firm supplying that market.

Consumer benefits, emerge from various functions performed by a brand (Aaker 1992, 31-32; Altkorn 1999, 13-14, Kapferer 2005, 20-24). One of these is the identification function. A brand helps the buyer to identify, retrieve and process information about the product which helps to identify it at the point of sale. Thanks to the brand, a customer is able to distinguish a particular product from a competitive offering and is able to attach to it a specific functional or emotional value experienced earlier or acquired from advertising.

A practical function of the brand means easiness in locating it during a purchase which saves time and effort. A satisfied customer usually repeats the purchase of an accepted brand which shortens the decision-making process. This is particularly important when a choice among hundreds of generic products would be an irritating experience. To be a loyal customer means shopping easiness, buying process acceleration and overall effort savings.

Separate functional benefits offered by a brand are related to consumer risk reduction. Guarantee function supports the quality of a brand regardless of time or place of purchase. Guarantee function supports the quality of a brand regardless of time or place of purchase. Guarantee function attached to a brand has special significance in the case of services. Most services are produced and consumed at the same time and it is difficult to assess the quality earlier. The buyer must trust the seller. Offer of a branded service facilitates trust building.

In the case of tangible products, a brand has the meaning of a “signature” which helps to identify a manufacturer; and also economic and legal responsibility which is important for customer questions, dissatisfaction or complaints.

Another important function performed by a brand is the optimization function. Purchase of a selected brand often means choice of the best solution for a customer’s need. A brand also reduces social and psychological risk by helping in the selection of a product that is most accepted by a reference group. Also, a particular brand choice suggests the existing or desired personality of the buyer and helps establish self-esteem.

In most instances, a brand influences the frame of mind of a buyer – the purchase of a Patek Philippe watch brings about different feelings than the purchase of a Swatch watch. Driving a Mercedes Benz gives a different feeling of satisfaction than driving a Fiat. A strong brand contributes a lot of satisfaction derived from product ownership and makes a status suggestion. Hedonistic function of a brand refers to customer’s infatuation with a brand. In this case, brand experience is perceived as a kind of premium. Some brands are continuously purchased not only by individuals but also by generations – in this case a feeling of continuity and even familiarity emerges. In the case of brands considered socially responsible or socially engaged (an image attached to a currently fashionable concept of sustainability), the customer develops a feeling of participation in ethical behavior and, to some degree, contribution to social programs or responsibility.

In addition to consumers, commercial distributors enjoy various benefits related to carrying products of well known brands. A strong and well accepted brand supported by advertising and promotion contributes to better inventory turnover. Well known brands reduce business risk which is used as an argument in filling up shelf-space. Strong brands appeal and respond to customer expectations and make a business or retail outlet more attractive for

| More time to respond to competitive moves |
| Lower risk of brand extension |
| Higher price elasticity of demand |

Source: Authors, based on Urbanek (2002, 44-45), Kall (2001, 98-101)
buyers. A brand contributes so many benefits to
distributors that many of them develop distributor brands or
private brands. Many supermarket chains or department
store chains have developed well known, attractive and
respectable brands.

A valuable brand also creates benefits for employees of
a business (de Charnatony 2003, 79). Working with a well
known brand stimulates productivity, contributes to job
satisfaction and develops professional pride. A strong
brand supports motivation of the employees and makes
many of them identify with the brand they produce or deal
with. In the case of corporate brands such as Microsoft,
Citibank or Philips, brand represents overall value of the
organization and helps the employees act in a common and
consistent manner which is especially valuable in the case
of global corporations. The value of a brand very often
reflects on organizational culture and attracts the attention
of many prospective employees. For many who work for a
brand, this represents values shared with each other and
increases job satisfaction.

Well known and valuable brands bring benefits to the society. According to Kotler, branding products result in
increased product quality and stability (Kotler, Armstrong,
Saunders, Wong 2002, 630). The value of a brand contributes to manufacturers’ innovativeness since it stimulates the search for such product features that can be protected against copying by the competition. This often contributes to new product development which benefits society. Certain well known brands enjoy broad acceptance which benefit society and the planet. Greenpeace is a brand name that achieved general acceptance as an organization engaged in environmental protection.

Due to delivered value perception in the eyes of the consumers, benefits to distributors, employees and society,
a brand adds value to the business of the brand owner. However, in the process of value adding the customer is the key. Without a customer’s acceptance, a brand wouldn’t get wide-range recognition and will not benefit the owner.

The value of the brand for the brand owner may be analyzed from various perspectives. From a customer’s perspective, a brand creates benefits for a brand owner by influencing the buyer’s attitude toward the product and attitude is considered a major determinant of product purchase intention (Farquhar 1989, 27). The high value of the brand represents the product’s historical reputation which strongly influences customer choice. High brand value perception creates high brand loyalty and readiness to pay a premium price for the product. Usually the favorite brand is rather price inelastic as customers are reluctant to
resign from its value. In the case of favorite brands, customers are less sensitive to the marketing efforts of competitors which enforce the efficiency of the brand owner’s marketing programs (Keller 2008, 60-67).

A valuable brand may contribute to increased cash flow resulting from higher margins and higher prices and
also due to higher promotional effectiveness (Farquhar
1989, 25). A strong brand also contributes to higher sales
profitability (Kall 2001, 62). These advantages, if properly managed, may result in increased market share which builds additional competitive advantage for a firm.

Considering brand owner relations with retailers, a valuable brand helps to establish a stronger position in
dealing with intermediaries since it reduces the risk of failure within distribution channels (Witek – Hajduk 2001,
80). It facilities the negotiation of the terms of sale and
saves expenses. The owner of a brand does not have to
apply intensive business promotion tools, and even can
limit or narrow promotional marketing. An American
grocery market is characterized by lower placement costs
and more shelf space for well known brands (Farquhar
1989, 26). Usually a valuable manufacturers’ brand
successfully protects itself against private brands. It is
especially important in situations where supermarket chains
and their private brands expand into the retail market.

A valuable brand facilitates relations with suppliers, investors, employees, and other co-operating public.
Decreased risk and stable brand position in the market helps
the owner to negotiate stable and balanced business terms.
A strong brand extends the product life cycle and, to some
degree, protects the firm against business shake-ups or
cyclical sales fluctuations. Even in the case of some high
value brands that in the past enjoyed high awareness and
recognition, the cost of bringing that brand to life again is
lower than new brand introduction (the case of Mustang
and Volkswagen Beetle). As a result of solid, stable brand
ownership, the attractiveness of that brand significantly
increases in the eyes of investors, business partners and also
prospective employees.

The advantages and benefits of a strong, valuable brand
mentioned above may contribute to the creation of an
attractive competitive advantage for a firm. Often this type
of competitive advantage related to customers’ loyalty
based on brand attractiveness helps the firm to dominate the
market in a given product category and achieve above
average profitability. In some cases the well known,
valuable brand name can be used as a synonym of a product
category which happened to Jeans or Adidas. These brands
are understood as product categories in many markets and
have a global meaning.

Another strategic aspect of a strong, valuable brand is
the possibility to successfully introduce new product under
the same brand umbrella and brand licensing. Also, a
strong brand can be used as market segmentation criterion
by helping the marketer to reach particular target markets
requesting product variations that best fit their needs.
Various brands of chocolate, for instance, can reach various
consumers’ groups such as children, diabetics, or others
who have specific needs. This approach may significantly
increase manufacturers’ market share or coverage. The
technique of umbrella branding, in the case of a strong,
valuable brand, may help to broaden product assortment
which is sold under the same brand and also to introduce a
new product under a well known brand name. The catalyst here is previous brand awareness and also a general, positive attitude to the brand. In this case the owner’s cost of new product launching is usually lower than a new brand introduction situation. The case of licensing may contribute to the broadening of brand awareness and its marketing impact should be under strict control, however, since the relaxed use by the licensee may result in significant brand value and brand position depreciation. This certainly will result in the weakening or sometimes the loss of competitive advantage of a firm building brand equity.

Competitive advantage built and based on brand equity is less sensitive to various crisis situations and has a strong ability to survive difficult times (Farquhar 1989, 26; Keller 2008, 60-67). This is because a strong and well accepted brand benefits from customer loyalty even in situations of quality problems or failures in new product introduction (Kall 2001, 69).

The research and discussion of customer brand loyalty and competitive advantage created by brand equity is especially important in the age of global corporations and globalization of various aspects of marketing programs. Today as a result of offshoring and outsourcing business especially manufacturing operations, there is confusion in the minds of buyers related to the country of origin concept. As a result of this, it seems that the old “made in” image starts fading in the perception of buyers and is gradually replaced by brand image concept. The importance of brand image is not a new issue today; however, its importance is growing and takes a special place in the process of creating a competitive advantage of global organizations. Thus the ability to differentiate the brand name and brand positioning in markets and also the ability to use it effectively in creating brand image and brand loyalty is critical in international and global marketing management.

References

Evaluation of Internal Control Systems: The Case of Public Sector Projects in Uganda

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Internal control system is a topical issue following global corporate accounting scandals in developed and developing countries. One proactive approach to the problem is critical assessment of the structure and effectiveness of the organization’s existing control system. This paper develops a conceptual model for evaluating the internal control systems in Public Sector Projects in Uganda funded by the African Development Bank Group. The paper finds lacking in the projects some essential components of effective internal control systems. The control structures consequently become ineffective. The study recommends improvement to the internal control systems and suggests areas for further research.

Introduction and overview. Sudden collapse of companies is often attributed to a breakdown in the internal control system, defined as a process that guides an organization towards achieving its objectives. These include operational efficiency and effectiveness, reliability of financial reporting and compliance with relevant laws and regulations (COSO 1992). Absence of these variables can result in organizational failure. The findings of the Treadway Commission Report of 1987 in the USA identified weak internal controls as a cause of fraudulent corporate financial reporting.

Recent global corporate accounting scandals inform this study. Notable cases include Enron and WorldCom in the USA, Parmalat in Europe, ChuoAoyama in Asia, JCI and Randgold and Exploration companies in South Africa and Cadbury Plc in Nigeria.

Objectives of the Paper

This paper evaluates the internal control systems that the regional member countries (RMCs) of the African Development Bank Group (AfDB) institutes for the management of the Public Sector Projects funded by the Bank. Specifically, the paper:

• ascertains whether or not such controls provide strong internal framework of checks and balances to ensure that project funds are utilized solely and wholly for intended development goals of poverty reduction and inducement of social and economic development of the respective RMCs.
• Provides a basis for assessing and understanding the structure of checks and balances established by the respective governments of the RMCs for the management of Public Sector Projects funded by AfDB, and ascertain whether or not such systems comply with globally-accepted internal control mechanisms.

These raise a number of questions. The major question is whether or not the established internal control systems in RMCs are effective. This raises a number of inter-related questions:

• What role should internal control system play in Public Sector Projects management? Does management of these projects appreciate, understand, and clearly respond to this role?
• What internal control systems are currently in use? Do they include all the expected elements of internal control systems?
• Are internal control systems in the Projects adequately documented and regularly updated as changes occur?
• Should the AfDB continue to lend to RMCs that do not bring a project in compliance with the requirements of established internal control systems?
• Do the Projects that comply with recommended internal control systems realize their goals more often than those that do not?

A later section of the paper discusses and justifies the methods selected to find answers to these questions.

Justification for the Study

The AfDB operates in RMCs where corruption is prevalent and transparency often lacking. Transparency International defines corruption as abuse of public office for private gains through accepting bribery, kickbacks, and embezzlement of public funds. Corporate accounting scandals occur where the systems of internal controls are abused by those responsible for their effectiveness. The Corruption Perceptions Index (CPI) 2006, covering 163 countries compiled by Transparency International, reveals that majority of the African countries in the index scored within the low range of 1.9 - 3.6. Not more than five African countries scored within the range of 4.1 - 4.6. In contrast, majority of the European countries scored between...
7.4 and 9.6. The Corruption Perceptions Indices suggest a prevalence of corruption in African countries, implying that Projects funded by AfDB could be in countries where transparency and accountability are lacking. Given such control environment, the AfDB has to provide development assistance to the projects and ensure that such funds are spent for development purposes.

These issues and the recommendations of the findings of the Treadway Commission Report of 1987 in the USA motivate and justify this study.

Internal Control Mechanisms

The evolutionary process of developing a generally accepted definition and framework of internal control was realized in 1992 with the publication of a landmark report on internal control: Internal Control - Integrated Framework, referred to as “COSO”.

According to COSO (1992), the internal control system has three primary objectives: effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations.

COSO identifies major control components of an effective internal control system as: control environment, risk assessment, control activities, information and communication and monitoring. These elements must be present and functioning effectively for any internal control system to achieve the organization’s objectives.

COSO did not recognize Information Technology (IT) as one of the major control components. Organizations use IT for initiation, authorization, recording and processing of accounting transactions. IT ensures effectiveness of internal controls. However, COSO’s failure to recognize IT as a control component motivated other bodies to develop frameworks to remedy the omission. One such framework is the Control Objectives for Information and Related Technology (COBIT 1996, 1998, 2000, 2005, 2007).

COBIT identifies five types of IT resources as a source of information needed by organization’s processes. The resources include: people, application systems, technology, facilities and data. COBIT groups the organization’s individual activities within an IT environment into processes and domains. The domains are: planning and organization with eleven processes; acquisition and implementation six processes; delivery and support thirteen processes, and monitoring four processes.

Conceptual Framework

Most of the literatures on internal control framework include information and communication as a control component. Smooth flow of information and communication in an organization is influenced by the nature of the working relationship at all levels. When effective working relationship exists in an organization, delegation of responsibilities is achieved. Then internal control functions as intended. However, when a communication gap exists for any reason, sub-optimization results with adverse consequences.

Some control frameworks emphasize detailed explanation of the control components and methods for their design. They ignore details on how each of the components can be measured to assess their effectiveness. This causes a dilemma. For example, where two managers use different methods to measure the same subject and arrive at different conclusions. A challenge arises in ascertaining who is right or wrong, when a common benchmark for evaluation of measured results is missing.

Figure 1 illustrates conceptual framework of internal control developed by the researchers after critical review of relevant literature on internal controls and filling identified gaps. The framework components comprises of dependent and independent variables. The control components are independent variables; all are interdependent but each has an impact on the effectiveness of internal control systems.

The effectiveness of internal control, the dependent variable, is achieved through the presence and functioning of all the predefined independent variables in relation to the organization’s objectives. This achieves each category of objectives 1, 2 and 3 in Figure 1. Objective (1) includes efficiency and effectiveness of operations (2) accuracy and reliability of informative financial reporting and (3) compliance with applicable laws, regulations, policies and procedures. As showed in Figure 1 the objectives are overlapping, this means efficient and effective operations produce accurate and reliable informative financial reports that comply with applicable laws and regulations.

The independent variables comprise major and minor components. Individual minor components jointly feed into and form a specific major independent variable. The
measurement of minor independent variables locates any weaknesses in the major independent variables. The major independent variables are: Control environment that sets the control tone of an organization and influences the control consciousness of all employees.

Risk assessment is a process of identifying and analyzing relevant risks to the achievement of the projects’ objectives and determining the appropriate response.

Control activities are policies and procedures established to address risks and to achieve the entity’s objectives.

Information and communication involves key criteria for evaluating performance, employees understanding of their control responsibilities and mechanisms for addressing suppliers and employees concerns.

Monitoring requires oversight of internal controls by management or other parties and application of customized checklists within a process by employees.

Information Technology resources expected to be present in these projects include: staff competent in IT matters, application systems suitable for capturing and processing projects data, up-to-date technology and facilities architecture compatible with projects information processing requirements and storage of projects data.

The minor independent variables include: Authorization and approval procedures; Human resource policies and practices; Assignment of authority and responsibility; Ineligible expenditure; Accountability obligations; Segregation of duties; Controls over access to resources; Presence of internal auditors; Verification; Reconciliation; Review of operating performance; and Supervision.

Method

The study uses the case study method. The method generates answers to the “what? and how?” research questions asked in this study. (Babbie, 1998, p.33) supports the case study method as follows: “While most research aims at generalized understanding, the case study aims at understanding a single, idiosyncratic case”. For instance, in fulfilling the study objectives, the researchers analyzed the following documents: aide memoirs, audit reports, country portfolio review reports and other documents got from the Bank’s database. The documents are for the fiscal year 2006. June 2006 is selected to evaluate the functioning of the new policies and procedures effected by the Bank in 2002. The reforms set new policies and procedures for improved portfolio management, business processes, client service and delegated authority to perform those activities to Field Offices.

The research process builds on development of knowledge of the subject matter. This study adopts positivism view. Under positivism approach, knowledge builds from using quantitative data which undergoes statistical processing, analysis and interpretation. Since the causal relationships between the dependent and independent variables of internal controls in the Public Sector Projects are to be tested and analyzed statistically, positivism approach is selected for the development of knowledge of this study. The next step is choice of research approach.

The deductive approach is used in this study, since the approach explains the causal relationships between variables and enables the concepts of the research to be operationalized so as to measure quantitatively the relationship between relevant variables.

The evaluation scope includes: project-level controls, period end financial reporting processes, IT controls as well as processes that impact significantly the project objectives.

Understanding and analyzing the internal control environment, risk assessment, control activities, information and communication, monitoring of operations, information technology are critical to this study.

The financial reporting processes evaluated include: authorization procedures, segregation of duties, reconciliation of key accounts, updating of books of accounts and records. This information evaluates whether key controls in place reduce the risk of material misstatements.

IT general controls evaluated include: IT development and maintenance processes, system operations management, system security management (access controls for internal and external parties) and contract management of service organizations.

For evaluation purposes, the Public Sector Projects funded by AfDB can be selected from one RMC. A useful starting is the categorization of the Bank’s RMCs.

Grouping of the African Development Bank Group (AfDB) Member Countries

The principal activities of the AfDB are financing development projects and programs in the RMCs. The RMCs are classified into three categories for financial allocations purposes (African Development Bank, Basic Information 2005).

Category A comprises 38 countries with per capita gross domestic product (GDP) of less than US$540. These countries access African Development Fund (ADF) resources.

Category B comprises two countries with per capita GDP between US$940 and US$1,050. Nigeria and Zimbabwe are in this category and both access African Development Bank (ADB) and ADF resources.

Category C comprises fourteen countries eligible only to ADB loans. Their per capita GDP is above US$ 1,050 and have high AfDB financial rating. Libya, a non-borrowing country is in this category.

The Bank has approved loans and grants to finance 3,111 projects under three funding windows, from 1967 to
2005. Out of the 3,111 projects, 2,045 are for ADF, 991 for ADB and 75 for Nigerian Trust Fund (NTF) windows. The Bank’s ADF resources finances 66 percent of the projects portfolio in category ‘A’ countries. The countries are among the poorest in the world and they constitute 73 percent of the RMCs of AfDB (African Development Bank, Financial Profile, 2006). This means that majority of the Bank’s projects are funded by ADF resources.

The Bank grants concessional loans to support a country’s economic and social development initiative. The loans designed to aid the development needs of the RMCs have a repayment term of 50-year with a 10-year grace period. The 2006 Corruption Perceptions Index (CPI) of the Bank’s category ‘A’ countries are within the range of 1.9 – 3.3. Thus the Bank operates in environments characterized by high level of corruption. Consequently, accountability and transparency are lacking, yet the Bank’s concessional lending arm relies on the capital replenishment by member nations in order to continue lending operations.

The Bank’s 2005 approvals confirm that ADF funded projects are sector-specific. The RMCs identifies sectors, which are key to the development of the country’s overall economic production and living standards, to which development assistance is channelled. In line with the RMC development strategy and the Bank’s strategic orientations, priorities and operational principles, the Bank focuses funding on: agriculture and rural development, infrastructure i.e. transport, power supply, communications, water supply and sanitation, education, health, private sector development and good governance as priority areas.

Since the Bank’s projects in the Uganda Portfolio are in strategic priority areas and also the new reforms delegated authority to the Field Office to manage the portfolio, Uganda is selected for this study.

**Data Analysis and Discussion of Findings**

There are 14 projects of the Bank’s Public Sector Portfolio in Uganda. We received and analyzed data for 11 projects. Three of the 14 projects omitted are not yet operational. The management letters of the eleven projects analyzed drew management’s attention to weaknesses in the internal controls involving minor independent variables. These are: authorization, verification, segregation of duties, accountability, ineligible expenditure, operations and procurement processes. The frequency of non-compliance of each project with applicable policies and procedures is observed and quantified. The analysis determines the financial costs of non-compliance with laid down policies and procedures and ascertains whether or not such costs are material to the achievement of the organization objectives. The monetary costs of non-compliance is extracted, recorded and statistically processed. This enables the relationship between the dependent and independent variables to be measured quantitatively.

The level of materiality of non-compliance is determined in financial terms. Dividing the cost of non-compliance by the total funds disbursed to each project as at 30 June 2006 sets materiality level. The results below 5 percent imply that controls are effective while above 5 percent mean that controls are ineffective. The figure of 5 percent is an estimate from the researchers’ judgment of what is material. Information is material if omission or misstatement of such in a financial statement influences the economic decisions of users that are based on the financial statements. Materiality is relative and depends on the error judged in particular scenarios of omission or misstatement. The following equation demonstrates the structure:

Materiality equals:

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\text{Materiality} = \frac{\text{Total cost of non-compliance with policies per sector}}{\text{Total amount of funds disbursed to the projects per sector}} \times 100
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\]
A qualitative analysis to confirm whether or not such risks can materialize was carried out. Qualitative evaluation requires a benchmark against which to appraise the controls in the projects. A conceptual model in Figure 1 is used as a benchmark since it has all elements of an effective internal control system. The model identifies three objectives of an effective internal control system. The first is operational efficiency and effectiveness. Effectiveness relates to the quality of controls over the achievement of specific management objectives, while efficiency addresses the quality of controls yielding an optimum measure of resource inputs to productive outputs. This objective determines whether the organization is reasonably assured that no material inefficiencies exist in the processes. The second objective is accuracy of financial reports produced. This objective emphasizes the adequacy and effectiveness of management controls governing the reliability of financial data used for external reporting. The third is the organizations’ compliance with applicable laws, regulations, policies and procedures. This focuses on the adequacy and effectiveness of management controls that govern adherence to external laws and regulations. This checks the correlation between the laws and entity’s procedures and actual practice.

The model identifies six essential components of an effective internal control system: control environment, risk assessment, control activities, information and communications, monitoring and information technology. The model considers working relationships to ensure effective functioning of the six core control components. The six control components are assessed before expressing opinion on the design and effectiveness of the overall internal control systems. But this alone cannot identify the exact weaknesses in the internal controls. To do this, major independent variables are broken down into minor independent variables and measured against identified benchmark. This means that the control components of the projects are broken down into minor independent variables and measured against the models components. To understand and apply the criteria to the model’s control components the researchers used binary numbers of 0 and 1 as ratings in the analysis. A rating of 1 reflects a control component with control problem, while 0 rating signifies a control component with no control problem. Each of the model’s major independent variable is defined using several minor independent variables. A summary position of this definition when a problem exists in the control components is in Table 1. Table 1 defines each major independent variable with a set of corresponding minor independent variables, used as benchmark for rating the effectiveness of project controls.

During evaluation, the assigned ratings must match the predefined criteria of the minor independent variables in Table 1. In the final evaluation, if controls provide reasonable assurance that management objectives will be achieved, a 0 rating is assigned. A 1 rating is recorded if controls do not provide such assurance. The judgments of the researchers play a significant role in assigning these ratings. The projects minor independent variables are measured against the models minor independent variables and a rating assigned based on whether or not there is a problem with the control being measured, as shown in Table 2. Table 2 below demonstrates the evaluation process.

Table 1: Criteria for rating internal control components

<table>
<thead>
<tr>
<th>Control Components</th>
<th>Criteria for a 1 rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minor independent variables</td>
<td></td>
</tr>
<tr>
<td>Key control activities of the projects are not functioning as intended:</td>
<td></td>
</tr>
<tr>
<td>Transactions are not authorized</td>
<td></td>
</tr>
<tr>
<td>There is no segregation of duties.</td>
<td></td>
</tr>
<tr>
<td>Verifications of transactions before making payments are not done.</td>
<td></td>
</tr>
<tr>
<td>Key accounts records like bank, cashbooks, loans, accounts payable etc are not reconciled on a regular basis.</td>
<td></td>
</tr>
<tr>
<td>There is no control over access to resources</td>
<td></td>
</tr>
<tr>
<td>There is no accountability of funds advanced for projects activities.</td>
<td></td>
</tr>
<tr>
<td>Management does not review operations</td>
<td></td>
</tr>
<tr>
<td>Internal auditors are not present and where present there is limitations in scope of their responsibilities by management.</td>
<td></td>
</tr>
<tr>
<td>Procedures have not been documented regularly updated in respective manual for example finance, staff rules and regulations and operations manuals.</td>
<td></td>
</tr>
<tr>
<td>Staffs are not supervised while they carry out their schedule of duties</td>
<td></td>
</tr>
<tr>
<td>Control activities designed for running the projects do not adequately reflect organizations risk mitigation strategies.</td>
<td></td>
</tr>
<tr>
<td>Key criteria for evaluating performance are not identified, collected and communicated.</td>
<td></td>
</tr>
<tr>
<td>Employees do not understand their control responsibilities.</td>
<td></td>
</tr>
<tr>
<td>Complaints and disputes by suppliers are not resolved in a timely manner.</td>
<td></td>
</tr>
<tr>
<td>There are no independent process checks or independent evaluations of control activities on ongoing basis.</td>
<td></td>
</tr>
<tr>
<td>No internal reviews of implementation of projects</td>
<td></td>
</tr>
<tr>
<td>No IT security procedures for accessing projects master data files</td>
<td></td>
</tr>
<tr>
<td>No restriction of personnel in accessing all levels of different modules in computer applications</td>
<td></td>
</tr>
</tbody>
</table>

Source: Researchers’ design
Table 2: Evaluation of controls of the Public Sector Projects in Uganda against the model’s criteria

<table>
<thead>
<tr>
<th>Major Control Components</th>
<th>Benchmark for rating internal controls when a problem exists</th>
<th>Functioning of internal control components of Public Sector Projects</th>
<th>Rating of internal control components of Public Sector Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Minor independent variable</td>
<td>Minor independent variable</td>
<td>0</td>
</tr>
<tr>
<td>Control Environment</td>
<td>(a) Organisational structure does not reflect chain of command</td>
<td>(a) Organisational structure reflect chain of command</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>(b) Human resources policies and procedure not documented and regularly updated</td>
<td>(b) Human resources policies and procedures not updated with the requirements of new legislation</td>
<td>(b) 1</td>
</tr>
<tr>
<td>Risk Assessment</td>
<td>(a) Management has not defined appropriate objectives for the projects</td>
<td>(a) Management has defined project objectives</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>(b) Management has not put in place mechanisms for determining and mitigating risks critical to achievement of project objectives</td>
<td>(b) Procurement of old and not calf animals and delivery of expired chemicals only discovered during field inspections of projects.</td>
<td>(b) 1</td>
</tr>
<tr>
<td>Control Activities</td>
<td>(a) Key accounts not reconciled and updated on regular basis</td>
<td>(a) General ledger not kept</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>(b) No accountability of funds advanced for project activities</td>
<td>(b) Advance to staff not accounted for and no documentary evidence to prove activities are carried as planned</td>
<td>(b) 1</td>
</tr>
<tr>
<td>Information and</td>
<td>(a) Key criteria for evaluating performance are not identified and communicated to employees</td>
<td>(a) Criteria for performance evaluation is identified and communicated to employees</td>
<td>0</td>
</tr>
<tr>
<td>Communication</td>
<td>(b) Employees do not understand their control responsibilities</td>
<td>(b) Employees understand their control responsibilities</td>
<td>(b) 0</td>
</tr>
<tr>
<td>Monitoring</td>
<td>(a) There are no independent process checks of control activities</td>
<td>(a) There are independent process checks established by the Bank</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>(b) No internal reviews of project implementations</td>
<td>(b) No monitoring and evaluation of project implementation undertaken by management</td>
<td>(b) 1</td>
</tr>
<tr>
<td>Information Technology</td>
<td>(a) No IT security procedures for accessing project master data files</td>
<td>(a) IT security procedures for accessing project master data files available</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>(b) No restriction of personnel to access of different levels of the system</td>
<td>(b) Access to different levels of IT system restricted through use of passwords</td>
<td>(b) 0</td>
</tr>
</tbody>
</table>

Source: Researchers’ design

The outcome of the evaluation process in Table 2 is summarized in Table 3.

Table 3: Control evaluation form

<table>
<thead>
<tr>
<th>The Public Sector Projects Control Evaluation Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>Report Title: Evaluation of Internal Control Systems: The Case of Public Sector Projects in Uganda</td>
</tr>
<tr>
<td>Project No: 1 Report No: 1 Report Date: 18 June 2008</td>
</tr>
<tr>
<td>Project Leader: Angella Amudo Project Specialist: Eno L. Inanga</td>
</tr>
<tr>
<td>Ratings Modules objectives</td>
</tr>
<tr>
<td>0: No problem exists 1: Problem exists</td>
</tr>
<tr>
<td>Effectiveness and efficiency of operations</td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>Risk assessment</td>
</tr>
<tr>
<td>Control activities</td>
</tr>
<tr>
<td>Information &amp; Communication</td>
</tr>
<tr>
<td>Monitoring</td>
</tr>
<tr>
<td>Information Technology</td>
</tr>
<tr>
<td>Overall</td>
</tr>
</tbody>
</table>

Detailed analysis of the above ratings is done in section 8 of this paper.

Source: Researchers’ design

Analysis and interpretation of the evaluation results in Table 3 generate interesting findings. Control environment attained a rating of 1, which means a problem exists. An assumption was made that soft controls exist. The evaluation process proved otherwise. As a foundation upon which all other control components depend, this poses a challenge to the effective functioning of other control components. For example, updating the human resource policies and procedures is not regularly done.

The risk assessment has a rating of 1. This indicates that project managers ignored the risks and mechanisms to mitigate risks that threaten attainment of projects objectives. For example, the risks: delivery of expired chemicals and unsuitable animals for projects activities came to management’s attention during and after field visits. When project risks are identified during and after field visits, a 1 rating is awarded on this observation alone, even when the project objectives are defined and compatible with both development and the Bank’s objectives. When a risk factor is known in this manner, the other defined objectives become non-functional.

The results of control activities in the evaluation form indicate a 1 rating. This means control activities are not functioning as they should due to weaknesses in the control environment. For example reconciliation of key accounts records is not carried out. This results in errors and undetected fraudulent transactions in account books and records that can lead to substantial losses to these projects.

The information and communication results in the evaluation scored a rating of 0, indicating absence of a problem. This means that the criteria for performance evaluation are known by employees and employees...
understand their internal control responsibilities. In conclusion, controls functions as intended.

The monitoring results scored a rating of 1, indicating a problem exists. Documentary analyses reveal that the Bank established an independent check. However, internal monitoring and evaluations of implementations of project activities by management are not carried out. This delays allocation of funds and assessment of project implementation against yearly work plans.

IT attained 0 rating, indicating absence of a problem with the information technology controls in place. This is confirmed by access to resources that attained a rating of 0, although the overall rating changed to 1.

The study evaluates minor independent variables to locate any weaknesses in the major independent variables. This succeeded because the findings identified areas of weaknesses as being in: updating human resource policies and procedures; duties are not segregated; key records are not reconciled; proper books of accounts are not kept; ineligible expenditures are incurred; funds advanced are not accounted for to mention a few. The impact of these findings on management’s objectives determines whether or not internal controls are effective.

Interpretation of the evaluation results of overall ratings in relation to management’s objectives, summarized in Table 3, reveals that effectiveness and efficiency of operations attained a rating of 1, indicating a problem exists. This is consistent with the materiality level results in Figure 2. For example, project funds advanced to staff for projects activities are not accounted for. Optimum spending on projects activities cannot be ascertained. Thus operations may not be efficient and effective.

Reliability of financial reporting also scored a 1 rating, meaning that controls in these projects do not produce accurate and reliable financial reports. The evaluation process re-affirms that projects transactions and events are not verified, books and records of accounts are not complete. The general ledger is missing and also, key accounts are not reconciled and updated. Such control processes generates inaccurate financial information which ultimately affects the quality of financial reports produced.

Compliance with the laws and regulations also attained a rating of 1, indicating management does not comply with applicable laws, regulations, policies and procedures. For example the financing agreement stipulates that the Bank’s funds should not be used for paying taxes, however, when government delays releasing counterpart funds, project managers use the Bank’s funds for paying taxes. Since non-compliance is material, this means controls in this area do not function as intended and, as a result, are ineffective.

The model requires that all the six major independent variables must be present and functioning for internal controls to be effective. From the above analysis and in line with the evaluation results in table 2, summarized in table 3, this is not the case. This is because only information and communication and IT are present and functioning properly, the other four are not. With the analyzed information the study now answers the research questions raised in section 2.

### Research Questions and Answers

The project documents analyzed confirm management design and implement controls to steer the AfDB projects in Uganda to achieve the identified objectives of operational effectiveness and efficiency, accurate and reliable financial reports which comply with applicable laws and regulations.

However, there is variance between expectations and actual realizations. For example, the Bank’s procurement policies and procedures require management to meet at least three quotations from three different suppliers for purchases above established threshold. This is to compare and select the lowest price for the highest quality item to meet the objectives of economy and efficiency of operations (Banks procurement rules and procedures). When management disregards these rules, prices are not compared to ensure the highest quality items are acquired at the lowest price. The actual role of internal control then differs from expected role.

The evaluation results reveal internal control structure in existence in these projects are: Control over preparation of withdrawal applications of funds; Control over bank and cash balances; Control over purchases and payments; Control over payroll and Monitoring, evaluation and reporting. The findings indicate that some elements of effective internal control system are missing. This renders the project controls ineffective when measured against components of an effective internal control system.

The study demonstrates that the internal control systems are documented in some projects and not in others. Where policies and procedures are documented for example in human resource, they are not updated with changing legislations, regulations, policies and procedures. Adherence to outdated policies and procedures has adverse consequences on the projects.

As the Bank’s mission is to aid development initiatives in the RMCs, the risk of lending to the RMCs that do not comply with internal controls requirements is high. The Bank could impose heavy penalties on countries that do not maintain sound internal control systems for the management of projects funds. Poor internal controls undermine development initiative pursued by the Bank and the RMCs since funds are not utilized for development.

Since development goals are long-term, this question is for further research and requires collection of data over a number of years.
Conclusions, Recommendations and Suggestions for Further Research

According to this study, the structure of the internal controls in the projects includes controls over: withdrawal applications for funds from the loan and grant accounts, bank and cash, purchases and payments and monitoring, evaluations and reporting. Not all the components of an effective internal control system recommended by the model are present in the control structure of these projects. The structure of internal control systems can be strengthened through incorporation of missing elements of an effective internal control shown in Figure. For example Risk assessment component and mitigation strategies should be anticipated, designed and embedded within the rest of the activities and spelt out in the control structure.

Monitoring of operations ensures effective functioning of internal controls. However, project managers only carry out supervision mission arranged by the AfDB to identify major problems the projects experiences. Continuous monitoring should be undertaken to assess the achievement of preset objectives stipulated in the appraisal reports.

Internal auditors’ responsibilities are limited in scope. For instance, accountability of projects’ funds is retired without verification by internal auditors. This leads to undetected errors. Although the internal auditor is not mandated to verify all projects transactions, he samples transactions and tests the effects of controls over them to ensure the organization is in the right track.

The organizational structure with defined lines of authority and responsibilities does not ensure effective functioning of internal controls because at times the authority and responsibilities may not flow as demonstrated by the structure due to the nature of working relationships amongst personnel at different levels. The interferences caused by working relationships on controls should be considered.

The results of the study can either be generalized or modified to suit the unique circumstances of the RMCs of the Bank. Out of the Bank’s fifty-two funded RMCs, the study was carried out in only Uganda. Selecting eleven projects from Uganda for this study limits research using relevant research methods. Also generalization of the findings of the study to projects in other RMCs is limited. The adoption of the results of the study by a RMC will depend on the circumstances in a particular country. If similar to the situations in Uganda they can be generally applied. In case differences exist, these are captured in the modification of the uniqueness in those respective countries.

To use selected research methods such as testing hypotheses and analysis of quantitative data using statistical tools to generalize findings to other RMCs, more countries should be included in the study to provide data for this purpose.

The Bank and other development partners, assisting RMCs in poverty alleviation efforts can fund further research.

References


This paper addresses the question whether capital account liberalization increases risks of balance of payments (BoP) crises in Suriname. It finds that given the present macroeconomic and institutional fundamentals rapid liberalization would most likely increase such risks and, accordingly, advises policy makers to tread cautiously in this regard.

Introduction

Capital account liberalization can be defined as: “the process through which countries liberalize their capital account by removing controls, taxes, subsidies and quantitative restrictions that affects capital transactions. It involves the dismantling of all barriers on international financial transactions and the purchase and sale of financial or real assets across borders.” (Singh K., 2000, p.57). The different types of capital account transactions that may be subject to control are (Johnston, 1998): capital and money market flows, credit operations, direct investments, real estate transactions and personal capital movements. Furthermore, capital controls include provisions specific to commercial banks and institutional investors.

A balance of payments crisis may be defined as a shortage of international reserves to cover balance of payments needs such as imports and external debt servicing. It is typically identified with a sharp drop in international reserves or a sharp devaluation or both (Berg, Borenstein, Milesi-Ferretti, & Patillo, 1999, p.1). According to this definition, a currency crisis falls within the domain of BoP crises. However, there is no agreement on how to measure currency crises. Each study appears to have a different measure.

The 1990s and the early 2000s witnessed many BoP crises, mostly in the developing world (see e.g. Frankel and Rose, 1996; Singh K., 2000, Hutchison and Neuberger, 2002). These crises have been extremely damaging to the countries concerned. Explanations for the source of these crises have been varied; from, on the one hand, poor macroeconomic and institutional fundamentals to, on the other hand, rapid and ill-conceived capital account liberalization, in some cases forced on the victim by various international financial organizations. The present study aims to consider these explanations in the context considering whether capital account liberalization will increase the likelihood of balance of payments crises in Suriname.

Since early 1990s, Suriname adopted what may be called a gradualist approach towards liberalizing the economy. It also sought to increase its integration into the world economy through greater regional integration, and in particular accession to CARICOM. As part of the terms of this accession Suriname has of late (January 2006) liberalized capital inflows from other CARICOM countries. Some policy makers in Suriname see this liberalization of the capital account as a basis for liberalization beyond CARICOM, arguing that there are considerable benefits to the economy from such a strategy. The present study seeks to caution against such a strategy (the strategy of extending capital account liberalization beyond CARICOM) without considering fully its potential destabilizing effects. It is argued that such a strategy would increase the probability of BoP crises given Suriname’s weak economic and institutional fundamentals.

Literature Review

Theoretical Literature

The theoretical literature review focuses on the contending views of the role of capital account liberalization in BoP crises as well as on identifying important pre-cursors of such crises. The views will be clustered into so-called Neoclassical and Keynesian views on the role of capital account liberalization in balance of payments crises following Nicholas (2006).

Neoclassicals typically do not conceive of any deleterious consequences emanating from capital account liberalization therefore, they typically advocate full capital

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1 Capital account is interchangeably used with capital and financial account throughout this study.
2 One simple measure is that of Frankel and Rose (1996), in which a currency crisis is measured as an increase of the nominal dollar exchange rate with at least 25% in a year, while it has increased by at least 10% or more than in the previous year.
Account Liberalization and BoP Crises

Tabel 1. Keynesians versus Neoclassicals on Capital flows.

The response to volatile short-term capital is controls on those flows (Stiglitz, 2003, p. 65). The Keynesian chosen policy using money that can be pulled out on a moment's notice. Speculative money cannot be used to build factories or more than bets on exchange rate movements. This following statement illustrates the Keynesian position; “hot money...short-term loans and contracts are usually no more than bets on exchange rate movements. This speculative money cannot be used to build factories or create jobs, companies do not make long-term investments using money that can be pulled out on a moment’s notice...” (Stiglitz, 2003, p. 65). The Keynesian chosen policy response to volatile short-term capital is controls on those flows.

Keynesians, in contrast, believe that financial markets are inherently unstable and consider capital account liberalization, especially short-term capital flows, as the main trigger of BoP crises. Free flows of short-term capital, mainly capital of a speculative nature, can easily lead to a crisis, because they can be rapidly reversed. They consider important pre-cursors of BoP crises to be a deterioration of exports, caused by a deterioration in the terms of trade and/or an overvaluation of the currency, and reflected in declining trade and current account balances. The following statement illustrates the Keynesian position; “hot money...short-term loans and contracts are usually no more than bets on exchange rate movements. This speculative money cannot be used to build factories or create jobs, companies do not make long-term investments using money that can be pulled out on a moment’s notice...” (Stiglitz, 2003, p. 65). The Keynesian chosen policy response to volatile short-term capital is controls on those flows.

<table>
<thead>
<tr>
<th>does capital account liberalization increase risks for BoP crises?</th>
<th>Keynesians</th>
<th>Neoclassicals</th>
</tr>
</thead>
<tbody>
<tr>
<td>recommendation</td>
<td>Partial liberalization</td>
<td>Full liberalization</td>
</tr>
</tbody>
</table>

Main findings from category one studies

Kaminsky and Reinhart (1996) were the first to incorporate capital account liberalization as a variable to explain BoP and banking crises. Their paper explored the links between banking crises, exchange rate crises and financial liberalization in twenty countries, of which fourteen were developing ones and it covered the period 1970-1995. They concluded that currency and banking crises are “closely linked in the aftermath of financial liberalization”; that the occurrence of a banking crisis is a good predictor of a BoP crisis; and knowing that there is a banking crisis underway helps to predict currency crises. This study was conducted before the East Asian crises, but the findings were confirmed by it. Studies by Demirgüç-Kunt and Detragiache (1998) as well as Mehrez and Kaufman (1999) support these findings. The former also found a two-way interaction between banking and currency crises. All the above studies found that banks become more vulnerable to external economic shocks when capital account is liberalized before the banking system is being strengthened. Financial liberalization leads to an intensification of competition among banks and consequently to greater moral hazard and risk-taking than before. The findings suggest that vulnerability to BoP crises is reduced by strengthening the banking system through prudential regulation, bank supervision and enhanced transparency.

Another major finding of category one studies, mostly those conducted in the aftermath of the East Asian crises, is that capital account liberalization has led to a build-up of short-term external debt, which in turn was a robust predictor of the crisis. A short-term external debt to reserves ratio of more than one, or a sharp increase in the ratio, makes a country prone to a crisis because of the risk for sudden and massive reversibility of those flows for rational or irrational reasons (see e.g. Furman and Stiglitz, 1998; Rodrik and Velasco 1999).

Main findings from category two studies

Rossi (1999) found that countries with a large number of controls on capital inflows tend to be less prone to currency crashes, simply because of the limited amount of easy reversible funds. Williamson and Drabek (1999) also provided evidence onthis issue. Regarding the East Asian crises, they concluded that the countries that were least affected by the crisis were those which had not liberalized their capital. Singh A., (2002) comes to similar conclusions. China and India are frequently used in many category two studies as examples to illustrate the point about capital controls reducing BoP crisis risks.

Main findings from category three studies

There are a few studies show that capital account liberalization does not increase BoP risks, and some among

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1 The process of liberalizing the domestic financial sector and external capital flows. The latter is known as capital account liberalization.
2 Banking crises lead to currency crises and visa versa.
3 Remaining maturity of shorter than one year.
these which even show a positive relation between capital controls and currency crises. One such study is Glick and Huchinson (2000). These authors used an alternative measure to assess the role of capital account liberalization in currency crises. The macroeconomic determinants of currency instability were controlled, while the impact of the banking sector on currency crises in the aftermath of capital account liberalization was taken into account. They concluded that countries imposing capital controls are more likely to experience BoP crises than countries with free capital flows. According to this study, capital restrictions send “bad signals” to markets, which in turn increase the probability of currency crises as a result of net capital outflows.

Although, as can be seen from the above, there is no agreement in the empirical literature on the question of whether capital account liberalization is an important determinant of BoP crises, it is perhaps fair to say that the majority of findings answer this question in the affirmative; capital account liberalization does have a causal impact on BoP crises in developing countries.

### Suriname’s Capital Account and Sovereign Credit Rating History

#### Capital Account

Suriname’s capital account can be categorized as controlled. As noted above, capital inflows from other CARICOM countries were liberalized as of January 2006⁶, but capital outflows to other CARICOM countries are still controlled. Capital inflows as well as capital outflows beyond CARICOM are controlled. Prior approval is required from the Foreign Exchange Commission for each transaction. Direct investments, both inward as well as outward, require approval of the FEC. However, proceeds from liquidation of FDI can freely be exported. Real estate transactions and money and capital market transactions are also controlled. However, it can be argued that in practice, capital transactions are less controlled because of the possibility that capital can flow out of the country through the current account⁷.

Capital account flows are mainly related to development aid from the Netherlands - the former colonial power - while financial account flows mainly consist of private flows⁸ and government loans. Capital flows as well as financial flows increased considerably in the first half of the 2000s (see Table 2). Increased FDI are related to the mineral sector, while the increased financial flows, category “Other”, are mostly foreign exchange inflows of residents from exports⁹ and also repatriation of foreign currency holdings from abroad by residents.

<table>
<thead>
<tr>
<th>Table 2. Capital and Financial Account (% of GDP)</th>
<th>1991-2000</th>
<th>2001-05</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital account</td>
<td>0.9</td>
<td>2.3</td>
</tr>
<tr>
<td>Financial account</td>
<td>-5.3</td>
<td>12.2</td>
</tr>
<tr>
<td>FDI</td>
<td>-2.2</td>
<td>7.8</td>
</tr>
<tr>
<td>Other</td>
<td>-3.1</td>
<td>4.4</td>
</tr>
</tbody>
</table>

Source: Nicholas (2006, sheet 3) and Author; based on IMF (2006 a)

#### Sovereign Credit Rating History of Suriname

Suriname remained in the single B category since the first rating of B- by Standard and Poor’s (S&P) in 1999. In 2004, Suriname obtained a rating of B1 by Moody’s and B by Fitch. The speculative grade ratings emanate mainly from poor macroeconomic performance in the 1980s and 1990s, a weak external position, widespread involvement of the government in the economy and external debt defaults. However, macroeconomic performance improved gradually since 2000 due to booming mineral sector and prudent macroeconomic policies. As a result S&P upgraded Suriname’s sovereign rating to B in 2006 and to B+ in 2007. The two other rating agencies remained Suriname’s rating on the same level. The main reasons for the low credit rating despite improved macroeconomic conditions are: persistent arrears to bilateral creditors, the economy’s vulnerability to external shocks emanating from fluctuations in commodity prices, slow structural changes such as in the area of public sector reform, multi party based coalition with different views, relatively weak external position.

### Is Suriname ready for Capital Account Liberalization?

To answer this question we will look at the potential for Suriname to attract short-term capital flows in the event of full liberalization and the present economic fundamentals of the economy. From the relevant literature reviewed above it would seem that the economic fundamentals of importance are the current account balance, foreign exchange reserve position, the banking system and bank supervision, and the fiscal situation. But we begin with the

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⁶ This has taken place within the framework of regional integration. However, there exists currently no regional emergency fund to bail-out countries in case of BoP crises.

⁷ The current account is liberalized through the 1990s.

⁸ Mainly related to FDI flows of multinationals.

⁹ Surrender requirements for export proceeds of non-mineral exports (except for small gold exports) were abolished in the early 2000s. Exporters are obliged to transfer the export proceeds to their foreign currency deposit at a local commercial bank within sixty days. Those transfers are registered as short-term financial inflows, in accordance with the rules of the latest BoP manual.
Potential for short-term capital inflows in the event of a full liberalization of the capital account.

**Potential for Short-term Capital Inflows**

Suriname has significantly higher nominal domestic currency deposit interest rates compared to the USA and most of the other large CARICOM countries (see figure 1).

Figure 1. High local currency deposit interest rates differentials (%)

![](image1)

Source: Author; based IMF data (2006 b)

Suriname’s high level of interest rates is only comparable with that of Jamaica. It can be argued that, in the context of a relatively stable exchange rate, such large nominal interest rates differentials have the potential to attract short-term capital in the case of free capital flows. The nominal exchange rate of Suriname is stable at the rate of SRD 2.8 per US$ as of 2004. Suriname’s private sector appear more doubtful about the potential for large inflows of short-term capital because of the low country rating (see above) and underdeveloped short-term money market (interviews with Caram and Harmsma – see annex 1). However, part of the reason for the underdeveloped money market is precisely the constraints on capital flows and short-term flows have been notoriously insensitive to credit ratings of countries.

**Current Account Balances and the Exchange Rate**

Suriname’s current account is structurally in deficit and has deteriorated over time (see figure 2): from -2.4 % in the 1980s to -2.7% in the 1990s and -5.6% in the 2000s. One important reason for the long-term structural imbalance is the massive imbalance in the services account – which outweighs the surplus in the trade account. But the deterioration in the current account balance would also seem to reflect a deterioration in the trade balance surplus suggesting, among other things, a growing overvaluation of the exchange rate. It is to this issue that we now turn.

In a recent study, Madho (2006) concludes that in the period 1995-2004, the real exchange rate of Suriname was overvalued by 14 % relative to the US$ and 6 % relative to its major trading partners. Furthermore, she concluded that the impact of over-and undervaluation was less on the bauxite sector than the non-mineral sector. In addition, based on IMF calculation of the real effective exchange rate (REER)\(^\text{10}\), the conclusion can be derived that the SRD has cumulatively appreciated by 32% in the period 2000-2005 (IMF, 2006 a). Those two available studies lead to the conclusion that the currency is overvalued. As the literature review suggests, currency overvaluation has been one of the important economic pre-conditions for BoP crises in the context of capital account liberalization.

Figure 2. Deteriorating External Sector

![](image2)

Source: Author, based Nicholas (2006) and IMF (2008)

In a recent study, Madho (2006) concludes that in the period 1995-2004, the real exchange rate of Suriname was overvalued by 14 % relative to the US$ and 6 % relative to its major trading partners. Furthermore, she concluded that the impact of over-and undervaluation was less on the bauxite sector than the non-mineral sector. In addition, based on IMF calculation of the real effective exchange rate (REER)\(^\text{11}\), the conclusion can be derived that the SRD has cumulatively appreciated by 32% in the period 2000-2005 (IMF, 2006 a). Those two available studies lead to the conclusion that the currency is overvalued. As the literature review suggests, currency overvaluation has been one of the important economic pre-conditions for BoP crises in the context of capital account liberalization.

**International Reserves and International Debt**

The current total\(^\text{12}\) reserve holdings of Suriname are almost of US$ 800 million. This represents about 5.5 months of imports. From figure 3 it may be seen that

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\(^{10}\) A weighted average of bilateral real exchange rates of important trading partners.

\(^{11}\) A weighted average of bilateral real exchange rates of important trading partners.

\(^{12}\) Total reserve holdings defined as official reserves plus private foreign currency holdings.
Suriname’s total reserves and reserve cover has been rising since the late 1990s from precariously low levels to what is deemed to be an acceptable level by the IMF. The IMF typically uses a benchmark of under 3 months reserve cover to signal inadequate cover.

Figure 3. Low International Reserves and Import Cover Ratio and High Foreign Currency Deposits

Source: Author, based on IMF data (2003 and 2007)

One concern however is that most of the total reserves comprise private holdings with the banking system (see figure 3). If one just looks at official reserves the picture is less comforting. Official reserve cover of imports is at present just 2 months. This would suggest that the monetary authorities would find it difficult, without outside assistance to withstand any sustained speculative attack on the currency.

Somewhat mitigating the reserve position is Suriname’s relatively favourable short-term external debt situation. Short-term (government external) debt\(^{13}\) to gross international reserves ratio is much lower than the benchmark of one (1). As data for the period 2002-5 would suggest, moreover, this ratio has even been declining (see figure 4).

Figure 4. Healthy Short-Term Public Sector External Debt/Gross International Reserves Ratio

Source: Author based on IMF data (2006 a)

This would suggest that the current short-term debt situation should not be an issue in the liberalization debate. However, it should not be forgotten that the low short-term debt ratio is itself due to the existing controls.

Banking System

The relative soundness or otherwise of Suriname’s banking system can be ascertained by looking at such things as capital adequacy ratios\(^{14}\) and figures on non-performing loans (NPL’s), as well as the regulatory and supervision framework. Capital adequacy ratio is a solvency indicator. The benchmark for the risk weighted capital adequacy ratio (BIS-ratio) is 8. This is a minimum requirement. The non performing loan ratio expresses the NPL’s as a percentage of the gross loans. The international norm for NPL’s is 3 (maximum).

The latest capital adequacy ratio figures (figure 5) give no cause for alarm. While the large banks were well above the minimum requirement of 8 between 2000 and 2006, it is only in 2006 that the small banks nearly satisfy the minimum requirement. One major cause of the significant increase of the capital adequacy ratio of the small banks in 2006 is the revaluation of their immovable property.

Figure 5. Capital Adequacy Ratio Large and Small Banks

Source: Author based on IMF data (2007)

In contrast with the satisfactory capital adequacy ratio’s, both, large and small banks are well above the maximum NPL ratio of 3. This indicates the nature and extent of the relative fragility of the banking system, especially of the small banks. The large banks exceed the norm by more than twice, while the small banks are far beyond the limit (figure 6).

The Central Bank of Suriname annual report 2001-2003 provides an explanation of the weak financial status of the small banks\(^{15}\). It states “the misuse of a “Production-Investment Fund” created in 1997 to stimulate economic activity, has contributed to financial difficulties of the state-  

\(^{13}\) Defined as defined principal debt service falling due during the next year.

\(^{14}\) Refers to regulatory capital to risk-weighted assets.

\(^{15}\) Consist mostly of state-owned banks.
owned banks. The funds were channeled through the state-owned banks.

Figure 6. Non Performing Loans Large and Small Banks

![Graph showing non-performing loans for large and small banks over the years 2000 to 2006.]

Source: Author based on IMF data (2007)

The allocation of funds to local investors was not based on good banking principles, but rather on other vague principles. This resulted in among others high non-performing loans at the state-owned banks.” (p.174)

Currently, the government is trying to resolve the problems at the state-owned banks with assistance of the Inter-American Development Bank. Obviously, this is something that would have to be resolved before any move to extending capital account liberalization if the intention is to minimize the potential for speculative capital flight and attendant BoP crises. However, it should be noted that the small banks account for a very minor fraction of the whole banking system, and many of the banks are state-owned, suggesting only a limited contagion effect, if any.

One aspect of the Suriname banking system which does give cause for concern in the event of capital account liberalization is its dollarization. The Surinamese banking system is highly dollarized by international standard. The deposit dollarization ratio as well as credit dollarization ratio is above 50% in recent years (figure 7).

Figure 7. High Financial Dollarization

![Graph showing high financial dollarization over years 2000 to 2006.]

Source: Author based on IMF data (2006 a)

It can be argued that the high level of financial dollarization gives rise to considerable BoP crisis risks in the event of full capital account liberalization. The risks are twofold. First, and most obviously, it would greatly increase the potential for a speculative outflow in the manner say of Argentina during its financial crisis. Those holding dollar deposits would worry that the government might impose capital controls in the event of a shortage increasing the likelihood of flight. Second, and more seriously, it would increase the potential for a massive contraction in credit (emanating from the capital flight) and resulting in considerable damage to production, including export-oriented production.

What then of the regulatory framework?

What can be said is that some progress has been made by the Central Bank of Suriname in prudential regulations and bank supervision area since 2003. In this year five new Basle compatible prudential regulations were brought into force (IMF, 2005 b). The regulations were aimed at guaranteeing financial soundness of the banks and are, to a large extent, similar to those mentioned in the literature review. Among the regulations are those relating to solvency\(^{16}\) of banks, and to risk assessment and management - aimed at preventing of high levels of non-performing loans. Significantly, given the above-mentioned extent of Suriname’s financial dollarization, one of the regulations brought in was the requirement for commercial banks to hold reserves in respect of foreign currency deposits from 2004 onwards.\(^\) Recent indications would suggest that this particular regulation has had the impact of moderating if not actually reversing the dollarization trend.

Government Budget

The general literature on BoP crises has also suggested that excessive monetization of fiscal deficits may have been an important pre-condition for the observed negative impact of capital account liberalization on the BoP of many developing countries.

Figure 8. Overall Fiscal Balance

![Graph showing overall fiscal balance from 1999 to 2007.]

Source: Author, based on data of Ministry of Finance (2008)

\(^{16}\) Minimum capital adequacy ratio of 8%.

\(^{17}\) The current reserve ratio is 33.33%
The data for Suriname suggests that the authorities have in fact been quite prudent in their management of the countries finances. From a serious problem in the late 1990s it would seem that there was considerable progress in the 2000s (see figure 8).

The average overall fiscal surplus between 2001 and 2007 was 0.1% of GDP. The progress was largely the result of the government institutionalizing fiscal discipline by adopting formal rules for domestic and external debt of maximum 15% of GDP and 45% of GDP respectively. The Minister of Finance has been made personally liable for excesses. The Central Bank Act 1956 was also amended in mid-2005 to avoid misuse of the Bank by the Minister of Finance.

Conclusions and Policy Recommendations

What the preceding suggests is that the Surinamese authorities should adopt a cautious approach to capital account liberalization beyond those commitments made in the context of accession to CARICOM. There are no doubt benefits to be gotten from a deepening of the liberalization process, but these benefits would require certain economic fundamentals to be addressed as a pre-condition, if the liberalization process is not to result in a heightened risk of recurrent BoP crises. The economic fundamentals which are found to be of concern in the Surinamese context are the weakness of the current account and the state of the banking system. With regard to the current account some concern has been expressed about structural problems with financial flows involving services and the overvaluation of the exchange rate. The overvaluation problem can be dealt with over the relatively short-term, but the services problem appears to be more entrenched. With regard to the banking system, the real problems seem to be the high NPL’s especially of the small banks and its excessive dollarization. The NPL problem should be solved before any comprehensive liberalization effort can be taken. As it is showed, BoP crises can be easily triggered by weak banks when capital flows are liberalized. Although the dollarization process shows some signs of a reversal, and prudential measures have been introduced to provide certain safeguards, further progress towards de-dollarization would be required before one could feel confident that the system would be able to survive speculative flows.

Other important pre-conditions for further liberalization would seem to be that the authority of the Surinamese Central Bank with respect to management of capital flows should be enhanced and some regional or international line of credit be secured to ride out potential storms. The authority required by the Central Bank would be the possibility to introduce emergency measures with regard to capital flows under certain well-defined circumstances.

References


IMF (2008), WEO database


Annex I. List of interviewees

<table>
<thead>
<tr>
<th>Name/Position/ Date of interview</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mr. A.E. Telting, Governor of the Central Bank of Suriname, Dec. 5, 2006</td>
</tr>
<tr>
<td>Mr. A. R. Caram, Former Governor of the Central Bank of Aruba, Nov. 24, 2006</td>
</tr>
<tr>
<td>Mr. A. Harmsma, President of the RBTT Bank (Suriname) N.V., Nov. 15, 2006</td>
</tr>
<tr>
<td>Mr. G.H. Gersie, Director of Monetary and Economic Affairs Division, Central Bank of Suriname; Former Chairman of the Foreign Exchange Commission, Nov. 17, 2006</td>
</tr>
<tr>
<td>Mr. F. Kruisland, Lawyer, Nov. 20, 2006</td>
</tr>
</tbody>
</table>


This study is a synthesis of the authors’ research on the investment development path (IDP) concept as applied to Poland and investigated from the point of view its general trajectory as well as geographic and industry/sector idiosyncrasies. Collected data cover a time span ranging from the beginning of the country’s transition to a market led system until 2006. All those three points of view provide grounds for specific economic policy recommendations. The major challenge is to sustain substantial FDI inflows and at the same time spur outward FDI outflows to much higher levels.

Introduction

The present paper is an attempt to develop a synthesis of the authors’ multi-stage research conducted over the last two years. According to the main premise of this study, an analysis of the overall IDP of a country should be supplemented by specific studies focusing on the geographic and sectoral/industrial patterns of FDI in order to reveal the relationships between the overall net outward investment position (NOIP) and NOIPs with respect to individual countries or group of countries, as well as within individual sectors and industries of the said country. Such a holistic treatment of the IDP issue allows for a deeper understanding of the underpinnings of a given IDP trajectory and allows for the formulation of more meaningful and workable policy recommendations. Thus the purpose of this synthesis is to provide findings and conclusions based on a multifaceted analysis of Poland’s FDI situation, within the framework of the Dunning’s IDP paradigm, and use those findings and conclusions to both refine Dunning’s model and offer policy recommendations.

Conceptual Framework

The concept of IDP was first proposed by J. Dunning in the early eighties (Dunning, 1981). Since then it has been refined and extended several times, with most significant modifications contained in Dunning (1986), and Dunning and Narula (1994, 1996, 2002). Several other authors have made contributions to the development of this concept, including Lall (1996), and Durán and Úbeda (2001, 2005).

According to the basic IDP proposition, the inward and outward investment position of a country is connected with its economic development. Changes in the volume and structure of FDI lead to different values in the country’s NOIP, defined as the difference between gross outward direct investment stock and gross inward direct investment stock. The changing NOIP passes through 5 stages intrinsically related to the country’s economic development, measured by its GNP.

Parallel to its conceptual development, numerous empirical studies have been undertaken to test the validity of the IDP model. There are two main strands in these empirical studies: one represents multi-country studies using cross-section analysis. The other strand focuses on one country’s NOIP either vis-à-vis all countries of the world or countries (world regions) that represent the main destinations for FDI as well as the main source of FDI [1].

Although the classic analysis of IDP concentrates on the relationship between a country’s GNP or GDP and its NOI position in order to determine and predict the IDP stages, it is apparent that parallel to the IDP dynamics there are important changes occurring in both the geographic and industrial composition of inward and outward FDI when the country moves through its IDP stages. Therefore, the two aspects of the IDP – geographic and industrial – seem to deserve more attention. And yet it is difficult to derive detailed prescriptions or predictions regarding the relationships between the IDP stages and the geographic and industrial composition of FDI from either the Dunning’s model or empirical studies that have been undertaken in order to test that model. Therefore, this study focuses on those relationships.

Dunning’s model is largely silent on the geographic patterns of inward and outward FDI in relation to the IDP. There seems to be a tacit agreement in existing literature that a country according to the IDP model is at a given point in time at only one stage of its IDP. However, it may be, at the same time, at quite different stages of its NOIP with respect to individual countries and/or regions. Thus it is possible to identify separate NOIP paths with different geographic destinations and sources of FDI, and different NOIPs indicating different stages on those paths. Those propositions have of course a significant bearing on the
geographic implications of existing and desirable economic policy instruments and policies.

In Stage 1, the geographic patterns of FDI are straightforward. Obviously, inward FDI comes from countries at higher stages in their IDP and outward FDI is virtually non-existent. In Stage 2, the relevance and importance of the geographic patterns of FDI increase. According to Dunning and Narula (2002, p. 241), “Outward direct investment emerges at this stage. This may be either of a market-seeking or trade-related type in adjacent territories, or of a strategic asset-seeking type in developed countries. The former will be characterized in countries that are either further back on their IDP than the home country, or, when the acquisition of created assets is the prime motive, these are likely to be directed towards countries further along the path”. Although these two authors are silent on the geographic patterns of inward FDI in Stage 2, it can be implied that such investment will continue to originate mostly in countries at higher stages of their IDP. In Stage 3, it is predicted that outward FDI will be directed more towards countries at lower stages in their IDP than those ahead of the home country (Dunning & Narula, 2002). When a country moves to Stage 4 of its IDP, the nature and geographic patterns of FDI change quite substantially. Inward FDI is “[...] increasingly sequential and directed towards rationalized and asset-seeking investment by firms from other Stage 4 countries” (Dunning & Narula, 2002, p. 143). Outward FDI, on the other hand, is increasingly directed to countries at lower stages and to a large degree takes the form of moving operations, which domestically lose competitiveness, to off-shore locations (ibid.). It is noteworthy at this juncture that in Stage 4 more and more FDI will be conducted within multinational corporations. Finally, a country being in Stage 5 will receive FDI from both countries at lower stages in their IDP and countries being in the same Stage 5. The former will be of market-seeking and knowledge-seeking nature and the latter will be associated with the rationalization of value-adding chains among the Triad countries and will reflect a high propensity for cross-border alliances, mergers and acquisitions. By the same token, outward investment will be directed to both groups of countries. Also, inward and outward investment will be complementary to each other (Dunning & Narula, 2002).

Similarly to geographic patterns, certain general predictions regarding the shifts in sector/industry composition and nature of FDI parallel to the IDP stages can be derived from Dunning (1997) and Dunning and Narula (2002). In Stage 1, inflows of FDI are directed towards labour-intensive manufacturing and the primary product sectors, such as mining and agriculture. Outward FDI is negligible or non-existent because “the O-specific advantages of domestic firms are few and far between” (Dunning and Narula, 2002, p. 140). In Stage 2, inward FDI is predicted to remain largely in natural-resource-intensive sectors. However, it is supplemented by forward vertical integration into labour-intensive production in light, relatively low-technology manufacturing. Outward FDI, fuelled by the newly-acquired O-specific advantages of domestic firms, will be concentrated mostly in the production of semi-skilled and moderately knowledge-intensive consumer goods. As mentioned before, it will be either of a market-seeking or trade-related type, undertaken in adjacent territories, particularly in countries at lower stages in their IDP. In Stage 3, the comparative advantage of labour-intensive production will deteriorate as a result of rising domestic wages. This, in turn, will stimulate inward FDI to flow to technology-intensive manufacturing and other industries capable of delivering higher value added locally. Motives for such inward FDI will shift towards efficiency seeking production and, to some extent, towards strategic-asset acquisition. Outbound FDI will be driven by market-seeking strategies (directed more to countries at lower stages in their IDP) and strategic asset pursuit in other Stage 3 or Stage 4 countries to protect or upgrade advantages of domestic (investing) firms. In a country entering Stage 4, production processes and products will be state of the art and foreign investment will be made in capital- rather than labour-intensive production by firms seeking strategic assets and rationalising their value-adding activities across national borders. Accordingly, a country’s L-specific advantages will be mostly or entirely based on created assets. Outward FDI will be motivated by the necessity to maintain firms’ competitive advantage by moving operations, which lose competitiveness domestically, to countries in lower stages in their IDP. Finally, in Stage 5, which attracts most of Dunning’s (1997) and Dunning and Narula’s (2002) attention and analysis, indications of industry or sector preferences of inbound or outbound FDI are mostly concealed in assertions that Stage 5 highly developed, Triad countries show a marked convergence of their economic structures and that FDI in both directions is increasingly of created asset and efficiency-seeking nature, with greater emphasis on growth via strategic alliances, as well as mergers and acquisitions.

There is hardly an abundance of studies that devote more than cursory attention to the evolving industrial/sectoral structure of FDI in the context of IDP. Nevertheless existing research does point to certain important shifts in sectoral and industrial composition of inward and outward investment taking place when a country progresses from one stage of its IDP to another. However, it is evident that these shifts are far from being uniform across countries. Clearly country-specific factors (idiosyncrasies) play an important role in shaping the sectoral and industrial patterns of FDI.

One of the shortcomings of Dunning’s model is the lack of clear indication of the changes in relative importance of services versus manufacturing sectors when a country moves along its IDP. Also a general conclusion from the existing empirical studies is that the manufacturing sector remains strong, and in many cases dominant, particularly in FDI inflows, throughout Stages 2, 3 and 4, although there is a clear shift from resource-intensive to labour-intensive production.
The Trajectory of Poland’s IDP, 1990-2006

In order to identify the stages of Poland’s IDP since the beginning of the country’s transition to a market economy, data presented in Table 1 were examined. The most important indicator of the nature of IDP trajectory is the NOIP. For the entire period under study that NOIP position was negative and constantly deteriorating [2]. This change in the NOIP is typical of Stage 1 and also, up to a point, of Stage 2. However, another important indicator is the absolute amount of both FDI inflows and outflows. Taking into account both indicators, one can conclude that Poland was in Stage 1 roughly in the first half of the nineties and entered Stage 2 in the second part of that decade. Clear indicators of entering the latter stage were: (a) a substantial increase in FDI inflows and (b) a slowdown of the NOIP deterioration.

When a country approaches Stage 3, the growth of FDI inflows slows down and that of FDI outflows accelerates, thus the two FDI stocks, inward and outward, start to converge. Dunning’s model uses the relationship between NOI and GNP to draw the IDP trajectory. During the first two stages the NOI falls, in Stage 2 at a slower rate, then it levels out when a country enters Stage 3. Several researchers (see for ex. Bellak, 2001) have used NOI per capita and GNP/GDP per capita instead of these two variables’ absolute values to plot the IDP. Among other reasons, per capita figures allow for making comparisons between countries.

As for the NOI per capita ratio in Poland there was a precipitous decline which corresponded in time to the first decade of the studied period. The continuing fall was interrupted by a brief flattening of the said ratio, which occurred in 2005. This sudden change in 2005 might have indicated an imminent transition from Stage 2 to Stage 3. However, the following year the ratio fell again. Nonetheless, there were other symptoms pointing out that Poland was approaching Stage 3. In both 2005 and 2006 there was a surge in FDI outflows from Poland and in both these years FDI outward stock doubled on average. On the other hand there was also a sudden surge in FDI inflows in 2006 (amounting to almost 20 billion dollars) which prevented the analysed ratio from levelling off.

Thus, in spite of the fact that there are discernible symptoms of Poland’s possible transition to Stage 3, it is premature to conclude that such a transition will occur soon. A time frame of at least three more years is necessary for making a more conclusive statement.

In light of the above analysis, conclusions reached in the authors’ previous research (Gorynia, Nowak & Wolniak, 2007) stating that Poland was unquestionably at the end of Stage 2 of her IDP, moving into Stage 3, have not been confirmed by the latest available data and thereby must be revised. There are no new, clear signs showing movement towards Stage 3 yet. Thus there appears to be a slight departure in Poland’s IDP from the ideal trajectory construed in Dunning’s original IDP model. Three reasons may explain this difference. Firstly, Poland’s capacity of absorbing FDI has grown due to accession to the European Union in 2004. Secondly, in spite of growing labour costs and other FDI disincentives, the attracting pull of the large domestic market has prevailed. Thirdly, the relatively dynamic growth of outward FDI has been generating investment levels still much below those recorded as inward FDI.

Hypotheses

Based on the literature review and recognising that Poland is still in Stage 2 of her IDP, as determined in the preceding section, the following main hypotheses regarding the country’s FDI geographic patterns in the evolving NOIP may be formulated:

H 1: Inward FDI will predominantly originate in developed countries, being at higher stages on their IDP, with which Poland will have a NOIP that is negative and deteriorating, albeit at a decreasing rate.

Table 1. Poland’s FDI Inward and Outward Stock, NOI, NOIP per capita, and GDP per capita, 1990-2006

<table>
<thead>
<tr>
<th>Years</th>
<th>FDI Inward Stock, millions of USD</th>
<th>FDI Outward Stock, millions of USD</th>
<th>NOI</th>
<th>NOIP per capita, USD</th>
<th>GDP per capita (a), USD</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>109</td>
<td>95</td>
<td>-14</td>
<td>-0.4</td>
<td>1547</td>
</tr>
<tr>
<td>1992</td>
<td>1370</td>
<td>101</td>
<td>-1269</td>
<td>-33.3</td>
<td>2198</td>
</tr>
<tr>
<td>1993</td>
<td>2307</td>
<td>198</td>
<td>-2109</td>
<td>-63.6</td>
<td>2232</td>
</tr>
<tr>
<td>1994</td>
<td>3789</td>
<td>461</td>
<td>-3328</td>
<td>-87.3</td>
<td>3057</td>
</tr>
<tr>
<td>1995</td>
<td>7843</td>
<td>539</td>
<td>-7304</td>
<td>-191.7</td>
<td>3086</td>
</tr>
<tr>
<td>1996</td>
<td>11463</td>
<td>735</td>
<td>-13909</td>
<td>-365.1</td>
<td>3702</td>
</tr>
<tr>
<td>1997</td>
<td>14587</td>
<td>678</td>
<td>-13909</td>
<td>-365.1</td>
<td>3702</td>
</tr>
<tr>
<td>1998</td>
<td>22461</td>
<td>1165</td>
<td>-21296</td>
<td>-559.4</td>
<td>4068</td>
</tr>
<tr>
<td>1999</td>
<td>26075</td>
<td>1024</td>
<td>-25051</td>
<td>-657.5</td>
<td>4014</td>
</tr>
<tr>
<td>2000</td>
<td>34227</td>
<td>1018</td>
<td>-33209</td>
<td>-871.4</td>
<td>4110</td>
</tr>
<tr>
<td>2001</td>
<td>41247</td>
<td>1156</td>
<td>-40091</td>
<td>-1049.5</td>
<td>4746</td>
</tr>
<tr>
<td>2002</td>
<td>48320</td>
<td>1457</td>
<td>-46863</td>
<td>-1226.8</td>
<td>4944</td>
</tr>
<tr>
<td>2003</td>
<td>57877</td>
<td>2145</td>
<td>-55732</td>
<td>-1462.8</td>
<td>5486</td>
</tr>
<tr>
<td>2004</td>
<td>86623</td>
<td>3274</td>
<td>-83349</td>
<td>-2181.9</td>
<td>6610</td>
</tr>
<tr>
<td>2005</td>
<td>90711</td>
<td>6279</td>
<td>-84432</td>
<td>-2216.1</td>
<td>7944</td>
</tr>
<tr>
<td>2006</td>
<td>124530</td>
<td>16288</td>
<td>-108242</td>
<td>-2841.0</td>
<td>8940</td>
</tr>
</tbody>
</table>

(a) According to official exchange rates
H 2: Outward FDI will be predominantly directed to adjacent territories, with market-seeking investment going to countries which are further back on their IDP, and asset-seeking investment directed towards countries further along the path.

H 3: Poland will be in Stage 2 in her IDP with the developed economies, whereas at the same time she will be in Stage 4 with the countries that are at a lower level of development than Poland.

In spite of the idiosyncrasies in the situation of individual countries, the following hypotheses can be formulated with respect to Poland’s IDP and sectoral/industrial composition of FDI. These hypotheses also refer to Stage 2 of the IDP.

H 4: The importance of natural resource-intensive industries of the manufacturing sector in inbound FDI will be gradually eroded by the growing importance of labour-intensive production in light, relatively low-technology manufacturing.

H 5: Outbound FDI will be concentrated mostly in the production of semi-skilled and moderately knowledge-intensive consumer goods.

H 6: In spite of the growing importance of the services sector, the manufacturing sector will remain the dominant destination of FDI inflows and outflows.

The following two sections will focus first on the geographic and then on sector and industry patterns of Poland’s NOI, thus testing the above-stated hypotheses.

Geographic Patterns of NOI Position, 1996-2006

This section attempts to incorporate the geographic analysis of FDI into the classic IDP model. Table 2 presents the relevant information on Poland’s NOI vis-à-vis the world, the Triad countries, Poland’s neighbours and her main trading partners in CEE, and China (representing here the group of large emerging markets). Table 3, on the other hand, details geographic information on Poland’s NOI with Germany and the individual CEE countries covered by this analysis.

As was evident in the preceding sections, Poland’s NOI with all countries (world total) was consistently negative. It is obvious that this global NOI was largely determined by FDI inflows from and outflows to the Triad countries, with which Poland’s NOI was deteriorating throughout the period under investigation. Within the Triad, the highest negative NOI values were recorded for the European Union (EU), followed by USA and Japan. These data indicate that with the Triad, considered as the world’s most developed economic area, Poland was firmly in the second stage of her IDP, reflecting on one hand the pull of her large internal market and a growing economy, and on the other hand the weak competitive position of Polish firms as demonstrated by their limited outward FDI destined for the Triad region, with the exception of EU-15 member states in recent years (in 2006 more than 5 billion USD was invested by Polish firms in the EU – National Bank of Poland, 2007). In particular, Germany has traditionally been a main destination of Polish outward FDI within the EU-15. Poland’s NOI vis-à-vis Germany showed also slightly different dynamics compared to those for the Triad as a whole. Certainly, the rate of decline in NOI with the Triad was higher than that for Germany. At the same time, it is discernible that the rate of declining NOI with the Triad showed some signs of abating. These findings thus largely confirm Hypothesis 1.

An interesting evolution of NOI can be observed with respect to neighbouring, CEE transition countries. Between 1996 and 2002, the NOI value for this group of countries was negative, but starting from 2003 it became positive.

Table 2. NOI of Poland with the World, Triad Countries, EU, CEE Transition Economies and China (in millions of USD), 1996-2006

<table>
<thead>
<tr>
<th>Years</th>
<th>World, total</th>
<th>USA</th>
<th>Japan</th>
<th>EU-15</th>
<th>Triad, total</th>
<th>CEE Neighbours</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>-4108.6</td>
<td>-450.9</td>
<td>-7.5</td>
<td>-3472.0</td>
<td>-3930.4</td>
<td>-9.5</td>
<td>1.4</td>
</tr>
<tr>
<td>1997</td>
<td>-8862.1</td>
<td>-1128.3</td>
<td>-14.0</td>
<td>-7083.7</td>
<td>-8226.0</td>
<td>-19.9</td>
<td>4.6</td>
</tr>
<tr>
<td>1998</td>
<td>-15161.7</td>
<td>-1901.5</td>
<td>-117.4</td>
<td>-12065.6</td>
<td>-14084.5</td>
<td>-37.4</td>
<td>4.4</td>
</tr>
<tr>
<td>1999</td>
<td>-21990.5</td>
<td>-1487.8</td>
<td>-115.1</td>
<td>-18247.1</td>
<td>-19850.0</td>
<td>-22.6</td>
<td>3.4</td>
</tr>
<tr>
<td>2000</td>
<td>-31586.8</td>
<td>-1812.8</td>
<td>-153.7</td>
<td>-27175.1</td>
<td>-29141.6</td>
<td>-37.9</td>
<td>1.0</td>
</tr>
<tr>
<td>2001</td>
<td>-37302.4</td>
<td>-2387.7</td>
<td>-192.3</td>
<td>-32555.8</td>
<td>-35135.8</td>
<td>-55.3</td>
<td>1.4</td>
</tr>
<tr>
<td>2002</td>
<td>-41641.2</td>
<td>-2857.5</td>
<td>-0.4</td>
<td>-36642.8</td>
<td>-39500.7</td>
<td>-39.4</td>
<td>0.6</td>
</tr>
<tr>
<td>2003</td>
<td>-46654.8</td>
<td>-3443.5</td>
<td>-179.5</td>
<td>-40001.6</td>
<td>-43624.6</td>
<td>140.3</td>
<td>-11.6</td>
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<tr>
<td>2004</td>
<td>-59419.8</td>
<td>-3593.9</td>
<td>-387.1</td>
<td>-51612.4</td>
<td>-55593.4</td>
<td>832.1</td>
<td>-11.9</td>
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<tr>
<td>2005</td>
<td>-65547.0</td>
<td>-4305.3</td>
<td>-689.6</td>
<td>-58793.6</td>
<td>-63788.5</td>
<td>1002.8</td>
<td>-47.9</td>
</tr>
<tr>
<td>2006</td>
<td>-75600.3</td>
<td>-4701.3</td>
<td>-1000.2</td>
<td>-70102.5</td>
<td>-75804.0</td>
<td>4401.6</td>
<td>-57.7</td>
</tr>
</tbody>
</table>

Table 3. NOIP of Poland with Germany and the Neighbouring Transitional Economies of CEE (in millions of USD)

<table>
<thead>
<tr>
<th>Years</th>
<th>Germany</th>
<th>Belarusk</th>
<th>Czech Republic</th>
<th>Baltic Republics</th>
<th>Hungary</th>
<th>Russia</th>
<th>Ukraine</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>-1080.8</td>
<td>-0.2</td>
<td>-13.4</td>
<td>1.3</td>
<td>-0.4</td>
<td>-2.8</td>
<td>6.0</td>
</tr>
<tr>
<td>1997</td>
<td>-2041.5</td>
<td>0.0</td>
<td>-30.0</td>
<td>1.3</td>
<td>-3.5</td>
<td>0.0</td>
<td>12.3</td>
</tr>
<tr>
<td>1998</td>
<td>-3466.4</td>
<td>0.7</td>
<td>-38.1</td>
<td>2.7</td>
<td>-14.2</td>
<td>-3.1</td>
<td>14.6</td>
</tr>
<tr>
<td>1999</td>
<td>-4631.8</td>
<td>1.3</td>
<td>-37.1</td>
<td>5.8</td>
<td>-12.0</td>
<td>0.6</td>
<td>18.8</td>
</tr>
<tr>
<td>2000</td>
<td>-5583.3</td>
<td>1.6</td>
<td>-31.2</td>
<td>5.8</td>
<td>-9.0</td>
<td>-20.3</td>
<td>15.2</td>
</tr>
<tr>
<td>2001</td>
<td>-6645.8</td>
<td>2.5</td>
<td>-23.0</td>
<td>8.7</td>
<td>-15.2</td>
<td>-51.8</td>
<td>23.5</td>
</tr>
<tr>
<td>2002</td>
<td>-7227.4</td>
<td>0.5</td>
<td>-10.4</td>
<td>9.2</td>
<td>-83.0</td>
<td>-5.6</td>
<td>49.9</td>
</tr>
<tr>
<td>2003</td>
<td>-7357.0</td>
<td>4.8</td>
<td>22.9</td>
<td>17.3</td>
<td>-124.2</td>
<td>107.5</td>
<td>112.0</td>
</tr>
<tr>
<td>2004</td>
<td>-8655.7</td>
<td>9.3</td>
<td>68.2</td>
<td>26.3</td>
<td>-312.0</td>
<td>902.1</td>
<td>138.2</td>
</tr>
<tr>
<td>2005</td>
<td>-10615.5</td>
<td>13.8</td>
<td>603.0</td>
<td>41.0</td>
<td>-83.3</td>
<td>994.8</td>
<td>36.4</td>
</tr>
<tr>
<td>2006</td>
<td>-13919.1</td>
<td>27.3</td>
<td>679.8</td>
<td>2396.5</td>
<td>-136.7</td>
<td>1100.8</td>
<td>333.9</td>
</tr>
</tbody>
</table>


positive, showing rather impressive growth rates and reaching the value of 4.4 billion dollars in 2006. This clearly indicates that Poland had already entered Stage 4 of her IDP with the neighbouring transition economies treated as a group. However, this overall trend conceals important differences between the NOIP’s of Poland vis-à-vis the individual countries of the CEE region. The appropriate data are presented in Table 3. As evidenced by this table, currently Poland has a positive NOIP with all the CEE neighbouring countries, except Hungary. It is also important to note that Poland’s NOIP has evolved from a negative to a positive one with respect to the Czech Republic and Russia. The situation vis-à-vis the Czech Republic is interesting. The Czech Republic is considered to be more developed than Hungary and one would expect Poland to have more negative NOIP with the former than with the latter. This may indicate that Hungary is higher up the general IDP than countries with comparable level of GDP. Apparently, Hungarian companies are more competitive and more aggressive investors abroad than their regional counterparts. Thus the above findings tend to only partially confirm Hypotheses 2 and 3.

An exceptional case is that of Poland’s NOIP with the world’s largest emerging market, i.e. China. After the positive, albeit rather small, values recorded between 1996 and 1999, Poland’s NOIP with China systematically deteriorated and reached –60 million USD in 2006. Clearly, this trend is not consistent with Hypothesis 3 stated in the preceding section, and the underlying reasons deserve a more in-depth explanation. However, it should be noted that in absolute terms both Polish investment in China and China’s investment in Poland are still relatively low.

Sectoral and Industrial Patterns of the NOIP, 1996-2006

It is evident from Appendix 1 that in the whole period for which the NOIP values have been calculated, only during two years (1997 and 1998) and in one industry (hotels and restaurants) did this measure have a positive sign (but very low absolute values). In all remaining years and industries the NOIP values were always negative. The manufacturing sector had the highest negative values of NOIP throughout the studied period, ending with a level of over –21.8 billion USD in 2006. This reflects the sector’s importance and leading position in FDI flows in the Polish economy. At the same time, the calculations of the yearly growth rates demonstrate that the rate of negative growth of NOIP was decreasing, with a small counter trend recorded in 2003 and 2004, thus providing another piece of evidence that Poland was at the end of stage 2 of her IDP.

Within the manufacturing sector, up to the end of 2002 the highest NOIP values were registered for food, beverages and tobacco: all falling into the light industry, relatively low technology and low knowledge intensive classification category. Thereafter came, with slight differences between them, motor vehicles and transport equipment as one grouping plus chemical and rubber products as the other, both in the relatively high technology, capital and knowledge intensive classification category. From 2003 on, one year before Poland’s entry into the EU, a shift occurred with motor vehicles taking the lead and retaining it till the end (i.e. 2006), followed by chemical and rubber products, and the food, beverages and tobacco grouping. The lowest NOIP values were observed in wood, paper, publishing and printing – a branch falling also into the light industry category. The said negative NOIP values increased until the end of 2004, decreased in 2005 and again increased in 2006.

As Appendix 1 data indicate, the leading industries in the service sector were financial intermediation (in reality: banks and other financial institutions) and trade and repairs (meaning mainly investment by large distribution companies, especially on the retail level). Both those branches started with practically the same level of negative NOIP in 1996 and ended in 2006 with a NOIP of nearly –16 billion USD for financial intermediation and over –12 billion USD for trade and repairs, exhibiting consistent growth of their negative NOIP. However, noteworthy was the overall falling trend in their NOIP year to year growth rate, arguably indicating strengthening competitive advantage of Polish firms investing abroad.

Referring to the three hypotheses stated before, Hypothesis 4 is only partly confirmed by the above analysis. Indeed, there was a shift away from resource-intensive, light industries, such as food, beverages and wood. Instead, the manufacturing industries that emerged as the dominant ones in Poland’s FDI, with the highest values of NOIP,
were relatively high technology, capital and knowledge-intensive: motor vehicles, transport equipment and chemicals. As for Hypothesis 5, it is evident that the dominant position among the manufacturing industries’ outbound FDI was held by refined petroleum products, followed by metal and mechanical products, and food products. Therefore, Hypothesis 5 cannot really be confirmed. It is important to note in this context that relatively large amounts of outbound FDI have come from the financial intermediation sub-sector (until 2005, that sector’s investment exceeded the manufacturing sector’s investment abroad). Finally, Hypothesis 6 is not confirmed by the above analysis either. Although the manufacturing sector’s position has remained relatively strong, the sector is not in a leading position any more, neither in FDI inflows nor in FDI outflows. It is the services sector (including financial intermediation, trade and repairs, transports and communication) that now accounts for the largest part of Poland’s FDI.

**Economic Policy Considerations**

An important venue for improving country competitiveness lies in stimulating and accelerating the growth of small and medium sized firms in Poland. In this context, mergers and acquisitions as well as business alliances should be encouraged via, for example, fiscal instruments and a relaxation of antimonopoly legislation.

Firms, both domestic and foreign owned, should be allowed to receive support in expanding into foreign markets by outward FDI. This calls for indirect and direct financial state assistance in innovating and developing core company competencies which, embedded in new products and technologies, would facilitate them in generating sustainable firm specific ownership advantages abroad.

Stimulating outward FDI and thus moving to bridge the considerable gap between inward and outward FDI in Poland requires overcoming the idiosyncratic and the unfortunate nature of the strategy of most domestic Polish firms of focusing in their internationalisation on exporting and not on outward FDI. Strong policy stimuli reversing such approach by supporting outward FDI should address the following issues:

(a) The risk associated with cultural and institutional differences separating foreign markets from their Polish counterpart, determined by the length of psychic and institutional distance.

(b) The lack or paucity of financial, material, human capital and other knowledge-intensive resources, so prevalent in most Polish-owned SMEs.

(c) The now pressing need to educate Polish entrepreneurs/managers about the advantages of moving beyond the stage of exporting in their foreign market expansion, as well as about the costs and benefits of different forms of cooperation, especially business alliance formation.

(d) The necessity, via government promotion programs, to at least decrease the negative country of origin effect accompanying marketing efforts of many Polish products in foreign markets, especially in the services and industrial product categories, attempting to compete with local and global players with well known and established brands.

One inherent source of competitive weakness of domestic Polish firms lies in their difficulties in absorbing new technologies and innovations. To redress this deficiency, firms must have first of all access to sufficient funds. Financial and fiscal measures in this respect call for a wider and more intensive use of government guarantees, credit insurance schemes and, for the weakest, government subsidies, conditional however on reaching specific time bound performance targets. Furthermore, in the institutional dimension, the state should encourage formation of micro-regional clusters based on specific location bound advantages, enterprise incubators as well as technological parks for increased and easier high technology creation and diffusion. The market alternative for funding technology development should include state encouragement of venture capital and/or private equity investments via privatisation of state shareholdings in large companies in R&D intensive industries.

An important factor in sustaining FDI, both inward and outward, lies in policy measures targeting the FDI environment with the objective of lowering transaction costs. The main contributing factors in this sphere include:

(a) Creating an efficient legal system, especially in the sphere of contract execution and settlement of investment disputes in courts and via arbitration.

(b) Eliminating bureaucracy and “red tape” in establishing and expanding both green-field and brown-field operations.

(c) Developing material infrastructure by financing or co-financing the country wide network of motorways, railroads and regional airports.

Economic policy should also focus on outward FDI to Poland’s less developed neighbours and partners as there it appears to be easier and/or quicker to discount the acquired competitive advantages of the ownership and internalisation categories.

In the sectoral/industry approach economic policy measures should embrace first of all technology upgrading and enhancing financing potential of firms directed towards the identified leaders: mechanical and metal products, the motor industry and petroleum, all within manufacturing sector, as well as financial intermediation, trade and repairs plus real estate within the services sector.

**Conclusions**

For the entire period of Poland’s social and economic transformation process, the country’s NOIP was negative
and deteriorating. This is indicative of Stages 1 and 2 of her IDP. Taking into consideration the dynamics of the NOIP, the absolute FDI inflows and outflows, the authors conclude that since the second half of the nineties Poland has been in Stage 2 of her IDP. Although there are certain symptoms indicating that the country may be approaching Stage 3, more years of IDP evolution need to be observed in the future to make conclusive statements about transition to Stage 3.

The geographic analysis of the NOIP conducted with reference to Stage 2 of the IDP revealed the following developments:

(a) Poland has been firmly in Stage 2 of her bilateral IDP with the Triad countries. Poland’s position vis-à-vis the Triad largely determines her global NOIP standing. However, Poland’s outward investment directed towards the EU has increased substantially in recent years and this may indicate approaching Stage 3 with respect to this part of the Triad. In other parts of the Triad, Poland’s investment is negligible, particularly in Japan. The dynamics of FDI relations with the Triad are largely consistent with the appropriate predictions derived from Dunning’s model.

(b) Poland’s NOIP vis-à-vis her neighbouring, CEE transition countries has been generally positive since 2002 (before it was negative). This position has been largely achieved through growing positive NOIP with Russia, the Baltic States, the Czech Republic and Ukraine, although the absolute NOIP values are usually not high. With these countries, Poland is already in Stage 4. On the other hand, Poland is in Stage 2 of her bilateral IDP with Hungary. These finding are only partially consistent with the predictions derived from Dunning’s paradigm.

(c) Poland’s NOIP with the largest emerging economy, China, changed from positive to negative and deteriorated during the period under study. However, the absolute (negative) value of NOIP is relatively low. This finding is inconsistent with the prediction based on Dunning’s model.

Thus a peculiar trade-off appears in the geographic breakdown of Poland’s NOIP. Either there are high absolute values recorded of the NOIP with developed countries and unfortunately negative ones, signifying the dominance of inward versus outward FDI flows, or there are low absolute values of the NOIP with CEE countries but with a positive sign, indicating more FDI outflows from Poland than inflows. In the first case Poland remains in a position corresponding to Stage 2 in the IDP model and, in the second case, mainly in a position equivalent to Stage 4 in the said model. This second case also attests to the relative superiority of the Polish economy as compared with that of her CEE neighbours and at the same time delineates areas for further expansion to exploit the competitive advantage of firms investing out of Poland, expansion that is easier and quicker attainable than in the more competitive and saturated markets of developed countries.

The industry structure of Poland’s NOIP showed that in both inward and outward FDI the dominance of the manufacturing sector was being radically eroded by services. Inside services on the rise were the shares of the financial intermediation sector, composed mainly of banks, insurance companies and various types of investment funds, as well as of retail trade, focused on mass distribution in hypermarkets, large discount stores and shopping malls. Also in both the manufacturing and services sectors the most dynamic were capital and knowledge intensive industries. In the context of industry structure Poland’s IDP revealed a certain paradox. It seems to be present in the crucial role played by the growth of the modern manufacturing and service sectors in both prolonging Poland’s stay in her IDP Stage 2 and at the same time in being the main motivating factor ultimately expected to move Poland into the more advanced Stage 3. Confronting the findings regarding the sector and industry structure of Poland’s NOIP with the appropriate hypotheses derived form Dunning’s IDP paradigm, the authors found little conformity between the two.

Finally, the role of economic policy in the IDP model as applied to Poland lies not in expecting or having growth of inward FDI slow down or even in decreasing inward FDI stock but in maintaining sustained growth in the said inward FDI and, at the same time, obtaining a much larger growth and absolute levels of outward FDI.

**Notes**

[1] Please see Gorny, Nowak and Wolniak, 2006 for a review of these two strands of empirical studies.

[2] The negative sign of the NOIP reflects a larger amount of inward FDI as compared to outward FDI. The deteriorating nature of the NOIP, in turn, indicates a faster rate of growth of inward FDI stock than of outward FDI stock.

**References**


Appendix 1.

The Sector/Industry NOIP of Poland, 1996–2006, in millions of USD

<table>
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<tr>
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<tr>
<td>motor vehicles and transport equipment</td>
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<td>-612.5</td>
<td>-564.5</td>
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<td>Agriculture and fishing</td>
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<td>-96.2</td>
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<td>Other services and not allocated</td>
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<td>TOTAL</td>
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<td>-2765.6</td>
<td>-4639.3</td>
<td>-4726.2</td>
<td>-4757.4</td>
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<td>-4959.4</td>
<td>-4788.8</td>
<td>-4617.5</td>
<td>-4230.9</td>
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<td>Source: Authors’ calculations based on NBP, 1997–2007.</td>
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Self-Managed Teams and the Role of the Manager: A Literature Review

Martijn Boelen, Maastricht School of Management, The Netherlands
Stephanie Jones, Maastricht School of Management, The Netherlands

What is an SMT? What is the role of a manager of an SMT? What are the interactions between the manager and the team, and with the rest of the organization? Should the manager focus on strategic goals and leave the team to get on with it? Or play the part of consultant/adviser/mentor to the team? Is his/her job selecting the project and the SMT members and letting them carry on? Does it depend on having the right team members – when you have team members who are ready, willing and able? How can the performance of the team be measured?

“You’ll be a what?!”, a friend asked after my recent job interview. “A manager of a self-managing team [SMT]”, I repeated. “So, you will be paid for doing nothing”, he replied, “with the members of the team managing themselves, that’s a job I would also like!”

I knew then that what he was saying could not be true. I know now that I have a very busy job, which in certain aspects is even more difficult than being a manager in a typical hierarchical organization with directive management and no team-based structure. In order to do my job, to achieve performance, I can’t just sit back and do nothing. But before I started I could not explain to him or others that managers have an important contribution to make in the effective deployment of self-managing teams in an organization. So what is the role of the manager of an SMT? Perhaps my friend is right, and doesn’t it really matter what the manager does, as the team members manage themselves? What is the view of existing research on this apparent contradiction?

Firstly, what are the benefits and disadvantages of SMTs? What are the conditions needed to have an effective self-managing team? What is the effect of the behavior of the members of the team? Is there any “ideal” behavior that will contribute to the success of a self-managing team? Secondly, how can the manager – in this case me – contribute to the effective performance of this team? But if the team members need guidance, or motivation – maybe they are not ready for an SMT? Thirdly, what about the performance of the SMT? Any part of any organization exists because it contributes one way or another to the goal of the organization. An SMT can therefore only be effective if the outcome of its activities satisfies the needs of the whole organization. Will the manager keep track of the self-managing teams’ performance?

Generally, a team (Katzenbach and Smith, 1994) “is a small number of people of complementary skills who are committed to a common purpose, set of performance goals, and approach for which they hold themselves mutually accountable.” Putting several people together that perform more or less similar or interrelated tasks does not constitute a team, but merely a working group.

Cummings (1978) and Manz and Sims (1987) describe SMTs as autonomous, composite or self-managing “work designs”, that include “a relatively whole task, members who each possess a variety of skills relevant to the group task; worker discretion over such decisions as methods of work, task schedules and assignment of members to different tasks; and compensation and feedback about performance for the group as a whole”. The use of self-managing teams, in their opinion, involves a shift in focus from individual methods of performing work to group methods. According to Carnall (1982) (semi-)autonomous group working “involves the establishment of work groups with specific responsibilities and with conditional autonomy to undertake the task in a way to be decided within the group but constrained by the conditions within it works”. Grean and Uhl-Bien (1991) define a self-managing unit as having responsibility for executing, monitoring, and managing its own performance and work processes.

“Self-Managing Teams are responsible for many traditional management functions such as assigning members to various tasks, solving team quality and interpersonal problems, and conducting team meetings. They generally entail an increase in decision-making autonomy and behavioral control for its members “(Neck and Manz, 1994). Thibodeaux and Faden (1994), writing on “Self Regulating Work Groups”, define SMTs as “having internal task control on a relatively permanent basis for any identifiable task requiring multiple skills. They are typically responsible for managing quality control, inventory purchases, employee training and personnel issues like absenteeism”. Van Amelsvoort (1993, 1996) considers that self-directive work teams, as he calls them, enjoy a certain degree of autonomy in the choice of work methods, and members of such teams arrange matters such as work assignments and production planning themselves. Furthermore, the number of hierarchical levels and specialists is reduced drastically as a result of this. He attaches the most value to the collective responsibility of all team members of a self-managing team for “the complete process in which products or services are delivered to internal or external...
customers”. He adds “the team plans and monitors the process, solves daily routine problems and improves the processes and working methods, without continuously involving management or other forms of support.”

Self-managing teams are considered to be “groups of interdependent individuals that can self-regulate their behavior on relatively whole tasks responsible for making a product or a service and employee discretion over decisions such as work assignments, work methods and scheduling of activities” (Cohen et al., 1996). Clifford and Amrik (1998) add that “self-directed teams are small groups of employees who have day-to-day responsibility for managing themselves and their work.” Attaran and Nguyen (1999) seem to go a step further, though, as in their definition the team is responsible for almost anything: “self-directed teams are groups of employees who are responsible for a whole product or process. The team not only performs the work, it is actually involved in designing and evaluating work processes. Employees take ownership of results, managing many of the things supervision or management used to do.” Molleman (2000) stresses the autonomy within self-management, not only with respect to the output a self-managing team wants to realize, but also in relation to the organization of its internal “transformation process” to arrive at this output. Muthusamy et al. (2005) conclude that “self-managing work teams are responsible for their work as well as for monitoring their performance. Instead of having a supervisor tell them what to do, these teams are responsible for gathering information, making decisions and meeting the organizational goals.”

Kirkman (1997) distinguishes two clear “dynamic components: the process of self-management and collaborative teamwork”. Self-managing work teams can be seen as “having the following responsibilities: they manage themselves, they assign the jobs to members, the plan and schedule the work, the make production- or service-related decisions and the take action to remedy problems.” Fisher (1993) uses more or less the same definitions adding that the each individual in the group is responsible for performing multiple tasks, as opposed to traditional organizations that may be divided in groups of functional specialists. Yeatts (1998) is even more specific and includes the rotation of tasks between group members, both technical and managerial (such as monitoring the team’s productivity and quality). It may be concluded that a comprehensive definition would include three important components:

1. the SMT, in relation to its environment within and outside the organization of which it is part, and from which the responsibilities and goals of the whole team can be derived;
2. the processes taking place within the team itself;
3. the nature and characteristics of the individual members.

Elements of these different definitions are categorized into three components (see Figure 1).

<table>
<thead>
<tr>
<th>External relationships</th>
<th>Internal processes</th>
<th>Team members</th>
</tr>
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<tbody>
<tr>
<td>Team has conditional autonomy</td>
<td>Joint responsibility and mutual accountability for team result.</td>
<td>Possess variety of skills, that compliment those of other team members</td>
</tr>
<tr>
<td>Constraints by the conditions of the organization in which the SMT works</td>
<td>Team (autonomously) takes decisions on: methods of work; task schedules; assignment of work to individual team members; immediately solving problems</td>
<td>Give feedback about performance of other team members</td>
</tr>
<tr>
<td>SMT has to meet organizational goals</td>
<td>Responsible for managerial tasks such as monitoring and managing performance; quality control; production planning</td>
<td>are self-managing</td>
</tr>
<tr>
<td></td>
<td>Interdependence between team members</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Involved in design and evaluating work processes</td>
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</table>

Although the level of each element differs from SMT to SMT, the following definition can be the basis for the present study: an SMT autonomously decides on issues such as the methods of work, planning, work schedules and work assignments related to the role of the team in the organization. Its members are collectively responsible for quality control, performance monitoring and evaluation. The team consists of people with complimentary skills who have an open relationship and who give feedback on each others’ performance.

**Demands for Employee Well-Being**

Developments in technology, the markets and the globalizing economy have forced organizations to be flexible, innovative and competitive and modify their organizational structures (Muthusamy et al. (2005), Manz (1984, 1987, 1993), Yeatts (1994), Delmestri (2001), Cohen (1996), van der Zwaan & Molleman (1998), de Leece et al. (1999), and Fisher (1993). But at the same time most organizations have to deal with declining productivity, increasing absenteeism and employee turnover (Manz, 1984). Next to that, factors such as labor unions, the growth of individualism, low power distance (in most western countries), increasing
organizational demands, linking the concepts of organizational design and employee satisfaction.

An example of the problems related to this issue occurred at an IT company in The Netherlands at the end of the 1990s. As staff members in this sector were very hard to identify, attract and retain, the company set up the workplace like a recreational centre, with bar, gaming machines, easy chairs and no strict working hours. In the beginning the company flourished, as the demand for their services was very high. Eventually the market became tighter, the company went bankrupt. One of the reasons was that the psychological well being (the “cohesiveness”) of their employees prevailed over task requirements such as meeting deadlines and maintaining quality. As long as there was an abundance of work and little competition this was not really a problem as customers could not go anywhere else, but when the market shrank, and “normal” performance was necessary, management had no tools to change employee’s behavior and the employees, used to certain privileges, started to leave the company. As there was no equilibrium between employee well-being and organizational task demands, the organization was not efficient.

One of the solutions might have been implementing SMTs. As, according to Sexton (1994) the goal of an organization basing the organizational structure on SMTs is to:

a. improve the quality of work life for employees;

b. increase organizational effectiveness and productivity; and

c. build a work structure that is responsive both to the task needs of the organization and the social and psychological needs of its employees.

Organizations that do not take the needs of the individual employee into account when designing the organizational structure deny the deficiency needs of their employees: the individual does not feel anything if they are met, but can feel anxious if they are not met. The deficiency needs are: Physiological, Safety needs, Love/Belonging, and Esteem needs. As an example, many conversations between colleagues around water coolers, coffee machines or during lunch are actually about the organization not answering these needs, e.g. “my boss does not see how hard I work” (esteem), or “our boss never attends any social events” (love/belonging) or even, during re-organization: “I have heard they are closing down our department” (safety). All these conversations actually express discontent about the way the organization and its management (as a representative of the organization) behave towards the individual employee. If more autonomy in many work-related issues would be given to the individual employee, many of these complaints would be gone. Moreover, employees would be more satisfied as most or even all their needs as expressed by Maslow would be satisfied. It is not surprising therefore that Breau (1985) found that autonomy is linked with employee performance, job involvement and reduced absenteeism. In other words, people feel better when they are more autonomous in their work and as a result, as we have seen earlier, they perform better.

Towards the introduction of SMTs

As a result of several developments inside and outside organizations, it became clear that the existing organizational structures based on Taylor’s scientific management, depending on individual specialized tasks with direct management steering was not effective anymore. Dealing with issues such as employee well-being could lead to better results for organizations. One of the solutions to deal with this problem, the concept of SMTs, was found in the socio-technical theories (Delmestri (2001), Sexton (1994), Manz (1992). Socio-technical systems theory and design views production systems as comprised of both technological and social parts. The primary aim is “to design a work structure that is responsive to the task requirements of the technology and the social and psychological needs of employees: a structure that is both productive and humanly satisfying” (Cummings, 1978). From the socio-technical system perspective, human needs have precedence over technology. From this derives that the emphasis in the SMT is quality of life without sacrificing organizational effectiveness. This last element is translated into the concept “quality of work life”. Restructuring the organization into SMTs can have several advantages in contributing towards organizational effectiveness. These possibilities can be measured in terms of productivity and member attitudes and behaviors (Kirkman et al., 2000):

1. SMTs require leaner and flatter organizations with less management layers and less bureaucracy (Delmestri, 2001);

2. less bureaucracy with emphasis on control and procedures and hence more flexibility (Amelsvoort, 1993)

3. reduces costs (Manz (1980), Cohen et al.(1996), Clifford & Amrik (1998), as fewer employees are needed, and there can be lower personnel turnover

4. increased personnel satisfaction (Delmestri, 2001)

5. improve productivity (Spreitzer et al., 1999) and quality of work output (Sexton, 1994)

Creating an SMT

The first step to create an SMT is not necessarily empowerment, but team-building, making sure that the members of the future SMT have developed the appropriate behaviors, skills and competence to effectively work together (Donovan, 1996). Many organizations “just” create teams and start transferring responsibilities to those teams without preparing the members correctly. This attitude is in many cases the
result of the fact that SMTs are mostly introduced in existing organizations with existing employees. Employees in many cases have vested interests, e.g. working in a specific location or doing a specific job. Taking those job elements away can create a lot of resistance during the transition process. For that reason, managers tend to take it for granted that existing interests should be honored and build the new organizational structure around these given facts. This might be a big mistake, as it greatly influences team composition. As a consequence, teams are not composed of people that have complimentary knowledge, experience and personal traits, but merely consist of people that have performed the same job before and e.g. live conveniently close to the location where the team is located. This method of team composition is, although realistic, far from ideal when introducing SMTs and can result in SMT failure. Guzzo (1996) gives several issues to be dealt with when composing a team in general: who is in the group, team size, specifying the group’s task and members’ roles and creating organizational support systems such as training opportunities. It is therefore not enough just to say: “let there be SMTs”, the organization should also be ready for them.

**Measuring SMT effectiveness**

Cohen (1996), using the model included in figure 1 (below), makes a connection between variables that are important for the effective functioning of an SMT. Her study includes four categories of predictor variables: task design, group characteristics, encouraging supervisory behaviors and an organizational context that supports employee involvement. The group task (design) attributes are viewed as contributing to SMT effectiveness as a result of their impact on motivation and on self-regulation. The second group of variables relate to the behavior of (external) ‘leaders’ in order to support the functioning of the SMT. Group characteristics are important as their internal processes determine the final outcome of the SMT. Cohen divides the characteristics in three groups: composition, beliefs and process. Finally, the way the organization allows employees to be involved and thus an SMT to function can influence its effectiveness.

Cohen’s study of work teams in a large US telephone company showed that a precondition for designing an effective SMT should be to focus on enhancing the context for employee involvement, as this has the strongest link of all variables with quality of work life. Next to that a significant outcome of the study was that no variable has a positive relationship with all effectiveness outcomes. Group characteristics predict absenteeism, and only group task design and group characteristics predict group performance. Finally, and Cohen found this surprising, encouraging leadership behavior has no positive effect, even a negative effect, on the performance of the team. She found this surprising as it seems to contradict existing leadership theories. One of the possible reasons for this might be that the more managers intervene in the life of SMTs, the more they obstruct effective outcomes. Even if supervisors offer encouraging behaviors, how well-intentioned, team performance can be undermined.

**Personality and SMT effectiveness**

Barry (1997) summarizes existing relevant research on the relationship between group member personality and effectiveness of the group. Five personality factors emerged:

1. extraversion; associated with being sociable, assertiveness, talkative and active
2. agreeableness; associated with being flexible, trusting, cooperative and tolerant
3. conscientiousness; associated with being thorough, responsible and organized
4. emotional stability; associated with not being anxious, depressed and worried
5. openness to experience; associated with being imaginative, curious, original, intelligent.

In his research, Barry concentrated on extraversion, finding a positive relationship between the proportion of high-extraversion group members and the group’s focus on task accomplishment and performance. The same study on the relationship between personal traits, team traits and team effectiveness showed that teams that are more agreeable and more emotionally stable are likely to have higher performance.

**Employee self-management**

One of the most important aspects in which an organization built on SMTs differs from a “standard” organization is the absence of leadership. Manz and Sims (1980) define this as “a process through which the supervisor structures reinforcement contingencies that modify the behavior of subordinates”. In organizations however, there are other ways to motivate employees to do their work properly, e.g. through self-management. A person displays self-management when in the absence of external constraints he manages an “administration of consequences”. Self-management includes those directly involved in the self-controlling process and those resulting from the behavior. The theory of self-management relates to the role of an individual in an SMT, where contributing to the team goal is the personal goal of the individual members. It is therefore important to set clear targets for individual behavior, so that reaching these targets can be “rewarded”. This reward can be given both in the team and outside the team, and could be an individual or a team reward.

Manz (1992) suggests that the introduction of SMTs tends to increase the level of self-management opportunity and the discretion of employees. The limitations of the group impose limitations on the individual. Self-leadership addresses what should be done and why and how it should be done. In self-leadership organizations, workers play a greater role in influencing strategic processes and higher level management decision-making.
Barriers to SMT Implementation

Changing an organization into using SMTs as the basis of its structure can raise many issues, comprising the following elements:

1. The individual in the SMT can exhibit “groupthink” (Manz & Simms, 1987 and Janis, 1982), a “non team-oriented personality” (Barry & Stewart, 1997), and “resistance” (Kirkman et al., 2000). Too much “groupthink” can be damaging to quality of decision-making and output—invoking excess cohesiveness—explaining why some groups get on very well but are not very effective, which also depends on their alignment to the company’s goals.

2. The organizational environment, such as managerial commitment, the organizational culture and task structure, and co-ordination between different groups within the organization, which might not be conducive to setting-up SMTs (Carnall, 1982).

3. The composition and set-up of the SMT, such as team design, group characteristics and membership (Guzzo & Dickson, 1996) which might not relate to ideal SMT characteristics.

4. The role of management external to the SMT, such as management tasks, the way that managers are rewarded, and the skills they require for the empowerment of the SMT members (Clifford & Amrik, 1998) which may not help SMTs develop.

Cohesiveness

Group cohesiveness is linked to members’ positive valuation of the group and their motivation to continue to belong to it. When group cohesiveness is high, all the members express solidarity, mutual liking and positive feelings towards group tasks. Group cohesiveness may, however, lead to group pressure on members with deviant opinions towards the evolved informal group norms. Strict group norms can have a negative effect on group performance, as argued by Janis (1982) in discussing “groupthink”. As a result of “groupthink”, the striving for unanimity (to avoid exclusion) overrides the motivation of group members to realistically appraise alternative courses of action. The actions taken on the basis of the group decision may consequently not be the best possible solutions to problems, thus influencing the effectiveness of the organization negatively. In essence the group loses its ability to make use of all the knowledge, experience and ideas of its members and instead seeks complacency and complete agreement. SMTs can be vulnerable to the same kind of defective decision making process (Neck, 1994) as members will likely experience a tendency to conform to the general views of the team because members depend on each other for effective completion of tasks. To counter the occurrence of “groupthink”, Neck & Manz (1994) constructed the principle of “team-think”. This theory counters the defective decision making results of groupthink by stressing constructive thought within the team, e.g. by encouraging divergent views of team-members, open expression of concerns and awareness of limitations. The team should be encouraged to show positive thought patterns, to see problems as challenges. The outcome of this “team-think” should be more effective decision making and enhanced team performance. Ginnett (2005) suggests that groupthink could be avoided by first discussing the issue in subgroups, bring in an outside expert to comment on the issue or let one of the team-members behave as a designated “devil’s advocate”.

Individual barriers

Employees should be able and willing to manage themselves when external leadership is not present, or more distant than in hierarchical organization, acting on personal goals and self-administered consequences, without needing external reinforcements. The personalities of the team members should be congruent to the tasks they are performing: highly individualistic people are not ideal in a SMT environment. Otherwise, the SMT adoption process can be slowed down, and the future effectiveness of the SMT can be compromised. Kirkman (2000) showed in his research in two Fortune 50 organizations structured in SMTs that resistance to SMTs emerges from employee concerns related to trust in management, low tolerance for change, lower employee job satisfaction and lower organizational commitment. Employees showed concern about managerial support, role clarity, team social support and workload distribution issues. Employees in high power distant environments will dislike the idea of self-management. Employees who show these types of resistance were less satisfied with their jobs and less committed to their organizations after the SMTs were put in place, which hurt the performance of this SMT. An “ideal” team-member of an SMT should:

- be able to self manage;
- have a positive attitude towards interaction;
- be extravert;
- be responsible;
- be emotionally stable;
- be indifferent towards power distance;
- be flexible;
- show cooperation;
- not be highly individualistically;
- be open to different opinions.

Organizational barriers

These include the ability of organizations to:

- release power to employees: for many managers used to being “in control” it is very difficult to let the team decide on their own. A precondition for SMTs to work is that the organization shows that the team’s autonomy is taken seriously.
- create the context for employee involvement: an SMT cannot function properly without good links with its environment and without its members having
the skills to perform the job and to be truly self-managing. Cohen’s research clearly showed that employees need a sense that they are involved with the organization and that the organization is involved with them. This can be achieved by having power, information, recognition (here is link with the theories on individual self-management) and resources.

- express trust: even if the organization is able to transfer power to the teams and show involvement it is still very important that management expresses trust in the SMTs that they are able to perform the job. That means e.g. that higher management doesn’t demand too many detailed progress reports or arranges too many meetings with the team.
- enhance the employee’s quality of work life: this is one of the underpinning ideas of SMTs and therefore one of the issues that should be taken into account by the organization. Although all the other elements that have mentioned before contribute to an improved perception of quality of work life for the employee, the organization should always stay aware of this. It is also in the small things, such as defective computers, failing air conditioners or work space in general, they all relate to Maslow’s deficiency needs.
- create effective team composition: a team should not consist of members that have more or less the same traits and behaviors. As it is important that they support each other and that team setting creates an advantage compared to the individualistic approach, team members should be complimentary to each other. The organization should take this into account when composing the teams. And after the initial establishment, the teams when recruiting new members should be aware that it is a common fault to recruit similar people to those already in the team.

The Role of the Manager

If employees lead themselves and their teams, and are empowered to make decisions, do they need a manager? The simple answer is yes – especially to keep them aligned to the goals of the organization as a whole. Mills (2003) warns that the success of employee empowerment “depends on the ability of the organization to reconcile the potential loss of control inherent in empowerment practices [like SMTs] with the fundamental organizational need for goal congruence.” Control loss by management means control gain by employees. It can be constructive or destructive. Mills warns that empowerment without external alignment with the organizations goals will lead to control loss and could create overall harm. This alignment can be provided by external leaders of SMTs, but they lack traditional legitimate authority, acting as “facilitators” or “communicators” without giving direction regarding the work of the SMT. Manz (1987) calls them “unleaders”, or people who lead others to lead themselves. From his research at a large manufacturing plant organized into SMTs, it appeared that an effective “unleader” may be primarily a facilitator who relies heavily on communication and who carefully balances a “hands-off” and a directive style according to the requirements of each unique situation. Manz (1987) discusses six important self-management leader behaviors, based on the “unleader”-concept introduced and used later by Cohen (1994), suggesting that an effective external leader of an SMT:

1. encourages self-reinforcement, (e.g. of group performance)
2. encourages self-observation/evaluation (e.g. monitoring and evaluating the level of performance)
3. encourages self-expectation (e.g. let the SMT have high expectations of its performance)
4. encourages self-goal setting
5. encourages rehearsal (first think, then act)
6. encourages self-criticism, (e.g. be critical on low group performance)

Kirkman (2000b) suggests that most managers are used to being ultimately accountable for the performance of their people, are proactive in setting goals, delineating work processes, and closely monitoring individual and group performance. But leaders of SMTs must play the role of coaches and facilitators, helping teams define tasks, structure activities and monitor their own progress. Such a team leader needs to know when to step in and, more importantly, when to step out of the way. Kirkman gives more or less the same behaviors for a team-leader of an SMT as Manz, but adds “displaying of trust and confidence in team’s abilities”. Susman (1976) sees the role of the external team leader as one of mediation between the SMT and its environment, being at the boundary between the team and the (rest of) the organization. Fisher (1993) considers team leaders “to work more as a ‘work process architect’ than as a ‘work operations monitor’”. The primary targets of their work are relationships rather than tasks, and teams rather than individuals. He calls the team leader “boundary manager”, engaged not in the “throughput” part of the operation (that traditionally was the main focus of a manager), but in the relationship with the boundary: customers, other teams, competitors, and technology. Supervising the throughput activities is largely done by the team members themselves. If the team leader manages these external elements successfully the team will be more effective. Managers act as translators as they try to help the team members to understand the “chaotic reality” of their environment. Fisher summarizes by stating that “[traditional] supervisors work in the system, team leaders [of SMT] work on the system”. In this way, the team leaders provide the necessary structure to the SMT, as a substitute for hierarchy. Without this substitute, teams could end up into chaos. Druskat (2003) investigated the “boundary-spanning” activities of the external leader of an SMT. External leaders are positioned at the boundary between the SMT and the organization. External leaders of SMTs are responsible for the performance of the team, just like “normal” managers, but are supposed to lead by delegating the monitoring and managing of the performance to the SMT itself. The behavior of the external managers of effective SMTs can be organization-
focused or team-focused. Within these two areas, the different behaviors could be divided into four different categories:

1. Relating with team and organization members and building political awareness
2. Scouting for information and keeping informed about what was going on inside and outside their team
3. Persuading team-members to cater to the needs of the organization and the organization members to take team members' needs into account
4. Empowering their teams, where coaching is an important art

The four different functions support one another and enable the external leader to move effectively between the team and the organization, thus making it possible for the team to be effective, aligning the goals of the organization and teams. The team will be more accepted within the whole organization, but at the same time the SMT will have and feel more ownership over the outcome of its activities. Druskat draws the conclusion that working at the boundary requires conscious strategic maneuvering for the team leaders. Encouraging behavior as described by Manz (see above) becomes more meaningful when leaders have caring, trusting relationships with their teams and have enough information to know what action they should best take. Best-performing leaders rely on referent and expert power to influence their teams and members of the larger organization. SMTs cannot do without external leadership. As they are mainly focused on their own internal processes for which the team members are responsible there is a big chance that an SMT wanders off from the goals of the organization, ending into chaos. There is an important role for external leadership to engage in boundary-management, providing the team members with the right tools and information to perform their job successfully and at the same time ensure the alignment of the SMT's work with the organizational goals. At the same time the external leader should lead the members of an SMT to "lead themselves", by encouraging effective behavior.

References


Disguising and Emphasizing Local Brand Origin in Emerging Markets: An Empirical Investigation

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Most consumers live in emerging markets; and yet, much of the consumer behavior theory is built on research conducted in high-income countries. Researchers have called for testing the validity of theories developed in a Western cultural context, in emerging markets; however, much work remains to be done. One area that merits investigation is emerging-market consumers’ preference for global brands, as it affects the strategies of both global and local firms. This study sheds light on the outcome of the attribution of local or global identity to local brands in the emerging market of Turkey. The study investigates the extent to which Turkish consumers correctly identify Turkish brands as local brands.¹

An important strategic decision used in product positioning is the selection of the brand name. In many markets, it is not unusual for local brands to carry foreign sounding names, with the purpose of endowing the brand with cosmopolitan traits. For example, Häagen-Dazs is a U.S. ice cream brand positioned as Western European; the motivation behind this positioning is that Western European desserts are perceived as high quality by U.S. consumers. This type of country-of-origin misattribution is commonplace in emerging markets, where many firms use English to position their brands as global brands, rather than as local brands. Similarly, in the Turkish market there are many international-sounding brand names, or brand names which presumably indicate worldwide recognition and imply quality.

Background

There are two schools of thoughts related to local versus global product positioning. One stream of research suggests that consumers worldwide prefer global brands to local brands and research found that perceived brand globalness is related to both perceived brand quality and brand prestige, and, through them, to purchase likelihood. Global brands are commonly agreed to be brands that consumers can find under the same name in multiple countries with similar, coordinated marketing strategies (Yip 1995, Branch 2001; Steenkamp, Batra and Alden, 2003). In fact, consumers are believed to prefer brands with a global image over local competitors even when quality and value are not objectively superior (Shocker et al. 1994; Kapferer 1997; Steenkamp, Batra and Alden, 2003). Consumers prefer global brands for their association with higher prestige (Kapferer 1997); global brands have higher prestige because of their higher price, among others (Bearden and Etzel 1982; Steenkamp, Batra and Alden, 2003). Consumers buy global brands to enhance their self-image and position themselves as cosmopolitan, sophisticated, and modern (Friedman 1990; Steenkamp, Batra and Alden, 2003).

Another stream of research claims that consumers prefer brands with strong local connections (Zambuni 1993, Steenkamp, Batra and Alden, 2003). In this situation, brands are positioned as icons of local culture (Bilgin, Sriram, Wührer 2004; Samli 1995). In spite of the popularity of global consumer culture, local culture remains a central influence on consumer behavior and individual identity (Samli 1995; Steenkamp, Batra and Alden, 2003).

Study

The present study attempts to investigate the extent to which Turkish consumers correctly identify Turkish brands as local brands. It investigates Turkish brand names and their implied country-of-origin communication, based strictly on the names themselves. The study suggests that, in the Turkish consumer context, language is used to either position the brands as international brands with a Western country of origin, or as local brands that are icons of the local culture. Specifically, we hypothesize that Turkish brands with English-sounding names will be erroneously identified with an Anglo-American origin, rather than as Turkish brands; and brands with Latinate-sounding names are more likely to be identified with Latinate countries.

¹ The authors acknowledge the generous support from the University of Richmond Quest for this article.
(Italy, in our instrument), rather than correctly identified as Turkish brands.

For the study, we used a judgment sample of managers attending a master’s program at one of Turkey’s premier graduate schools. The managers were asked to check the correct country of origin of a number of different Turkish brands. The Turkish brands were presented randomly, along with other international brands. The countries offered for selection were: Austria, France, Germany, Italy, Japan, Switzerland, Turkey, the United Kingdom, and the United States.

We conducted nonparametric chi-square tests. Our findings suggest that there is a significant pattern for all of the brands positioned as Latinate. These brands were identified preponderantly as Italian. Specifically, Cavallo D’Oro (food products)—whose distribution of country identification was significant ($\chi^2 = 68.93$, df = 6, $p<.01$)—was identified as Italian. Similarly, PastaVilla (food products)—whose distribution of country identification was significant ($\chi^2 = 57.57$, df = 3, $p<.01$)—was identified primarily as Italian, and was also correctly identified as Turkish. Rio Santo (food products) was identified both as Italian and as originating from a country not listed on the survey; however, the distribution of country identification was not significant.

Brands with English-sounding names were identified as follows: Golden Rose (cosmetics)—whose distribution of country identification was significant ($\chi^2 = 22.93$, df = 5, $p<.01$)—was identified primarily as Turkish, but also strongly as a U.S. product. Silk and Cashmere (fashion)—whose distribution of country identification was significant ($\chi^2 = 69.84$, df = 6, $p<.01$)—was identified primarily as Turkish, but also strongly as British. Porland—whose distribution of country identification was significant ($\chi^2 = 128.73$, df = 7, $p<.01$), while primarily identified as Turkish, was also identified as a British brand.

Brands with unambiguously Turkish names were identified as follows: Dorya Home (furniture)—whose distribution of country identification was significant ($\chi^2 = 17.56$, df = 7, $p = .014$)—was primarily correctly identified as Turkish. Efes (beer)—whose distribution of country identification was significant ($\chi^2 = 67.06$, df = 1, $p<.01$)—was correctly identified as Turkish. Derri (fashion)—whose distribution of country identification was significant ($\chi^2 = 10.00$, df = 4, $p = .04$)—was correctly identified as Turkish. And Damat-Tween (fashion)—whose distribution of country identification was significant ($\chi^2 = 116.28$, df = 2, $p<.01$)—was correctly identified as Turkish.

Surprisingly, Bind (pastry and chocolate)—whose distribution of country identification was significant ($\chi^2 = 10.21$, df = 4, $p = .037$) —was identified primarily as Swiss, but also as Turkish. The strong Swiss association is likely attributed to the fact that the manufacturer has studied extensively Swiss chocolate production, and many Bind chocolates have the shape of Lindt offerings as well.

**Discussion, Limitations, and Directions for Future Research**

The study findings show that marketers use strategies that may, at first sight, appear contradictory. They target Turkish consumers with foreign-sounding brands and them with unambiguously local brands. The strategies are successful, in that educated Turkish consumers are identifying these brands as intended — as foreign for the foreign-sounding brands and as local for the brands with Turkish names.

Specifically, a number of Turkish brands (i.e., Cavallo D’Oro, Pasta Villa, Rio Santo, Silk and Cashmere, Golden Rose, and Bind) use foreign brand names to adopt another country-of-origin identity, or, possibly, to disguise the brands’ Turkish identity. Through the use of language, these brands are identified as originating in a particular foreign country or region (foreign-country positioning), and, through this association, the brand acquires traits characteristic of brands from that particular country or region— such as prestige or cosmopolitan characteristics. In other words, these brands with foreign-sounding names aim to appeal to consumers seeking the prestige and quality associated with Western European or Anglo-American brands.

It is also evident that other Turkish brands (i.e. Dorya Home, Porland, Derri, Damat Tween, and Efes) have Turkish names and thus clearly identify themselves as local. They closely align themselves with the local culture, appealing to nationalist sentiments and local preferences.

It is likely that, as the Turkish economy grows and Turkey’s influence in the region strengthens, local brand managers may decide in favor of local-country-positioning strategies. In fact, many of the Asian republics of the former Soviet Union are looking to Turkey for leadership. In the consumer realm in particular, Turkey serves as a source of influence. It is conceivable, then, that the use of language to identify a Turkish brand with another country of origin may be reversed. Foreign brands targeting Turkish consumers may use Turkish names to appeal to local preferences and nationalist sentiment. Also, as Turkey develops a competitive advantage in certain industries, brands in neighboring countries or in countries with significant imports from Turkey may adopt Turkish brand names.

Among the limitations present in this study are sample homogeneity, listed-country skew, and brand awareness. The judgment sample of Turkish managers used for the study consists of subjects with a similar employment experience, education, age, travel experience, and knowledge of foreign languages. These managers are not representative of Turkish consumers.

The countries listed on the survey may have skewed the choices selected by each subject. There were disproportionately more countries with Germanic languages than countries with Romance, or other languages. A greater
limitation, however, is the brand awareness possessed by the sample. There were a number of “Don’t Know” responses, which affected the significance of the results. These “Don’t Knows” may mean that (1) the subject is aware of the brand, but unwilling to guess the country-of-origin; or (2) the subject is unaware of the brand, and thus unwilling to guess the country-of-origin.

This study suggests additional questions in relation to brand-origin recognition accuracy (BORA) in emerging markets. One such question is whether or not the study findings would be similar if the study were conducted in other emerging markets (i.e. China, Brazil, Argentina, India, Russia, and Poland). Do companies in other emerging markets disguise the country of origin of local brands marketed in these countries and, most importantly, do consumers identify the foreign-country-positioned brands as, indeed, foreign?

Additional studies may also be performed in the Turkish market to enhance insights into business and brand strategy. It may be noteworthy to find out if Turkish brands disguised as foreign are more successful than Turkish brands whose Turkish country of origin is emphasized. Finally, another stream of research could investigate if Turkish consumers prefer local brands for certain product and service categories and global brands for others.

References


New firms developing or adapting new technology usually have insufficient resources, but can gain access to the necessary resources by cooperating with external partners through international strategic alliances. This process inevitably involves different individual personalities with different attitudes to knowledge secrecy and sharing. Where development of new technological knowledge occurs within the boundary of the firm as a legal entity, the firm and its people automatically own the new knowledge. However, where this takes place within an international alliance the new knowledge may not be automatically appropriated, and may be claimed by any one of the alliance partners.

Introduction

Contractual control over the results of external research activity for commercial value always requires the allocation of ownership of codified new knowledge. This is essential in realizing the value of the start-up firm concerned. Yet, the bulk of the new knowledge created may be of a tacit or un-codified nature. Kept in the minds of the founders and other personnel in the new firm and subject to the behavior and attitudes of people working within the alliance partners, aspects of individual personality can moderate attitudes towards secrecy or sharing of new technical knowledge, and where the ownership of this new knowledge should lie. These behaviors can be located on a continuum between tendencies towards complete sharing and total secrecy. The former style can include openness, generosity, unguardedness, gregariousness, cooperativeness, and a spontaneous attitude to new opportunities. The latter preference would tend to show controlling, closed, parsimonious, careful, uncooperative and thoughtful behaviors. People opting for these styles tend to ‘take their time over things’ and often show loner behaviors. In testing personal attitudes to sharing and controlling, the authors have employed two techniques: firstly, observation based on personal interaction over several meetings considering several critical incidents, and secondly through the use of a conflict mode instrument which measures cooperativeness and accommodating tendencies compared with competitive and avoiding characteristics.

In the process, this paper argues that another, second boundary beyond the legal entity of the firm exists: where the firm’s internal knowledge generating networks extend into surrounding international alliance cooperation networks, creating a ‘knowledge boundary’. The area between both can be defined as the space where internal and external networks actively exchange ideas to create new, mainly tacit knowledge, but over which the firms’ own networks have no full control.

This is the context in which we consider the importance of the personalities concerned, and their tendencies towards secrecy or sharing. The ‘lines’ of the knowledge border are defined by the focus and expertise which each one of the participants brings into the exchange, as well as their attitudes towards knowledge ownership. Hence, the area between legal and knowledge boundaries is also defined in terms of interaction of individual focus and attitudes, which in turn widens the initial border lines, increasing the problematic nature of knowledge control and ownership. This paper explores these issues in the context of a case study of a high technology start-up firm in Asia of a few years ago, which was successfully able to retain its created knowledge, and realize its value in terms of attracting venture capital investment.

Successful new technology firms seem consistently able to utilize alliances and membership of strategic technology partnering networks to leverage partner knowledge in the development of their own core competences and the creation of significant new shareholder value, without significantly sacrificing or trading away their own unique and quickly evolving knowledge asset base. How do they do it?

Firms cannot know or plan in advance the precise locations of their constantly changing strategic knowledge boundaries, yet successful ones are able to judge these at any one time accurately enough to not sacrifice or trade away core knowledge assets in strategic technology partnering alliances, necessary to develop a strategic market position critical to the creation of shareholder value.
value. The firm’s unchallenged legal ownership of its unique knowledge is the ultimate repository of all of the shareholder value contained within the firm, which can attract venture capital investment or other forms of commercial interest.

In order to maximize growth in shareholder value, the management of technology start-ups must leverage owned knowledge in acquiring new knowledge in alliance with other firms, technology research organizations and private contractors. As this is an ongoing process, the firm’s own knowledge base constantly mutates in response to new knowledge gained within alliances, with market intelligence from the firm refining the knowledge search within the alliance.

A key part of success for a small firm in working with much larger and stronger strategic alliance partners yet retaining proprietary knowledge lies in the attitudes, personalities and behavioral characteristics of the key players. Here we profile behaviors and preferences of members of a small firm and a representative member of a strategic alliance partner, considering in detail their observed behaviors based on critical incidents, and their response to a questionnaire to explore tendencies towards cooperation and accommodation (Thomas & Kilmann, 1974).

Such a firm is concerned with appropriating the tacit knowledge generated beyond the legal boundary and within the knowledge boundary, and avoiding excessive leakage from a firm’s own ‘proprietary’ knowledge. The more complementary the knowledge brought in by international partners or the larger the knowledge overlap, the larger the potential for sharing, resulting in leakage of knowledge, and the blurring of ownership of the knowledge. Appropriating and controlling new knowledge requires a continuous process of ‘refocusing’ and narrowing down of the company’s knowledge boundary so that overlap is reduced. Where international alliances involve companies with multiple complementary foci dealing with single focus firms, the process of identifying the latter’s exact knowledge ‘niche’ also requires that internal networks rapidly absorb and transfer the knowledge back into the legal boundary. Because of the tacit nature of the knowledge and the unpredictability of the personalities involved, the transferring of knowledge to within the legal boundary will always be problematic. In particular, in examining the personalities, their tendencies towards sharing and controlling knowledge (and where these personalities occur on this continuum) will be examined.

Support for this dilemma of the need for knowledge resources but the fear of knowledge leakage and resultant loss of commercial value comes from a small technology business based in Asia. This firm specializes in creating competitive mobile data services over satellite, making use of an extensive number of international strategic alliances, and is a small niche player in a global field, dominated by powerful foreign companies with deep pockets. Technology progress is achieved in alliance with these offshore partners, all of which constantly strive to extract the maximum benefit from their association with the firm concerned and its personnel. The firm applies technical knowledge by forming international, inter-alliance teams to take a known, codified “block” of intellectual property (IP) and combining it with other IP to create an innovative advance in a particular product or service. The IP may be owned by the company, or it can be owned by individual partners. Because this particular block of knowledge is codified, its ownership is beyond doubt. But the process of combining and developing the blocks requires the continuous application of tacit knowledge which is contained within the team, leading to the creation of an entirely new block of knowledge. Management influences the focus of each alliance partners’ team members by means of regular team progress meetings, where the team reports on all aspects of the development work. In this way, management keeps their teams focused and tries to minimize the non-essential leakage of proprietary knowledge. But there is still the unknown factor of the personalities involved and their attitudes towards knowledge control and knowledge sharing.

Discussion

Start-up firms enter alliances close to or even overlapping their core business (Hagedoorn & Schakenraad, 1990), but frequently to exploit the knowledge potential of their alliance partners, (Inkpen, & Crossan, 1995, Kogut, 1988, Hamel, 1991), requiring the protection of core knowledge from partner opportunism. Keil has suggested (1999) that simultaneous engagement in multiple alliances plays a significant role in the success of large firm multiple alliance networks. A fast moving firm would create new knowledge at the same time as partner firms occupy knowledge domains it has recently vacated. In fact, only by allowing partner firms “into its knowledge domain” can the firm leverage its knowledge to stay ahead of global competition.

The major problem is the need for the management of a small firm to precisely judge the “boundary” of the knowledge the firm must keep. A mistake in judgment here could be disastrous for the firm, as core technology required for the next stage of development could be in the hands of future competitors. A discussion of how firms manage their knowledge boundaries included in a recent paper by Tina Vilkamo of Nokia and Thomas Keil delivered at the Helsinki University of Technology (Vilkamo & Keil, 2000), touched on this dilemma in a series of six case studies of firms partnering with Nokia, without reaching a firm conclusion. The case is still open.
One neglected area in this problem over judgment and definition is the role of the personality of the individuals concerned, and their tendencies towards sharing or controlling the knowledge at their disposal. This is another important focus of this paper which attempts to inform the knowledge creation, ownership and management process.

In the case of a traditional, slowly evolving firm, the knowledge frontier more or less coincides with the legal entity of the firm (Hitt, Ireland & Hoskisson, 2001). Most knowledge creation is performed within the legal entity of the firm, and is therefore indisputably owned by the firm. Hagedoorn and Schakenraad (1990) point to the distinction between efficient inter-firm networks (involving traditional slowly moving firms) and dynamic inter-firm networks (involving high growth firms). It is likely that in the case of a new, very quickly evolving high technology firm, the knowledge frontier on the advancing technology side lies far ahead of the legal frontier. The faster the evolution is developing, the more blurred the boundary can become. Combine this with the personalities involved and the waters become increasingly muddied.

Knowledge created and existing within the knowledge boundary but outside the legal boundary, while valuable for the future of the firm, has no influence on shareholder value until it is brought inside the legal boundary. Therefore, the key task of management in a high growth firm can be to ensure that jointly developed knowledge creation is maximized in the alliance network system within the knowledge boundary, and in ensuring that a strategically significant portion of that new knowledge is brought within the legal boundary and therefore the unchallenged ownership of the firm. These are contradictory tasks, as operations within the knowledge boundary are characterized by cooperation and joint effort, while the creation of the shareholder value of the firm, which can be seen as management’s ultimate task, depends on that new knowledge being competitively appropriated and brought within the unchallenged legal ownership of the firm.

Thus the personal and behavioral characteristics and attitudes of the managers of the small high technology firm in their situations must be both cooperative and accommodating, to attract and encourage the alliance partner to share in the creation of new knowledge at the boundary, but also competitive in terms of protecting their firm’s interests, and avoiding giving anything anyway. This is a contradiction which can prove difficult for individuals to manage – as discussed below.

**Literature Review**

Many new, start-up firms can be crushed as they cooperate and compete with existing global players and other aggressive new start-ups from around the world in fast changing networks and alliances, all jostling for a central position in the emerging market. Much of this activity, of course, is the result of a clash of personalities between the entrepreneurs concerned. An understanding of how a new firm can navigate safely through the chaos of an emerging market, and find the key value-creation position in that market, can have the effect of increasing the chances of ultimate success and decreasing mortality rates for new firms. Such value-creation clearly depends a great deal on knowledge creation, ownership and management. This needs skill, focus and a sense of priorities.

It is widely seen that in order to grow, new high growth technology firms need to join forces with other firms on a global scale (Oviatt & McDougall, 1994, Hauge, 1997). It is also agreed that many of these new organizations generally do not have the resources that are available to larger firms (Larson, 1991, Zacharakis 1997). A key concern is the protection of proprietary technology and know-how. Where globalization includes some likelihood of technology transfer, and the firm is too small to directly own the foreign entity to which the technology is being transferred, other very powerful safeguards need to exist to protect the knowledge being created (Buckley, 1997). This is an increasing cause of vulnerability among small firms.

The potential problems facing a small firm planning to launch itself into a high growth path can often seem to be so daunting, as to cause it to abandon the decision altogether. Alternatively, having already taken the step, mistakes made in the growth process can jeopardize the very success of the venture itself (Zacharakis 1997).

On the other hand, the key motivation for young, high growth firms to undertake this step is the realization that high growth may be essential for business survival in the coming years. The relentless lowering of technical, financial and political barriers to trade and investment means that competitors can appear in the domestic market from anywhere in the world with little or no prior warning. For the same reason, technical progress and market changes are being enacted within a worldwide framework. Perhaps the increasing sophistication and effectiveness of strategic thinking among business leaders has contributed significantly to this globalization of competitive markets (Ireland, 1997). Firms which can develop a worldwide vision of the future, and which can operate within a strategic structure which allows scope for worldwide vision, planning and operations, will be in a position to anticipate and benefit from those changes (Hamel and Prahalad 1996, Rider 1997).

Network alliances, usually arising from a central or primary transaction that has been expanded into a more general relationship network, have significant influence in enhancing the growth and competitiveness of entrepreneurial firms (Larson, 1991). Informal but strong bonds between firms develop as a result of repeated cooperation, where the cooperation becomes a source of economic advantage. These relationships can be
compromised by opportunistic or negligent behavior on either side.

Very high and sustained growth based on technological innovation is normally unavailable to smaller firms due to resource constraints, and barriers to entry that limit expansion into global markets are systematically higher for smaller firms than for larger firms. As a result, companies are beginning to use the structures of the international networks and alliances in their various forms, as a means of competing with large multinational enterprises on a global scale (Zacharakis, 1997, Acs, 1997, Rider, 1997, Hara, Kanai, 1994, Gulati, Gargiulo, 1998). An organisation structure can be created whereby the participating companies can acquire new knowledge from other firms and individuals within those firms, without either hiring the people or otherwise committing scarce resources to this learning process (Meyer, Avaréz and Blasick, 1997). These non-traditional structures are orientated towards survival and growth. Small firms can leverage their resources to achieve growth when they are involved in a meaningful way in a network of other, similar firms in the same industry (Human and Provan, 1997, McDougall, Shane, Oviatt, 1994). The end result can be a more flexible and dynamic structure than that of a traditional, hierarchical multinational enterprise [MNE], which can form a collective vision of the future market faster than the MNE (Rider, 1997).

High technology SME’s wishing to use their relationships with other firms to help exploit a global market niche have several alternatives to consider, all of which involve an alliance of one sort or another (Oviatt and McDougall, 1994). The entrepreneur thus faces a problem in deciding which alliance strategy to use which will maximize the entrepreneurial objective of survival and growth; the very essence of entrepreneurship (Sexton and Smilor, 1997). Furthermore, he or she must develop a clear vision of the future shape of the global marketplace for the firm’s future products, the strategic architecture, which is the key to long term growth. Sustainable, profitable growth is the product of foresight (Hamel and Prahalad, 1994). At the same time the entrepreneur faces the kind of vulnerability we have described at the beginning of this paper. While this long term vision has been the preserve of the MNE’s, there seems to be no reason why a purposeful “flotilla” of SME’s, bound together by a common vision, could not “intercept the future” way ahead of the MNE’s (Rider, 1997).

Hamel and Prahalal (1994) suggested that “many of tomorrow’s most intriguing opportunities – interactive television, on-board navigation systems for cars and trucks, cell therapy, remote at-home medical diagnostics, satellite based personal communication devices, a national video register of homes for sale, an alternative to the combustion engine – all will require the integration of skills and capabilities residing in a wide variety of companies”. However, they also observed that although almost every large firm has a “spaghetti bowl” of alliances, there is seldom an overall logic to the set of partnerships. They are entangled in a haphazard way – hence the “spaghetti bowl” image.

Discussion of the importance of effective control of the firm’s boundaries in alliances is more recent. In particular, the role of boundary agents as forces for controlling the outflow of the firm’s own knowledge in boundary-spanning activities such as developing new knowledge in alliance with partners is a possibility.

Conceptualization

One of the major features of international knowledge-building strategic alliances is the dual dance of partners in cooperating with each other in sharing knowledge so as to develop new knowledge. At the same time they are competing with each other in attempting to claim ownership of the new knowledge created, whilst protecting as much as possible the firm’s own knowledge base from leaking out to these partners. But much of the new knowledge created remains tacit and un-codified: it remains in the minds and experience of the individuals participating in the project. But because the most effective new knowledge generated by high growth technology firms tends to be tacit and un-codified, initial agreements and contractual arrangements are rendered effectively useless. So how does the management of the small firm protect the firm’s own tacit knowledge base from leaking out via team members interacting with the team members of the strategic partner? And how does this management team ensure that inter-alliance knowledge creating activity is directed more towards the needs of the small start-up firm, and less towards the needs of the alliance partners? Finally, how are the results of this activity claimed by the firm? What is the role of personality and attitudes, given that these influence the perception of value-creation in knowledge and the extent of pro-activity in the need to claim it? In particular, what can be the impact of competitive behaviors versus collaborative and accommodating preferences?

Conceptual Framework

Codified knowledge is that which is contained within the legal boundaries of the firm, with unchallenged ownership of the knowledge supported by contract, copyright and patent. Codified knowledge is more likely to be about ‘what’, but remaining in the form of tacit knowledge is ‘why’ and/or ‘how’. There is no effective way in which the firm can claim legal ownership of the tacit ‘why’ and ‘how’ contained within people’s minds, yet this aspect of knowledge is critical to the process of innovation and the generation of new knowledge. The personal attitudes towards the value of this ‘why’ and ‘how’ can vary significantly, adding another unpredictable dimension.
Management tends to exercise control by bringing focus to inter-alliance knowledge creation to build shareholder value, ensuring that company-owned knowledge and valuable company resources create value for themselves, not a partner. The primary and most effective way is to ensure that researchers report regularly to a series of project management meetings, where management has the opportunity to adjust, focus and direct the flow of work occurring in the inter-alliance spaces. These meetings also occur within the partner, so how does management ensure that their priorities prevail?

The management team of the small firm exercises control by ensuring that the focus of the work is in line with the firm’s objectives, assessing the innovative potential of the research work. As researchers interact with their counterparts from partner firms, their motivation can change from the objectives of their firm to the academic imperative to “discover new things”. The thrill of the chase and discovering of new knowledge within the intra-alliance teams can overwhelm the financial and business objectives of the firm. This tendency can be very strong amongst young researchers of a highly collaborative and accommodating nature. Competitive instincts can moderate these inclinations, although another problem can be a tendency of researchers to achieve breakthroughs for personal gain only. Management connection with the needs of shareholders to maximize the shareholder value of the research is the directing and stabilizing factor, but is hard to achieve in practice.

Within the teams, each team member is subject to the cooperative intra-alliance team pursuit of knowledge, and the start-up firm’s need to maximize value. Knowledge development is an inexact process, with unpredictable directions and outcomes. So the provision of focus via regular project management meetings is not in itself sufficient to ensure outcomes that favour the individual firm. Management also provides an element of “knowledge gravity” where new knowledge “gravitates” back from the inter-firm alliance research spaces to the individual firm. Researchers are subject to knowledge gravity by being aware of the knowledge that will benefit the firm, and will tend to focus on those developments most subject to their own firm’s gravity field. This implies that larger firms have a larger and stronger gravity field than smaller firms, and therefore will find that more of the new knowledge automatically “gravitates” towards them as opposed to their smaller partners.

Knowledge boundaries

The knowledge boundary can be defined as the point where the knowledge gravity field between two partners is in equilibrium. In an alliance between a larger and a smaller partner, the boundary will be much closer to the smaller partner’s “legal” boundary, so they must provide a higher level of focus to its team members than may be necessary for the larger member of the alliance. While focus can ensure that a firm’s researchers will concentrate on benefits for the firm, and knowledge gravity will provide a (subconscious) background force, this in itself is not enough to explain how new knowledge can be transmitted back inside the legal boundaries of the firm. This may be achieved by the use of a third element – the “knowledge conveyer belt” – whereby new knowledge is claimed by means of agreement, contracts, trademarks, patents or copyright, a further focus of the start-up firm’s team.

The Case Study

SatCo is a new technology firm specializing in developing low cost, IP based data services for mobile users via satellite. This case informs the discussion of the management and coordination of the two knowledge frontiers being central to the survival and growth of a fast growing alliance based firm, and the role of personalities and behaviors influencing the achievement of successful outcomes.

During the period July 2000 and July 2002, SatCo developed knowledge assets resulting in a group of professional venture capital firms [VCs] investing several million dollars in first round funding. The VC’s constantly referred to this knowledge base as the “crown jewels”, to be protected at all cost. With the long-term participation of one or two key technology experts, most of the value residing in SatCo was seen as contained within these crown jewels, without which the company would be effectively worthless. The prospective investors’ main concerns questioned whether or not the crown jewels were actually located inside the “Legal Entity Boundary”, and owned by the firm without any possibility of challenge by the alliance partners who had helped create them. The enormous complexity of the technology meant that it was only understood in its entirety by several groups of multi-organizational teams, and certainly by no one single person. These teams existed within SatCo, but also within the main alliance partners, among others an institute for research in telecommunications (part of a university department), and a major multinational with a strong brand name in the field.

Therefore, how did SatCo gain unchallenged ownership of the new knowledge, so that investors felt secure enough to invest in the firm? This is not clearly understood even today. On April 1st, 2003, the author attended a seminar organized by the VCs, where senior management of both SatCo and the university-based institute discussed how they “put it all together”. At no stage did these two sides of the three-sided alliance show any understanding of the mechanism of how it all “came together”, other than to point to the importance of trust and interpersonal relationships in making it happen. Some contentious disagreements between members of the different groups threatened to sabotage the process, making the
achievement of initial agreement and the protection of the crown jewels all the more remarkable.

The difficulty involved in “putting it all together” so that the crown jewels came to reside within SatCo, thus attracting VC capital investment, is shown by the widely divergent interests and objectives of the three alliance partners in developing the technology. Aspects of the technology involved are illustrated in the diagram below. The technology is explained in more detail in another conference paper jointly prepared by one of the authors (Verhardt and Delcorta, 2007).

Partner Objectives Regarding the Technology for SatCo included a clear need to own the technology so that the firm could attract VC funding, and to control the technology to keep out powerful global competitors, using the technology to develop marketable products and services in alliance with other significant product alliance partners.

For the university-based institute, there was a need to retain rights to aspects of the technology to be able to seed a second start-up company, although these aspects were unclear and intensely technical. Being part of a university, the academics saw their careers as built around research in this technology, and therefore required the freedom to publish the results of their research in global journals and at conferences; unfortunately, the reaction of SatCo and the prospective SatCo investors to such dissemination was highly negative.

For the multinational, distributing the technology to global product and service developers would enable this large company to dominate its market, so the key objective was to enhance the value and utilization of the powerful, next generation satellite system, to add significant ongoing value.

Management of the Knowledge Boundary at SatCo involved constant internal project management meetings held at SatCo, often including other alliance partners’ teams. Members of partner teams therefore knew very well the focus of the SatCo teams, were aware of the “Knowledge Gravity” effect exercised by SatCo, and knew where the knowledge boundary lay. The process can best be described as a combination of cooperation and friendly competition. Within this process, however, management paid particular attention to always protecting the integrity of the “crown jewels”, the specific set of mathematical formulae that formed the heart of the SatCo business and that provided almost all of the shareholder value in the firm. While researchers would wish to use the crown jewels in various ways to help the cooperative research effort, management would jealously guard all access to it, and only allow access when there was an undeniable and well-identified shareholder benefit.

The issue was that SatCo needed to access information and knowledge from the other partners, as part of its essential process of ongoing knowledge creation. But not only were there different agendas of the different alliance partners (as discussed above), the individual personalities influenced the outcomes in his process, given the tacit nature of the knowledge being created. These personalities may be measured by the location of each partner on the secrecy and sharing continuum, and their profiles in terms of competing and collaborating (based on the Thomas and Kilmann exercise, 1974).

By way of background, it should be explained that a high score for the Collaborative mode can waste time in solving problems, and may fail to encourage collaborative behaviors in others (it takes two to effectively solve a conflict). Little use of this mode can mean a lack of appreciation of differences as opportunities to learn and solve problems, and can also mean lack of commitment to problem-solving outcomes. Those scoring high on the collaborative preference can be seen as sharing, gregarious, helpful, open and willing to reach an amicable solution.

Being too Competitive can result in intimidating colleagues, who then do not want to share problems and discuss ideas. Those high on competing tend to go their own way, protecting what they see as theirs, acting as loners and being secretive and possessive. (By contrast, being low on this preference can mean feeling powerless and being unable to make firm decisions). Accommodating can be a sign of being too easy-going and can create lax discipline. However, not being accommodating suggests problems in building goodwill and a lack of recognition of knowing when the person might be wrong. Stubborn, inflexible and unwilling to see the views of others, those low on accommodation present a brick wall to those trying to co-operate.

Too much emphasis on Compromising can reflect a lack of appreciation and awareness of the important issues of the principles, values and long-term objectives of the organization. It also suggests bargaining and trading, gamesmanship, and undermining interpersonal trust. Too little reflects embarrassment over bargaining and refusal to make concessions. Finally, too much Avoiding suggests a lack of co-ordination where people avoid discussions of issues, the use of too much energy spent on caution and the avoidance of the concerns of others, and the need for matters to be faced and resolved by someone else. So, important decisions may be made by default, without adequate consultation. On the other hand, the under-use of Avoiding can result in the stirring up of hostilities and the feeling of being over-whelmed by too many issues (de Bono and Jones, 2008).

**Partner Personalities and Behaviors**

The two original managers of SatCo were profiled using the Thomas and Kilmann instrument. The founder/driver of the business and the original CEO (we can call “A”) was found to be extremely competitive by nature. Although willing to collaborate on occasion if necessary, he was completely opposed to the need to accommodate and was mostly influenced by the need to be
secretive. He was most reluctant to pass over the leadership position of SatCo when this was required in due course. His strong fixation on the importance of protecting SatCo from possible threats from the other partners paid off. His stubborn prioritization of the need to safeguard the technology, to attract VC funding and preserve the value of the business in order to compete internationally, played a large part in SatCo’s ability to keep the new knowledge being created from escaping through the knowledge boundary.

The co-founder and academic brains of the business (“B”), previously working in the university environment with “C” (below), was widely seen as “a nice guy” by the partners in the meeting. He definitely played a less powerful role in the protection of the crown jewels. Low on competitiveness and relatively lacking in co-operation skills and preferences, he was mostly focused on compromising and avoiding. He was not strong in sharing but was not particularly secretive either. He was more likely to accommodate the needs of others than most of the other characters involved in the meetings. Although regarded as the repository of the value of the business, the intellectual custodian of the crown jewels, the “$6 million man” for whom the VC buyer paid the capital to purchase the business, he would not have been effective in protecting the crown jewels on his own. He was simply too accommodating and not sufficiently competitive by nature, too sharing and keen on knowledge per se.

At the university-based institute, the individual (“C”), based at the institute, was the original source of the ideas that led to the technology behind SatCo, but was not involved in the company directly. He originally thought through the firm’s basic intellectual foundation, and originally owned and licensed the key technology to SatCo. “C”, like “B”, also lacked the profile to be a real knowledge protector. Extremely low on competitive instincts, happy to accommodate others and collaborate freely, he can be seen overall as a willing sharer. His focus on academic discovery and knowledge creation, without the commercial instincts of “A”, for example, could have led to the leakage of the crown jewels had he been in a position of authority in SatCo. This can be seen as typical of a knowledge creator and helps explain the vulnerability of scientific start-ups in the context of acquisitive multinationals.

The representative of the main multinational among the alliance partners, “D”, was a chief engineer and co-developer of the intellectual property needed by SatCo, and helped the firm to create necessary new knowledge to successfully attract investment. However, despite his position he was not able to capture SatCo’s crown jewels for his organization. As seen from the multinational’s agenda (above) he saw benefits in the spread of the technology generally, and it would have been in his interests to appropriate SatCo’s knowledge. But his profile was less competitive than “A”, more sharing and significantly more accommodating. Although low on avoiding and anxious to be kept informed about everything in the meetings, he had a stronger tendency to compromise than to collaborate. Under pressure of time and overwhelmed by an involvement in too many issues, “D” allowed SatCo to keep its precious crown jewels intact, whilst sharing his own organization’s knowledge with them.

A further player in the scenario (“E”) could have caused trouble but fortunately was contained by SatCo and the other partners. An outside contractor to SatCo but working within its team, he created his own organization outside of SatCo and its relationship with the institute and the multinational. Attending many of the meetings, he effectively muddied the waters of the triangular relationship, pursuing his own goals in a secretive manner and also showing a high degree of stubbornness. With a profile similar to “A”, he competitively protected his own interests and was described by SatCo staff as “arrogant” and “a prick”. He played a part in developing part of the technology needed by SatCo, but did not help in the task of protecting SatCo’s crown jewels. Fortunately he did not subvert the “coming together” of the other players and the successful attraction of VC funding for SatCo based on their successful retention of the crown jewels. The knowledge gravity working in SatCo’s favor continued to work, encouraged by focused and aggressive leadership.

**Conclusion**

Firms may have a knowledge boundary or frontier, in addition to the legal boundary that is usually thought to define the point where the firm itself ends and the “rest of the world” begins. The legal boundary is defined by what is legally owned or who is formally employed. Knowledge that is unambiguously contained within the legal boundary is usually codified and concerned about “what”. Knowledge intensive firms and firms that develop new knowledge hold a significant portion of their knowledge assets in their employees’ minds as tacit knowledge, primarily concerned about ‘why’ and ‘how’, and therefore by definition beyond the legal boundary.

Tacit knowledge can have just as great an effect on the shareholder value of the firm as codified and identified knowledge, so it is of interest to management to know the extent of the firm’s tacit knowledge asset, and to exercise control over its use.

With a brief look at the complex SatCo knowledge development process, we have posited that the knowledge boundary is just as important in measuring, protecting and growing the firm’s knowledge asset base, as is the legal boundary that narrowly defines what the company actually owns. Because much knowledge at SatCo was developed in alliance with larger and mostly international partners, many important additions to shareholder value occurred.
outside the legal boundary, and by definition beyond the direct control of management. We have examined how SatCo managed to exercise control over the development of new knowledge developed in partnership with other organizations who also wanted to use the new knowledge to increase their own shareholder value, an essentially competitive end to a cooperative activity. We have suggested that the primary tool management used was to bring sharp focus to the work of researchers working beyond the legal boundary of the firm, by means of regular project management meetings involving both researchers and management. We have also suggested that there is a certain “knowledge gravity” effect exercised by the firm, whereby researchers know intuitively what knowledge is valuable to their own firm and which is not. Taking the analogy a little further, the gravity of a larger firm will be greater than that of a smaller firm, so new knowledge is more likely to “gravitate” naturally towards the larger partner. In order to counteract the gravity effect, SatCo ensured that the teams developing knowledge beyond the legal boundary kept firm roots within the firm itself, with some members staying inside the legal boundary. This enabled the teams to become “conveyor belts” to carry knowledge back inside the firm from the work being carried out in the intra-alliance spaces, where it could be codified and appropriated by contractual or other legal means such as patents and copyright. The competitive and secretive personality of the SatCo founder/driver ensured the focus on knowledge retention. The academic brains of the organization would probably have been less effective in this task, as their tendency towards sharing without competitive instincts would have been too strong. SatCo was also helped by the tendency towards accommodation of the potentially powerful multinational partner in this case.

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The world is currently changing at a more rapid pace than ever before, driven by six ‘mega-trends’: technological progress, globalization, the new consumer, population trends, political uncertainty and the corporate social responsibility imperative. These trends are forcing companies to innovate and refine their fundamental business models. Investment promotion agencies and economic development organizations must not only deal with all those changes, but also with more intense competition. To do so, they need to understand their clients, their environment and their competitors, and to respond effectively.

Thinking about the world of 2020, less than fifteen years away, it is easy to underestimate the scale of the changes that will happen between now and then. Fifteen years ago, the world was emerging from the end of the Cold War; almost all investment came from developed countries and about 80% went to other developed countries (UNCTAD, 2007). Fifteen years on, investment flows have increased almost five-fold globally (UNCTAD, 2006). In 1990, there were about 35,000 transnational corporations (TNCs), with an average of four affiliates each (UNCTAD, 2006). Based on our own calculations using data from UNCTAD (2007), we have estimated that if the period 2005-2020 sees as much change and growth as the 1990-2005 period, and by all accounts the pace of change has not just stayed the same but accelerated, by 2020 we will be living in a world of 28,000 international investment projects annually, a world where 140,000 TNCs will have an average of twenty affiliates each around the world.

To gain an insight into the world of 2020 for economic development professionals, we conducted a review of long-term economic and social forecasts out to 2020, as well as conducting its own economic analysis of major global trends, including investment, technology and globalization. To understand how investment promotion and economic development organizations are preparing for the future, over 250 organizations around the world were surveyed, including clients of the IBM-PLI Global Location Strategies consultancy practice, members of the International Economic Development Council (IEDC) and the World Association of Investment Promotion Agencies (WAIPA).

For investment promotion agencies (IPAs) and economic development organizations (EDOs), the first key challenge is to understand how the world is changing and the powerful forces at work. These forces or mega-trends, the first dimension of the Rubik’s Cube, are shaping the world of 2020. These include globalization and population changes, which are altering the geographic possibilities and priorities of the private sector. They include technological progress and the rise of the new consumer, which are altering the rules of the market, creating new sectors and activities and resetting the weighing scales of market power. They also include unpredictable risks, such as political uncertainty and terrorism, and the corporate social responsibility imperative, no longer an optional extra, but a key component of corporate strategy.

These forces are driving the business innovation response, the second dimension of the Rubik’s Cube world. This can be seen in how business are reorganizing their fundamental models, stripping away non-core activities, expanding into new activities, placing greater importance on collaboration and partnership and reorganizing their core competencies to maximize efficiency.

Figure 1. Global Investment Flows 1990, 2005 and 2020f (Sbillion)
As the business world of the future is being formed, so too are the winners among IPAs and EDOs, the third dimension of the Rubik’s Cube. The best-in-class of 2020 understand that their clients are changing. Leading IPAs and EDOs also understand that their market is changing into a bigger market with more projects and where competition is increasingly fierce. New sectors, particularly services are emerging as key drivers of investment growth, while overall the focal point around which projects will cluster is shifting from sector-based to activity-based. New factors are also emerging, creating new opportunities to differentiate your location and to create a sustained competitive advantage.

To emerge as winners in the world of 2020, investment promotion agencies (IPAs) and economic development organizations (EDOs) need to not only understand these dimensions of the Rubik’s Cube world in which we live, they need to act now. The winners in 2020 will not be the organizations who understood best how their market was changing, they will be the ones who were the best at responding to those changes.

**Six Powerful Forces - Mega-trends - are Shaping the World of 2020**

Globalization, demographics, technological progress, the rise of the new consumer, political uncertainty, corporate social responsibility are six mega-trends that businesses, regulators and lobby groups, as well as organizations involved in investment promotion and economic development cannot escape from.

**Figure 2. Number of TNCs & TNC Affiliates, 1990, 2005 and 2020f**

![Graph showing number of TNCs and TNC Affiliates](image)

Source: UNCTAD (2006) and IBM Institute for Business Value calculations

Globalization now encompasses people, companies and ideas, not just trade and economics. Globalization as a phenomenon is not new – but the pace and scope of the current wave is unprecedented. The proportion of goods and services that are traded grew from 40% to almost 60% between 1990 and 2005, facilitated by the WTO and falling tariff barriers (World Bank, 2008). Over the same period, the number of transnational companies (TNCs) doubled to 70,000 and the number of TNC affiliates grew more than fourfold (UNCTAD, 2006). The typical TNC now operates in ten countries, compared to just four in 1990. In 2005, global capital flows increased to more than $6 trillion, the highest level ever, with growth in emerging markets has been twice as fast as the growth in developed countries (Kroszner, 2007).

The global labour force is profoundly changing in age and location. In 2008, for the first time in human history, more people will live in cities than not (UN Population Division, 2006). The growth of cities means the growth of the global consumer base. Between 2000 and 2020, 94% of the 1.8 billion increase in the world’s population will be in developing countries (UN Population Division, 2006). Over the next two decades, sub-Saharan Africa and South & Central Asia will see their labour forces increase by between 200m and 300m each; in contrast, North America’s labour force will increase by just 20 million and Europe and Russia’s labour force will shrink by almost 40 million (Open Republic Institute, 2006).

Technological progress is more pervasive than ever before. New technologies are spreading faster than ever before, as shown in Figure 3, and as new technologies embed themselves, the worldwide economy continues to be transformed (International Telecommunications Union, 1999). One in five workers in the EU-15, the USA, Australia and Canada are now employed in ICT-related occupations (OECD, 2005). Technological progress has also spread more widely and is taking hold more deeply than ever before. Between 2000 and 2007, world Internet usage more than doubled to almost 1.2 billion people – by 2010, it is expected to increase to two billion; 40% of this increase came from Asia and some of the biggest increases in penetration were seen in developing countries(Internetworldstats, 2008). This will continue in the future as of the 5.4 billion people not online in 2007, 4.2 billion of them are in Africa and Asia while Oceania and North America have just 117 million more users to add (Internetworldstats, 2008). As more of these consumers and workers flood into the world economy, the priorities of global firms are shifting away from traditional markets.

The new consumer thrives on knowledge and wields unprecedented power. Due primarily to technology, there is a much greater balance of information between producers and consumers - eight of the fifty most popular websites in the UK are portals or retail search websites (Alexa, 2008). At the same time, the average consumer has a lot more to spend each year and this is not just a ‘rich country’ phenomenon. Compared to 2000, the average person in Hungary spends almost 30% more, about $2,000, on consumption each year, while in Turkey, the average person spends over $1,000 more (OECD, 2008).
Figure 3. Faster Spread of Technology: Years from invention to 50m users

Source: International Telecommunications Union; Skype.com; IBM Institute for Business Value calculations

With consumers around the world having more money to spend, and more information to make their decisions, businesses can rise – or fall – in months as exemplified by Google whose brand value increased from less than $1bn in 2004 to $8.5bn in 2005 (Millward Brown Optimor, 2007).

Figure 4. Major Multilateral Environmental Agreements and Signatories, 1975–2005

Source: Glenn and Gordon (2006) and IBM Institute for Business Value calculations

Corporate social responsibility is now a business imperative, not an optional add-on. CSR has evolved from a voluntary add-on to a corporate imperative that is rapidly changing the business landscape. Businesses now face increased scrutiny from consumers and workers about what would previously have been regarded as ‘non-market’ attributes of their goods. This is reflected in the growth of the Fairtrade label, 40% per annum between 2000 and 2007 (Fairtrade, 2007), and the rise in value of the green buildings material market (Co-operative Bank, 2006). Businesses are also facing more and stronger regulation. For example more governments are involved in environmental regulation internationally (Glenn and Gordon, 2007), and as is illustrated in Figure 4.

Figure 5. Business location decisions in response to political violence

Source: Lloyds (2007)

Investors also are paying more attention to environmental and responsibility factors that affect long-term returns. Socially responsible investing (SRI) now accounts for $2.5trn in the USA – or about one in every ten dollars – and for €1.6trn in Europe, and is expected to grow at 5% per annum over the next five years (Celent, 2007).

Unpredictable risks, in particular political uncertainty, loom in the background of decisions being made that will shape 2020. While changing market forces are much of the story in how the world is changing, non-market forces are also playing a role. One of these is political uncertainty and terrorism. Political uncertainty and terrorism affect business and the wider economy. Perceptions on how a country manages the risks of violence are of utmost important. As is shown in Figure 5, almost two in five respondents say they have avoided investments in certain territories due to concerns about violence (Lloyds, 2007).

Businesses are Responding to the Mega-trends by Becoming Globally Integrated Enterprises

The mega-trends at work in the world today shaping the world of 2020 are having a real impact on the world of IPAs and EDOs. Think of it as the Rubik’s Cube – on one side lie the mega-trends, which when they change bring change to businesses lying on another side of the cube. Businesses are focusing on core competencies, the activities that give them sustained competitive advantage -this is the area that is most important for IPAs and EDOs.

The focus on core competencies means businesses need to make decisions on four key areas – what activities to retain, to shed, to partner and to expand, as outlined in Figure 6.
The fundamental and rapid innovation in business models in response to the mega-trends is heralding the era of the globally integrated enterprise (Palmisano, 2006). With the globally integrated enterprise, the ‘production’ process – whether for manufacturing or services operations – is becoming geographically fragmented to an unprecedented degree. It is being spread to the best location globally to produce, not only with the aim of cutting costs but also to tap new sources of skills and knowledge, resulting in the integration of production and value delivery worldwide.

**Companies are Shedding Non-core Activities**

The switching of an activity from one done in-house to one obtained using external providers - outsourcing - now rivals offshore investment in scale and in breadth of activities, and the value of the global outsourcing market is expected to increase by 54% to US$1.43 trillion between 2006 and 2009 (Businesswire India, 2008). Growth in outsourcing spending is evident across all sectors, from manufacturing to public services.

**Companies are Looking for New Ways to Add Value Through Partnerships**

Partnerships, collaboration and cooperation key channels through which businesses add value. More than half of executives say that they have changed their business model over the past three years to take greater advantage of collaborative partnerships and more than 20% of the revenue generated from the top 2,000 U.S. and European companies now comes from alliances (Economist Intelligence Unit, 2006).

**Companies are Adding to Core Activities, Organically and Through Acquisition**

Businesses are increasingly using R&D internally and mergers and acquisitions (M&As) externally to expand their core competencies. Between 2000 and 2005 R&D spend by firms in developed countries increased from $370bn to almost $500bn; China’s spend on R&D increased by 18% between 2004 and 2005 to $115bn (OECD, 2007). M&A activity has grown steadily since 2003 and is expected to have been over $1tn in 2007; in 2005, emerging markets were involved in over 1,000 deals worth US$90bn (Economist Intelligence Unit, 2007).

**Companies are Retaining the Activities They do Best But are Looking for New Locations for These Activities**

As companies strip away activities to hone in on what they do best, they are also rethinking not just the what, but the how and the where as reflected in the growth of international investment. The number of Greenfield projects increased by more than 25% to almost 12,000 projects between 2003 and 2006 (UNCTAD, 2007). Developed countries remain the source for the bulk of projects with projects originating in Europe growing fastest (38%), while the rate of growth in projects coming from developing countries was as fast as those from the US (23%) (UNCTAD, 2007).

Developing countries are growing in importance as a source of investment projects, with one in seven projects now originating in a developing country; India and China are among the 20 biggest sources of Greenfield FDI projects, with India among the biggest investors into Russia, China and Malaysia. Developing and transition countries now comprise the destination for the majority of investment projects, hosting over 55% of new projects and over 60% of the estimated jobs created in 2006 (IBM PLI, 2007). In addition to geographical changes IPAs and EDOs are facing in the market, the typical project is also changing. Service activities now rival manufacturing in number for projects.

**IPAs and EDOs Must Respond to the Challenge**

As they face into the world of 2020, the challenge for investment promotion and economic development organizations is the challenge of the Rubik’s Cube: understanding the relationship between the different sides and getting all the pieces to work together. Not only do they do need to understand, they need to respond. The winners in the world of 2020 won’t be the most knowledgeable IPAs and EDOs, rather they’ll be the best at execution. There are three aspects of their business that IPAs and EDOs need to understand and respond to: their clients, their environment and their competition.

**Understand Your Clients, the Businesses**

Businesses are responding to the mega-trends by changing their underlying models and focusing on core competencies. IPAs and EDOs need to consider how they...
will respond.

Figure 7. Mega-trends, business innovation & the IPA/EDO response

Consider widening your focus to include firms of all sizes Our survey of IPAs and EDOs around the world indicates that while American organizations actively target firms of all sizes, other organizations, particularly outside Western Europe, tend to focus predominantly on larger firms, with almost three quarters of IPAs outside North America and Western Europe mostly targeting large firms (IBM Institute for Business Value, 2007). With investing abroad easier and cheaper than ever, offshoring is no longer the preserve of the global multinationals. Increasingly, it is a tactic for small- and medium-sized enterprises (SMEs), which may require different types of support. For example, IPAs and EDOs could consider forming collaborative relationships with organizations representing SMEs in target markets.

Respond to the rise of outsourcing With the growth of outsourcing, businesses that previously invested activities offshore may look to external specialist service providers. IPAs and EDOs need to ensure that their efforts include targeting those providers. Organizations that are successful in monitoring and responding to these trends will get a first-mover advantage.

Take an active role in helping firms form partnerships While the benefits are real, as shown by the example from New Zealand (see case study), evidence from the IPAs and EDOs suggests that facilitating strategic partnerships is not a priority currently, particularly for Western European and North American organizations (IBM Institute for Business Value, 2007). Form partnerships of your own Just as businesses are adding value and developing new core competencies through partnerships, so too IPAs and EDOs – in the age of globally integrated enterprises – can develop new value propositions by working together. As is illustrated in Figure 8, currently, IPAs and EDOs in Western Europe are more likely to work together with neighbours than organizations in other areas (IBM Institute for Business Value, 2007).

Figure 8 ‘To what extent do you cooperate with other IPA/EDOs in your region?’ (Score 1-5)

Understand Your Environment, the Changing Investment Market

The global investment market is changing and IPAs and EDOs around the world agree that on the importance of the workforce and skills challenge, the ‘war for talent’ (IBM Institute for Business Value, 2007). They disagree, though, on the importance of heightened competition due to globalizations. As Figure 9 shows, this is very much a concern of IPAs in Western Europe – and indeed elsewhere in the world – but hardly registers with their North American counterparts. Whereas over 70% of organizations in Western Europe cite globalization and competition as a key concern, just 11 percent in North America have the same worry.

Figure 9 ‘What do you see as the main challenges facing your organization in the next five years?’

Keep up the focus on the markets that are the main sources of FDI Five countries – the USA, Germany, the UK, Japan and France – remain the source for more than half of all projects. IPAs and EDOs need to build and maintain a presence in key markets and maintain regular contact with decision-makers.
Win your share of projects coming from new and emerging sources A focus on key markets needs to be balanced with recognition of new and emerging sources of investment. The number of projects originating in the BRIC countries – Brazil, Russia, India and China – increased by almost 30% between 2003 and 2006. Other smaller economies, such as Estonia, Singapore, Ireland and Slovenia, are now emerging as substantial per capita sources for projects – there were 277 Greenfield projects from those four countries alone in 2006 (IBM PLI, 2007).

Adapt your strategy to changes in the mix of activities and sectors being invested Best-in-class IPAs and EDOs have always understood sector and industry-specific factors, enabling them to anticipate strategic issues affecting investment decisions in talks with prospective clients. They are now also successfully identifying ‘new’ sectors and trends, as mobile investment projects emerge from previously non-traded sectors, such as renewable energy and water treatment. Also, projects are concentrating around activities as well as sectors. IBM’s Global Investment Location Database (GILD) shows that while production and sales remain the most commonly offshored activities, one in six projects is now in activities such as R&D, headquarters and shared services (IBM PLI, 2007).

Understand Your Competition and What You’re Being Measured On IPAs and EDOs need to understand who their competitors are and on what factors they are being benchmarked, to ensure their offering is unique. ‘Unique’ selling points are often common to many organizations, however. For example, more than 40% of North American EDOs stressed one or more of transport infrastructure, market access or cost of living as one of their key selling points (IBM Institute for Business Value, 2007). Across regions, as Figure 12 shows, common selling points differ, but within regions there is often similarity in the factors chosen.

Table 1. Most common ‘key selling points’ of IPA/EDOs by region

<table>
<thead>
<tr>
<th>Rank</th>
<th>North America</th>
<th>Western Europe</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Transport infrastructure</td>
<td>Presence of clusters or sectoral hub</td>
<td>Economic &amp; financial stability</td>
</tr>
<tr>
<td>2</td>
<td>Access to markets</td>
<td>Access to markets</td>
<td>Political stability</td>
</tr>
<tr>
<td>3</td>
<td>Cost of living</td>
<td>Overall quality of industry-specific skills</td>
<td>Quality of life</td>
</tr>
</tbody>
</table>

Source: IBM Institute for Business Value (2007)

Stay alert in a world where competition for projects is more intense Competition for investment projects is becoming more intense. Large countries such as China, India, France & the USA do receive the most Greenfield projects. Relative to size, though, smaller countries fare better, as Figure 12 shows. Other countries – particularly transition countries – are rapidly moving up the rankings. Of countries receiving 20 or more projects, Belarus, Ukraine and Kazakhstan are among those moving fastest up the rankings, jumping from well outside the Top 100 to as high as 63rd (Ukraine) in less than five years (UNCTAD, 2007).

Figure 12. Inward investment of Greenfield projects in selected countries, per million of population, 2002 and 2006
Benchmark the factors by which you are being measured. Regions in contention for investment projects are benchmarked across a range of categories. Some will be common to all projects, such as the general business environment and the quality of life for staff. Other criteria – and the specific weight attached to all criteria – will differ by activity and by sector. For example, attracting a data centre places a greater weight on data privacy regulations and reliability of power supply. This means IPAs and EDOs need to use these as benchmarks. Knowing which activities and sectors are being targeted allows more precision about the indicators.

Leverage the new priorities in location decisions. Like businesses, IPAs and EDOs must develop a ‘unique sales proposition’ – what makes their location unique. However, many IPAs and EDOs stress the same ‘key strengths’. While these factors may be important, it is often other factors – including semi-fixed factors such as language, culture and time zone – that can make a region truly unique. Adding value no longer comes through simply providing information, rather through astute marketing, bundling benefits and developing unique propositions.

Rise to the opportunity and challenge presented by technology. Modern technological infrastructure is a prerequisite for newly mobile service activities, the growth area for investment projects. However, few IPA/EDOs see their information and communications (ICT) infrastructure as a selling point (Economist Intelligence Unit and IBM Institute for Business Value, 2007). In the USA, less than one in five views their ICT infrastructure as a key strength – elsewhere it is less than one in ten (IBM Institute for Business Value, 2007). For emerging markets to take full advantage of the mobility of investment projects, key ICT infrastructure needs to be in place. For developed countries, advanced ICT infrastructure will be taken as a prerequisite, rather than a differentiator.

What is your plan for 2020? Investment promotion agencies and economic development organizations need to start working now to prepare for the world of 2020. The forces creating that world are at work today and, like the Rubik’s Cube, understanding how a change in one has knock-on implications for other is the necessary first step to winning. To rise to the challenge of the mega-trends, IPAs and EDOs need to consider some key questions:

What are the factors that make your location truly unique? While some, such as cost of labour or tax regime, are important, sustainable competitive advantage comes from more long-standing factors. These may not be the most obvious and could include location, language, culture, time zone and climate.

What markets, based on these sustainable sources of competitive advantage, will your location target over the coming years? How will this take account of the growth in activities-based projects, rather than sector-based?

What are the most important benchmark criteria for those markets? What targets will be set and in what areas? Who will your primary competitors be?

How will your location capitalize on the new ways in which clients are conducting their business? Will smaller and medium-size companies be a target? Will you seek to partner local outsourcing service providers with companies looking to shed non-core activities? Will you forge new relationships with previous competitor locations to add value in new ways to clients?

References


Source: UNCTAD (2007), IBM Institute for Business Value calculations

Figure 14. Internet penetration (%) in certain countries, 2000 and 2007

Source: Internetworldstats.com
Associations


OECD (2007). Research and development statistics. Retrieved December 19, 2007, from OECD Web site: http://www.oecd.org/topicstatsportal/0,3398,en_2825_497105_1_1_1_1_1_1_00.html


Telecommunications Regulation in the Caribbean Community: Challenges for Regulation in Suriname

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Victor van Reijswoud, Delft University of Technology, The Netherlands
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During the last decade, more than 100 countries have liberalized their telecommunications markets, motivated by the belief that competition will improve market performance. However, the process of deregulation in developing countries may be hindered by specific characteristics, such as corruption, weakness of the rule of law, and the absence of well developed accounting and auditing systems. Existing literature on regulation is based on the experience of the industrialized countries and does not take these unique characteristics into account. This paper aims to provide recommendations for the regulatory process, specifically focusing on characteristics of developing countries such as Suriname, by analyzing and comparing the regulatory environments in 13 CARICOM countries.

Introduction

For decades, the telecommunication industry was characterized as a natural monopoly and was dominated exclusively by protected public utilities. This approach was based on the belief that, because of economies of scale, it would be wasteful for more than one firm to operate in the market. Now, there is a decline in support for natural monopoly thinking, and the international trend is to open telecommunications markets up to competition (Hope and Moore, 2007). This trend started in the early 1980s when the industrialized countries decided to restructure their telecommunications markets, providing for market-based development, the licensing of additional operators, and the establishment of sector-specific regulators to drive network development (Henten et al., 2003). The motivation for this restructuring is a belief of governments that competition will increase the ability of the industry to satisfy growing customer demands with greater economic efficiency (Buckley, 2003).

To make sure that the objectives of liberalization are met, the liberalization process and the telecommunication market should be effectively and functionally regulated. Regulators have an important role to play in the creation and maintenance of competitive markets (ITU, 2007). The process of liberalization and regulation in many developing countries, however, is criticized for having led to markets in which dysfunctional regulatory institutions are unable to improve market quality (Laffont, 2005). According to Laffont, the effectiveness of the regulatory factors in developing countries is influenced in a negative way by specific characteristics of those countries. Existing regulatory frameworks and guidelines for regulation are based solely on experiences in developed countries. Characteristics as corruption, high costs of public funds, weakness of the rule of law, the absence of well developed accounting and auditing systems, and limitations of the government, which are often present in developing countries, are not given sufficient consideration.

The objective of this research paper is to give recommendations for the effective application of regulatory frameworks in developing CARICOM-countries and especially in Suriname. By reviewing the Telecommunications Regulatory Environment in 13 CARICOM-member states, the effectiveness of the regulatory measures and the influence of specific characteristics of developing countries will be determined.

Theoretical background

Regulatory Framework

Although each country may regulate in its own way, all agree that regulation of some sort is required. By regulating the sector, barriers to market entry by new operators can be removed. New operators need licenses and in order to give every operator a fair chance, an independent party needs to set rules. Most countries therefore will agree that regulation should be done for the following (main) reasons (Intven et al., 2000):

1. Licensing new operators;
2. Interconnecting of new entrants with incumbent operators;
3. Regulation of prices;
4. Fostering Competitive markets;
5. Ensuring universal access to basic telecommunications services.

These subjects form the basis of the regulatory framework (RFW) that was used in this research to analyze the different telecommunication markets in the CARICOM...


Licensing

“A telecommunications license authorizes an entity to provide telecommunications services or operate telecommunications facilities” (Intven et al., 2000: 2-1). The license provides all stakeholders, including consumers, operators, and the government, with a clear understanding of what the operator is and is not permitted or required to do. Licenses are particularly important in developing economies, because they provide certainty for investors and lenders, and therefore contribute to the confidence that is needed to invest in Telecommunications infrastructures. Licensing influences the structure of the telecommunications market; determines the number and types of market players; regulates the competition between the players; determines the revenues earned by governments in opening markets; and ultimately, it directly affects the efficiency of the supply of telecommunications services to the public. The licensing process is therefore one of the most important actions to be carried out by the regulator in the process of liberalization (Intven et al., 2000).

Interconnection

According to the ITU, Interconnection-related issues are ranked by most countries as the single most important problem in the development of competition in telecommunications (Intven et al., 2000). Without interconnection, consumers across different networks are not able to communicate with each other. The main goal of the regulation of interconnection is therefore to stimulate competition. However, some subsidiary goals are: decreasing transaction costs, stimulating technological growth, and protecting the customers (Gijrath, 2006). Incumbent operators have little to gain from interconnecting with their competitors, because they have all the customers. The new entrants on the other hand have little to offer to the incumbent operators, which make their negotiation position very weak. That is why decisive and informed guidance by regulators is needed to ensure effective interconnection arrangements (Intven et al., 2000).

Price Regulation

In an environment of pure competition there is no need to regulate prices. The prices are determined by the market mechanism. However, in many countries the incumbent is still a dominant market player, especially in the first months after liberalization (Hope and Moore, 2007). Price regulation is needed when telecommunication markets fail to produce competitive prices. Effective price regulation simulates the results of an effective competitive environment (Intven et al, 2000). Without price regulation, dominant firms can increase prices above competitive levels or may engage in pricing practices that hinder competition in a market, harming their customers (InfoDev & ITU, 2008).

Foster Competitive markets

Competition is important for the customers because it forces suppliers to become more efficient and to offer a wider range of products and services at lower prices. In a competitive market there is a level playing field and there are no dominant market players that can dictate the market. A perfectly competitive market does not need any government intervention; all market players respond to the actions of their competitors in order to stay in business. There is, however, no such thing as perfect competition. Markets will in many cases be dominated by a small number of large firms. Imperfect competition leads to market failure. Market failure is characterized by resources being misallocated or allocated inefficiently, which results in waste or lost value (Intven et al., 2000). The main objective of government intervention with competition policy is to respond to market failure. In the transition period from moving from a monopoly to a liberalized market, intervention is often required until the market has been transformed to a self-sustaining competitive market.

Universality of Access

Universality of access policies are meant to provide services to people who would normally not have access to telecommunications services, such as, for example, people in high cost areas and lower income groups (Intven et al., 2000). Almost every country is convinced that universality of access has to be strived for in some way. Most countries therefore have some kind of universality program. There are a number of different approaches to establish proper funding for these kinds of programs. Traditionally, most countries have used cross-subsidies to ensure universal access. Today, cross-subsidies between services are increasingly viewed as impractical and anti-competitive. Telecommunications experts argue that this kind of price regulation has not been effective when it comes to promoting universality (Intven et al., 2000). Besides cross-subsidies, there are four other mechanisms that are used around the world to implement universality policies today. These mechanisms are described below:

1. Market-Based Reforms: The introduction of market based reforms such as privatization, competition, and cost-based pricing, increase the supply of telecommunications services;

2. Mandatory Service Obligations: This is perhaps the most commonly used mechanism for promoting universality. By imposing obligations on operators, regulators try to increase universality access. Examples are: the obligation to provide services in certain (rural or high cost) areas. These kinds of obligations are used in developing countries to expand telecommunications networks;
3. Access Deficit Charges (ADCs): An ADC regime is like a cross-subsidy regime, but modified to fit a competitive market. The access deficits for services that are priced below cost are financed by both incumbents and other operators;

4. Universality Funds: In this approach revenues are collected from different sources, like the government and interconnection fees. The collected revenues are used to promote universality objectives. In contrast to ADCs, these funds are used to finance specific targets, like high cost areas and low income subscribers.

Characteristics of Developing Countries

While the principles of effective regulation are similar in most countries, some may be applied differently in developing economies. There are significant differences in resources and other constraints in developing economies from those of industrialized economies. This obviously has implications for regulation (Intven et al., 2000). Most regulatory literature is based on experiences in industrialized countries. Little attention has been paid to specific characteristics of developing countries and the influence they have on regulation (Laffont, 2005). Laffont describes the following characteristics of developing countries:

- High cost of public funds;
- The absence of well developed accounting and auditing systems;
- Wide-spread corruption;
- Weakness of the rule of law;
- Limitations of the government.

High Cost of public funds

In most developing countries public utilities, such as telecommunications, electricity, gas, water, transportation, and postal services, which are sometimes referred to as economic infrastructures, are expensive and not accessible to every one (Beato & Laffont, 2002). Inefficiency of tax systems and the generally high levels of corruption make it very difficult for governments to invest in infrastructures. This also affects the costs of other government interventions, especially regulation and competition policy (Laffont, 2005).

Absence of well developed accounting and auditing systems

Historically, the auditing systems in developing countries have only started two decades ago. Many weaknesses and problems need be addressed. Auditing systems in industrialized countries, in comparison, have evolved and developed over the past hundred years. The systems in these countries are well-established and have proven to be effective (Yuedong Li, 2006). The ability to audit costs is an essential instrument for regulatory and competition agencies. If this ability is not present the monitoring of costs is difficult, which in turn makes the risk of “cost padding,” i.e., diverting costs, very high. Firms usually have many ways of diverting funds to raise or pad costs: increasing salary and expense claims, “gold-plating” of expenditures, charging unrelated equipment to project costs, advertising for corporate image, charging for depreciated assets, not reporting of cost reducing improvements, and so on (Bougheas and Worrall, 2006).

Wide spread corruption

“Corruption is the abuse of public power for private benefit (or profit).” The main forms of corruption are considered to be bribery, embezzlement, fraud and extortion (Andwig et al., 2000). According to Laffont (2005), many developing countries suffer from widespread corruption, due to, in particular, the low internal costs of side transfers. When a private deal is arranged between two parties, they must take into consideration the costs of being discovered and the need to use indirect compensation, which is less efficient than direct compensation. The costs of these side transfers is expected to be lower in developing countries than in developed countries, because they are harder to identify and social norms may place a positive value on some types of side transfers, for example in small-scaled societies. This makes it more difficult to fight corruption (Tirole, 1992).

Weakness of the rule of law

This characteristic entails that enforcement of regulatory rules is poor, which leads to self-enforcing contracts or costly renegotiations. The high cost of enforcement is linked to the high costs of public funds, which was mentioned earlier. Another reason for poor enforcement is the lack of regulatory power. Regulators in developing countries often do not have full bargaining power. In regulatory frameworks that are based on experiences in industrialized countries, it is assumed that the regulator has full bargaining power, and thus is able to enforce laws, regulations, and policies. Examples show that this does not fit the reality of developing countries. The earlier mentioned corruption level in developing countries also influences the enforcement mechanism, as does the lack of skilled human resources. Regulatory contracts and other contractual relationships in developing countries suffer from this severe lack of enforcement. Most of the time, laws and rules are imported from the developed world and transferred by lawyers. The transfer of this institutional knowledge is relatively easy. However, it is much more difficult to enforce the transferred laws, because of the lack of financial and technical resources, the corruption of enforcement institutions, and the weak bargaining power of regulators (Laffont, 2005).

Limitations of the government

Some important issues that may have a negative
influence on regulation of telecommunications arise from characteristics of the government. Constitutional control of the government and the ability to enter into long-term contracts are often missing in governments of developing countries. The lack of the checks and balances typically found in advanced democracies, such as supreme courts, government auditing bodies, separation of powers, and independent media, makes the government easy prey to interest groups and patronage. The lack of well functioning political institutions, which is linked to the high level of corruption mentioned earlier, increases the uncertainty of regulations. This makes it difficult for the regulator to operate and to make credible commitments (Laffont, 2005).

**Theoretical Framework**

According to the literature, not every characteristic has an equal impact on the regulatory process. In the table below the regulatory factors and the characteristics that are mainly influenced by them are summarized.

<table>
<thead>
<tr>
<th>Regulatory factors</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Licensing</td>
<td>Under developed accounting &amp; auditing systems</td>
</tr>
<tr>
<td>Interconnection</td>
<td>✓</td>
</tr>
<tr>
<td>Price regulation</td>
<td>✓</td>
</tr>
<tr>
<td>Competition Policy</td>
<td>✓</td>
</tr>
<tr>
<td>Universality Access</td>
<td>✓</td>
</tr>
</tbody>
</table>

Source: Hahn (2008)

**Methodology**

The character of the current study is theory building. There is very little literature available about regulatory frameworks for developing countries. Most developing countries rely on the literature tailored to and based on the experience of developed countries. As Laffont (2005) states, advisors in developing countries relied almost completely on the experiences in developed countries, without taking the specific characteristics of developing countries into consideration. Essentially, precepts designed for the developed world were repeated in developing countries. There is therefore a need to further develop the existing literature and to also deal with the special characteristics of developing countries. In order to generate theoretical insights on regulation in developing countries, a comparative design was used, where the cases of 13 CARICOM countries were compared. The following CARICOM countries are included in the research:

1. Suriname is part of CARICOM and has many characteristics in common with other CARICOM countries. The results are therefore better applicable than from other developing countries.
2. Another reason is that as part of the objectives of CARICOM, member states try to compare experiences, learn from each other, and share scarce resources (CARICOM, 2008). Solutions to some of the problems experienced may be found in combining strengths, or the sharing of information or experts. This may be illustrated by the fact that 5 of the 15 CARICOM members already share one regulator 1.

The reason for choosing CARICOM is twofold:

The method used for data generation in this research

1. The OECS member states, Dominica, Grenada, St. Kitts & Nevis, St. Lucia and St Vincent & the Grenadines all share the same regulator “ECTEL”.

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was the use of semi-structured interviews. Because of time and money restrictions, most of the interviews were conducted via the telephone.

Table 2 CARICOM member states

<table>
<thead>
<tr>
<th>Country</th>
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<tbody>
<tr>
<td>1 Antigua &amp; Barbuda</td>
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<tr>
<td>2 Barbados</td>
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<td>3 Belize</td>
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<tr>
<td>4 Dominica</td>
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<td>5 Grenada</td>
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<td>6 Guyana</td>
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<td>7 Haiti</td>
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<tr>
<td>8 Jamaica</td>
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<tr>
<td>9 St Kitts &amp; Nevis</td>
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<td>10 St Lucia</td>
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<td>11 St Vincent and the Grenadines</td>
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<tr>
<td>12 Suriname</td>
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<tr>
<td>13 Trinidad &amp; Tobago</td>
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As is often the case in semi-structured interviews, the interview process was flexible. The focus was mainly on what the interviewee views as important and the questions in the questionnaire were used as an interview guide.

The effectiveness of the Regulatory environment was measured using the Telecommunications Regulatory Environment (TRE) methodology devised by Rohan Samarajiva in the World Dialogue on Regulation Sri Lankan case study (Samarjiva & Dokeniya, 2005). The methodology allowed key stakeholders to indicate their perceptions of the effectiveness of the telecommunications regulatory environment in a country. The key stakeholders are senior regulatory personnel in their respective organizations. They were carefully selected, because their response is assumed to be representative of their organization. Given the small sized regulatory organizations in the Caribbean, only one senior respondent per regulator was used to capture the opinions of their respective regulatory organization. Because the focus was strongly on the opinions of this group, there is a risk of participant bias on the subject. In order to minimize this risk, a control group was used to validate the answers given by the regulators. This control group consisted of three categories of respondents:

Category 1: Stakeholders directly affected by telecom sector regulation (Operators, Industry associations, and Equipment suppliers)

Category 2: Stakeholders who analyze the sector with broader interest (Financial institutions, Telecom consultants, and Law firms)

Category 3: Stakeholders with an interest in improving the sector to help the public (Academics, Research organizations, Journalists, Telecom user groups, Civil societies, Former members of regulatory bodies and other government agencies, and Donors).

Each respondent category’s contribution was given equal weight in determining the final scores. Therefore, the assessment reflects the views of the respondents in each category in an equal manner.

Results

General Findings

On average the regulators find the regulatory environment to be more effective than the control group. Furthermore, the regulators find the overall influence of the developing countries’ unique characteristics less important than thought by the control group. Table 3 shows the details of the influence of the characteristics of developing countries on the different regulatory factors, from the perspective of both the regulators and the control group.

The research shows that there is a relationship between the characteristics of the developing countries and the effectiveness of the regulatory environments in the CARICOM countries. As expected, not all characteristics have an equal influence on the different regulatory factors. In the table a comparison is made between the expected characteristics that influence the regulatory factors (according to the theory) and the results from this research.

The comparison shows some similarities, but also some interesting differences. The most remarkable difference is the fact that “Corruption” is not indicated by the regulators to have a high influence on regulation, while Laffont (2005) argues that this characteristic will have great impact on all regulatory factors. The control group confirms Laffont’s theory by scoring the influence of corruption on all regulatory factors high. The differences between the control group and the theory on the one hand and the regulators on the other, may be explained by the fact that most regulators in the region are somehow linked to the government and not yet government independent. Respondents (especially regulators) can therefore have a tendency to score corruption and limitations of the government as having little influence on the regulatory factors. During the interviews some regulators seemed to interpret the influence of corruption on the regulatory factors to point out the possibility of their own corruption (i.e., corruption of the regulator). Some respondents also needed to be reassured several times that all data would be dealt with confidentially. This may indicate the possibility that respondents answered questions in a cautious way.
Especially when it comes to characteristics like “limitations of the government” or “widespread corruption” this may explain the low impact that was scored by the regulators.

### Table 3 Expected results vs. Research results

<table>
<thead>
<tr>
<th>Regulatory factors</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Licensing</td>
<td>✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓</td>
</tr>
<tr>
<td>Interconnection</td>
<td>✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓</td>
</tr>
<tr>
<td>Price regulation</td>
<td>✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓</td>
</tr>
<tr>
<td>Competition Policy</td>
<td>✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓</td>
</tr>
<tr>
<td>Universality Access</td>
<td>✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓ ✓</td>
</tr>
</tbody>
</table>

Although the regulators consider the influence of the characteristics on price regulation and competition policy relatively low, they agree with the control group that the absence of well developed accounting and auditing systems has the biggest influence on both factors. According to both groups interconnection is also highly influenced by this characteristic.

### Challenges for Suriname

The most important regulatory challenge for Suriname concerns the Regulatory Organization. The Telecommunications Authority Suriname (TAS) employs 13 people and finances its operations by license and spectrum fees. Several respondents emphasized the dominant role that the TAS is taking in the liberalization process. According to two respondents, this dominant behavior is due to the lack of skills and experience of the regulator. The regulator became fully operational at the same moment that the two new entrants received their license. The inexperience of the regulator leaves much room for external consultants to influence policies and strategy. The dependency on external consultants and the inexperience of the regulator lead to two important challenges:

1. To minimize the dependency on external consultants
2. To find a solution for the lack of expertise and skills.

What makes both problems even more challenging is that the solution to the first problem seems to strengthen the second problem, and vice versa.

### Conclusions and Recommendations

Based on the experiences of the industrialized countries with liberalization and regulation, the ITU, the World Bank, and several other international organizations published literature about regulation and provided guidelines for the process. Although these guidelines have proven their value for the industrialized countries, they have not been as effective when applied in the developing countries. The existing regulatory guidelines do not sufficiently take into account the specific characteristics of developing countries. The objective of this research was therefore to identify the most important regulatory issues in the telecommunications regulation process in developing countries, in order to provide recommendations for effective application of the regulatory framework in developing countries, especially in
Suriname.

It was shown that all identified characteristics of developing countries have to some extent a negative impact on the effectiveness of the regulatory environment. However, not all characteristics have an equal influence on the different regulatory factors. According to the regulators, the characteristics “Absence of well developed accounting and auditing systems” and “High cost of public funds” have a stronger influence on the regulatory factors than “High level of corruption” and “Limitations of the government.” The absence of well developed accounting and auditing systems has the largest impact on several factors, namely: interconnection, price regulation, and Universality Access.

The small scale of their economies is an important issue that all CARICOM countries face. The markets in the different countries are too small to allow specialized bodies with specific expertise for each industry. Regulatory expertise is crucial in dealing with the challenges that not only Suriname, but all countries face. Different countries dealt with the issue of small economies in different ways. In Barbados, Jamaica and Belize, they created a multi-sector regulator, to more efficiently utilize resources and regulatory expertise. The OECS member states chose an “economies of scale” solution. The member states share one sector-specific telecommunications regulator, ECTEL.

It is recommended that the TAS also look at possibilities for economies of scope or economies of scale. Economies of scale can be reached, for example, if we work towards a CARICOM regulator and/or a CARICOM competition authority. Because other CARICOM member states deal with the same challenges, it seems obvious to share a scarce resource like regulatory expertise. By doing so, costs are minimized and the risks of influence by corruption and other characteristics of developing countries are lowered. As a first step towards the establishment of regional or multi-state authorities, it is recommended to harmonize the regulatory policies among the different regulators. This process will stimulate the exchange of knowledge and expertise.

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BOP and the Private Sector: A Value Chain Research Approach

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This article will elaborate on the role of the local private sector in creating sustainable economic development. The issue is how private sector development in emerging markets and developing countries is best brought about. A Value Chain Approach is suggested for achieving this focusing on emerging market SMEs. Private sector actors, especially SME’s are the engines of society. In Europe 93 % of all enterprises have less than 10 employees. There are 20.5 million enterprises in the European Economic Area (EEA) and Switzerland, providing employment for 122 million people. Two thirds of all jobs are in SMEs, so one third of all jobs is provided by large enterprises (Mikolc, 2005).

INTRODUCTION

In recent years, a paradigm shift has taken place in development thinking and practice. A consensus has grown to move away from aid and macro-economic reforms and toward a market-based approach to poverty alleviation is necessary (World Resource Institute, 2007). The global debate on poverty alleviation is now increasingly framed in terms of enabling economic opportunities for the poor, in order to create sustainable economic growth in developing countries (WRI, 2007). Perhaps the most significant consequence of this shift is the increasing conviction that the private sector should be engaged in the challenge to create economic growth in developing countries. Economic and political developments, in particular, globalization and the increased influence of markets and private investments worldwide, have added to the belief that mobilizing existing private sector financial and intellectual resources is vital in order to achieve sustainable development, reduce poverty and reach ambitious development targets such as the Millennium Development Goals (MDGs)\(^1\) (Dicken, 2003, Wheeler & McKague, 2002).

This conviction, however, is not new, nor is it based on idealism. In the 1994 World Investment Report for example, MNCs are described as the main vehicle for the achievement of economic stability and prosperity in developing nations, as they stimulate growth and improve the host countries’ international competitiveness (WIR, 1994). A relevant indicator of the importance of the private sector for developing countries is the fact that private sector investment in these countries has been growing for decades. In recent years, FDI by multinational companies (MNCs) in developing countries has increased rapidly. For example, it increased from $20 billion in 1990 to $240 billion in 2000. In the years that followed FDI declined until 2003, but is currently on the rise again. In contrast, Official Development Assistance (ODA) to developing countries today totals about $55 billion annually, and has been declining slightly over the last decade. In the mid 1990s, FDI surpassed ODA, and today the sheer scale of foreign direct investment versus ODA has demanded that the role of MNCs in development be taken seriously (Wheeler & McKague, 2002, Dicken, 2003).

Private sector in development has merited further action for a long time. However, a catalyzing moment did not occur until the World Summit on Sustainable Development in Johannesburg in 2002, when emphasis was placed on the role of the private and public sectors as key partners in solving problems on a global scale and improving the standard of living of the world’s poor. One of the most noticeable outcomes of the Summit in Johannesburg in 2002 was the focus on multi-sectoral partnerships as the principle means to pursue sustainable development. Since the Summit, there has been a noticeable increase in multi-sectoral partnerships among various levels of local and regional governments, UN agencies, small and large companies, academic institutions, NGOs and other civil society organizations. This includes Public-Private Partnerships (PPPs) and partnerships between civil society organizations and private sector organizations. Since then, ‘development’ is no longer seen as the exclusive territory of governments, traditional development actors such as the World Bank and the United Nations’ development agencies, or civil society organizations; the private sector is increasingly involved (Wheeler & McKague, 2002, World Bank, 2005, UNDP, 2006).

**The “business case” for development**

Participation of the private sector in the sustainable development agenda has been led primarily by MNCs. Increasingly, these companies are embedding concepts such as ‘sustainability’ and ‘Corporate Social Responsibility’ (CSR) in their visions, strategies, business practices and operations. Although the terminology around sustainability and CSR is the source of much debate, there is agreement on the fact that these concepts imply combining economic performance with environmentally and socially sound business practices (ref). Despite the fact that results achieved in the ‘social’ and ‘environmental’ arenas are difficult to quantify, MNCs trouble themselves to communicate to the public the efforts that are made to improve quality of life in the markets in which they operate, as well as their environmental performance. The emergence of a World Business Council on Sustainable Development symbolizes the increasing commitment of MNCs to sustainability.

The mechanisms behind the private sectors’ interest in sustainability are rooted in economic globalization. Perhaps the strongest incentive for MNCs to become more sustainable is public opinion: As a consequence of predominantly negative reporting on their role in globalization, MNCs have become the focal point of anti-globalization sentiments, ranging from scepticism to outright societal distrust. Opportunistic behaviour by MNCs - especially in developing countries - have increasingly resulted in public outcries. This watchdog role of civil society vis-à-vis MNCs has been simplified by the increased power and sophistication of the media, ironically also an outgrowth of globalization. At present, the perception of a company’s social and ecological performance has come to act as a societal ‘license to operate’. Those companies that improve their practices and are successful not only in the market place but also in the arena of public opinion will have the greatest freedom to conduct their business. Therefore, more and more MNCs are increasing their social and ecological commitment in their ‘enlightened self-interest’ (Spero & Hart, 1997, Dicken, 2003, Leisinger, 2003).

In their article on commitments of MNCs to development, Kolk and van Tulder (2006) recognized the need to look at MNC poverty alleviation strategies per sector rather than across the block (as is the case in Global Compact). This would mean that in specific sectors, specific MNCs should contribute to sustainable development according to their strengths.

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2 Sustainable development has been defined by the Brundtland Commission as "meeting the needs of the present generation without compromising the ability of future generations to meet their own needs" (UN, 1987).

3 See www.wbcsd.org/
many poor people, by facilitating their access to the market place and mainstream economic activity, and addressing their needs. This will lead to increased engagement of the poor in the global economy, increasing their self-esteem and dignity and reducing poverty. In short, BoP theory is about the creation of win-win situations (Prahalad & Hart, 2002, Prahalad, 2005, Hart, 2007).

Tapping into BoP markets requires that companies reconfigure their business assumptions, models and practices. New competitive business designs need to be created that involve developing unique products, services or technologies appropriate to BoP needs. BoP theory emphasizes that for most companies this requires re-imagining their business. A good way to achieve this is unconventional partnering, with Governments, NGOs, or multiple stakeholders to combine the right capabilities and effectively use local knowledge. Another important element of BoP theory is innovation on what Hart (2007) terms disruptive technology: The BoP is an ideal space for experimenting with high technology and environmentally sound products. MNCs aiming to serve the BoP should ‘leapfrog’ to make use of the newest available clean technologies for their products and services aimed at the BoP. When these technologies have been incubated and developed, they can be fed back into companies’ existing markets.

Despite its apparent success, however, BoP theory has received its fair share of criticism. Until now, the majority of companies engaging in BoP initiatives have used arms-length strategies to quickly tap into the ‘new’ BoP markets without understanding the needs and aspirations of those living there. As Hart (2007) acknowledges this has created “a growing backlash among academics, civil society and even local partners” (2007: 197). Some critics even argue that BoP theory is a veiled attempt at selling products and services to people who can questionably afford it, which will lead to more, instead of less poverty (e.g. Karnani, 2006). Also, critics question the claim that BoP initiatives by MNCs will lead to poverty alleviation. In particular, they doubt whether the ‘bottom billion’ of the BoP can be reached using the strategies outlined in BoP theory (Collier, 2007). These critiques and a further evolution of BoP theory has resulted in what Hart (2007) terms the ‘next level’ of BoP strategies and methodologies, which move away from the unidirectional view espoused in early BoP literature. It is now acknowledged that beyond consumers, people at the BoP should be seen as innovators, entrepreneurs, producers, researchers and market creators as well. Hart (2007) emphasizes that “producing in rather than extracting wealth from these communities will be the guiding principle. The objective is indigenous enterprise, co-creating technologies, products and services to meet local needs and building local business from the bottom up” (Hart, 2007: 194).

Business initiatives for the BoP, in which Western companies aim to serve markets at the BoP, illustrate the fact that the private sector can be instrumental in addressing the challenge of creating sustainable economic growth in emerging markets (Commission on the Private Sector and Development, 2004). Until today, however, BoP theory has focused primarily on consumption, and neglected production at the BoP (e.g. Karnani, 2006), resulting in arms-length strategies by companies to enter into BoP markets. In response to a growing backlash to these ‘early’ BoP initiatives, BoP theory is moving away from its unidirectional view and now advocates ‘business co-creation’ at the BoP, in which people at the BoP are partners rather than consumers (Hart, 2007). BoP theory does not fully reflect the fact that both the consumption and the production side of (international) markets can promote economic opportunities of people at the BoP and generate sustainable economic growth in emerging market countries. Providing people at the BoP with products and services that can improve their living circumstances is valuable, but it is also essential to increase employment at the BoP and improve the rewards of the economic activities in which people at the BoP engage, as this has a direct impact on the income of people in this socio-economic segment.

Although catalyzed by the work of Prahalad and Hart, business initiatives for the BoP can be seen as a logical outcome of the increasing inclusion of the private sector in the sustainable development agenda4, a recent global trend which is one of the consequences of a new paradigm for development. This paradigm is characterized by a move away from aid and macro-economic reforms and towards a market-based approach to poverty alleviation. The objective of the market-based approach to poverty alleviation is to make markets more effective, competitive and inclusive, benefiting people at the BoP by enabling their economic opportunities (WRI, 2007). The private sector is in a unique position to help address this challenge, for example by tailoring consumer product and services development to local conditions at the BoP, and establishing the necessary commercial infrastructure by providing people at the BoP with access to credit, distribution and communication networks. Also, it can provide opportunities for employment and support entrepreneurs and small and medium-sized enterprises (SMEs) at the BoP, contributing to private sector development and ‘unleashing’ entrepreneurship in emerging markets (Wheeler & McKague, 2002, Commission on the Private Sector and Development, 2004).

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4 Sustainable development has been defined by the Brundtland Commission as "meeting the needs of the present generation without compromising the ability of future generations to meet their own needs" (UN, 1987). This entails achieving the needs of economic development, social equality and justice, while overcoming environmental degradation.
Role of the private sector in development

Sustainable business development at the BoP, is proposed to encompass all business activities that create sustainable economic value for people at the BoP, whether on the consumption or the production side of (international) markets. The private sector – ranging from small entrepreneurs to MNCs – plays an important role as initiator and catalyst of these activities. However, the two other forces in society – the public sector and civil society - are also very relevant for sustainable business development at the BoP. Whereas the public sector is the creator of an enabling environment for business, civil society can act as a business development partner, connecting people at the BoP with companies and their initiatives, but also acting as a ‘watchdog’ with regard to these initiatives. In this Value Chain Research Framework, the complementary nature of the roles of the private and public sectors as well as civil society in sustainable business development are acknowledged. The three forces in society, the private and public sector and civil society, can be seen as three relevant sets of actors in sustainable business development (van Tulder et. al, 2004).

In the case of the private sector these include:
- Multinational Corporations (MNCs)
- Small and Medium Enterprises (SMEs)
- Micro-enterprises

In the case of the public sector these include:
- Developed country Governments
- Developing country Governments
- Development agencies and bilateral institutions

In the case of Civil Society these include:
- NGOs (national and international)
- Foundations
- Universities

These sets of actors can be represented in a triangle, as illustrated in Figure 1 below. Actors in the private sector, public sector and civil society increasingly cooperate in multi-sectoral partnerships to achieve sustainable business development at the BoP in emerging markets. This is represented by the arrows in Figure 1.

In order to discuss the role of the private sector in sustainable business development, it should be taken into account that the private sector is comprised of a very broad range of organizations, ranging from micro-entrepreneurs through small and medium-sized enterprises (SMEs) to MNCs. In development literature, ‘the private sector’ generally refers to the institution associated with MNCs. The Commission on the Private Sector and Development (2004) uses the term ‘existing private sector’ to denote this, as opposed to the local private sector. Clearly, the existing private sector can help address the challenge of enabling the economic opportunities of people at the BoP. It has a role to play in including them in the (global) market place and in making markets more efficient, competitive and above all inclusive (WRI, 2007). It can do so both by improving the consumption as well as the production-related business activities of people at the BoP. The former involves empowering people at the BoP by providing them with services and consumer products, increasing choices and reducing prices, as BoP theory envisages. The latter involves developing the local private sector and ‘unleashing’ entrepreneurship in developing countries. This is an element not explicitly included in BoP theory, but which is included in this approach based on value chains.

The key to the potential contribution of the private sector to production-related sustainable business development lies in the role it plays in business ecosystems, networks of foreign and local companies, in emerging market countries. As the Commission on the Private Sector and Development (2004) argues, the existing private sector can develop and strengthen the capabilities of local SMEs and micro-enterprises through the business ecosystem of which it is a part. More specifically, it can enhance the transfer of skills, technology and quality, enhance positive spillovers from FDI, bring companies into the formal sector, open markets and supply of inputs to smaller firms. Further, it would improve the ability of SMEs and micro-enterprises to get financing, and increase wages, productivity and standards of local companies. As SMEs and micro-enterprises are the source of income of the vast majority at the BoP, developing these forms of business is a good way to increase employment and create wealth at the BoP and thus to alleviate poverty (Wheeler & McKague, 2002, Commission on the Private Sector and Development, 2004, World Bank, 2005).

An interesting issue, however, is whether the existing private sector necessarily has to be involved in sustainable business development. Wheeler et al (2005), for example, in their article on Sustainable Local Enterprise Networks...
(SLENs), have argued that emphasis should be placed on the role of smaller indigenous SMEs and their local networks in business ecosystems, as they form the vast majority of businesses around the world and as such contribute greatly to new employment and the maintenance of livelihoods. In this light, Wheeler et al point to a striking omission in the BoP discourse. Given that a local perspective does not necessarily link to international markets, builds on indigenous rather than Western knowledge, and focuses on local value creation, there is potential, they argue, for “self-reliant, sustainable enterprise to emerge in the developing world with or without the involvement of external actors and large domestic firms” (Wheeler et al, 2005: 35).

The private sector – both ‘existing’ and ‘local’ – should, thus, be fully considered when researching sustainable business development at the BoP in emerging market countries. An issue that merits further investigation is the role of MNCs and large domestic businesses: they can contribute to the potential of the local private sector to create sustainable economic value for people at the BoP. As Wheeler et al (2005) argue, MNCs should “help create a more bottom-up, networked approach to the role of business and entrepreneurship in developing economies" (2005: 40). This involves re-conceptualizing their role from that of a pinnacle of the supply chain to that of a player in and a facilitator of a value-creating network.

The private sector – ranging from micro-entrepreneurs to MNCs – can play an important role both as initiator and catalyst of business activities that create sustainable economic value for the poor in emerging market countries. In the development literature, ‘the private sector’ generally refers to business as the institution associated with MNCs. When discussing the inclusion of the private sector in development this connotation is used implicitly. The Commission on the Private Sector and Development (2004) uses the term ‘existing private sector’ to denote this, as opposed to the local private sector.

The existing private sector can help address the challenge of creating the economic opportunities for people at the BoP. Sustainable improvements in the living standards of the poor are most likely when they get a chance to participate in economic activity that can enhance their livelihoods. The private sector has a role to play in enabling this: it can include these people in the (global) market place and make markets more efficient, competitive and above all inclusive (WRI, 2007). It can do so both by improving the consumption as well as the production related business activities. The former involves empowering people at the BoP by providing them with services and consumer products, increasing choices and reducing prices, as BoP theory envisages. The latter involves developing the local private sector and ‘unleashing’ entrepreneurship in developing countries (Commission on the Private Sector and Development, 2004).

As SMEs and micro-enterprises account for the income of the vast majority at the BoP, developing these forms of business is a good way to increase employment and create wealth at the BoP and thus to alleviate poverty (Wheeler & McKague, 2002, Commission on the Private Sector and Development, 2004, World Bank, 2005).

Value Chain Research Approach

Value chain analysis is an analytical approach that can be used to understand the nature of ties between local firms and global markets, and to analyze links in global trade and production. It provides insights into the way producers – firms, regions or countries - are connected with global markets, which influences their ability to gain from participating in the global economy. Furthermore, it helps to explain the distribution of benefits, particularly income, to actors that are participating in the global economy. This allows identification of policies, which can be implemented to enable producers to increase their share of the gains that globalization, can result in (Kaplinsky & Morris, 2002).

One of the main advantages of value chain analysis is that it provides insight into the mode of insertion of producers in global value chains. To understand the value of this potential of value chain analysis, it needs to be taken into account that currently, the gains of globalization are not distributed equally. There is a disparity between global economic integration and the extent to which people and countries actually benefit from globalization. An important explanation for this fact is found in the inappropriate insertion of firms, regions and countries in global value chains. This is the case when a producer specializes in particular links in the value chain that are subject to intense competition, resulting in a decline in terms of trade. When producers fail to insert themselves in an appropriate way into global markets, this may lead to a ‘race to the bottom’, in which they enter a path of immiserising growth locking them into ever-greater competition and reducing incomes. Kaplinsky and Morris (2002) describe immiserising growth as a situation where there is increasing economic activity (implying more output and more employment) but falling economic returns. Tropical commodities such as coffee and cotton provide an example of inappropriate insertion. Despite an increase in consumption, most farmers have not benefited from the increasing demand, as this increase has been coupled with an even greater decrease in the price of these commodities. Primarily the level of oversupply in many markets has caused this deterioration in the terms of trade, which, in turn, is a consequence of low barriers to entry (Singer, 2003).
Another advantage of value chain analysis is that it addresses the nature and determinants of competitiveness, and shows that the determinants of income distribution are dynamic. This implies that competitiveness at a single point in time may not provide for sustained economic growth. Value chains allow for a systemic focus and analysis, which is better suited to the dynamic nature of value creation and goes beyond the focus on a single firm or sector in an economy. Rather, by virtue of this analysis, all the links in the chain and all activities in each link are examined, to identify which of these are subject to increasing returns, and which of these are subject to decreasing returns.

By being able to make these distinctions, policy makers can decide which actions to take to facilitate upgrading of links in the value chain to generate better returns. An important example of a policy, which has been formulated as a result of value chains analysis, is forward integration. Its aim is to increase the level of value added in the producing country, for example by processing commodities in the producing country rather than just selling them as inputs. By analyzing economic activity from a value chain perspective, the opportunities in a chain as well as the obstacles to operating sustainable profitable chains become apparent. Obstacles are numerous. The lack of adjusted banking products, the non-existence of sound (industrial) policies, the absence of organized farmers, high trade tariffs, lack of technology and knowledge of consumer requirements and market demand, etc are just a few examples. Understanding these opportunities and obstacles in specific chains allows value chain development: identifying where, how and by what actor interventions can or should be made in order to overcome obstacles and increase the value that is created in the chain.

Organizations within the triangle of private sector, public sector and civil society each play a role in value chains, either as a chain actor or as an actor in the context of the chain. In each value chain, a different combination of actors is involved. By taking a value chain as the unit of analysis, insight can be gained into the opportunities and challenges which the triangle actors face in sustainable business development at the BoP in emerging markets. The goal of sustainable business development at the BoP is to create sustainable, closed loop chains, in which all actors benefit from the value that is created in the chain.

Conclusions

Value chains can include different numbers and types of triangle actors and can be found in emerging or developed markets or both. Figure 2 represents these various scenarios, indicated by the semi-transparent triangles. To illustrate, the extractive industry sector in South Africa includes the sub-sector of gold mining. Within the sub-sector of gold mining an example of a value chain would be the gold value chain in Pretoria, South Africa. This gold chain exemplifies a global value chain. The final product of the chain, after various stages of value-adding, is jewelry which is sold in a jewelry shop in London. Another example of a value chain would be the tomato chain in Iringa, Tanzania. In this case, tomatoes are produced and consumed locally, a clear example of a local or regional value chain.

Value Chain analysis as a research approach to BOP theory overcomes some of the weaknesses raised in early discussions of BOP theory. The Value Chain approach focuses on both the supply and demand side and adds to the analysis the various links in the business systems. Understanding of the strongest and weakest links in the system may result in a more effective approach to increase economic development in BOP markets.

To date most BOP research has focused on the link of Western MNCs to BOP markets. However, it is clear that in the context of economic development local, or “Southern”, private sector companies also play an important role and
ultimately will have an essential role since in most economies SMEs play such a role in local employment and economic growth.

BOP research should, therefore, include a multi-perspective approach. Providing insights from public and private sectors and civil society, Western and Southern companies, various intermediaries within the value chain, and a consumer and production perspective, the Value Chain Research Approach to BOP is a comprehensive tool for further BOP Theory development and practice.

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UN Global Compact: www.unglobalcompact.org


The Influence of External Factors on the Economy of Suriname: The True Causes of Inflation

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This paper focuses on the fluctuations of the alumina price and the effect they have on the economy of Suriname. There are two different generally accepted views with regards to the causes of inflation in Suriname. One school posits that inflation is caused by an increased money stock and advises governments to uphold monetary measures of control. Another view is that negative impacts of external factors, over which the Suriname government has no control, put pressure on the local currency, which then leads to inflation. The first, conventional view is widely accepted and the Suriname government has based its monetary policies on this view accordingly. Based on Suriname’s recent history, where inflation was accompanied by low alumina prices, this paper addresses the effects of external factors on the economy of Suriname. It also looks for a way the Suriname government can prevent inflation as a result of negative external shocks or reduce the effects of them.

Introduction

Suriname is a small open economy well endowed with natural resources. As a result, primary industries have historically played a key role in its economic development. Since the colonial period of Suriname, which ended in 1975, both the country’s economy and the general public have been affected by developments outside the country. This dependency on external factors has historically been through world-market prices for sugar, coffee, cocoa and bauxite/alumina, going back as far as the middle of the 17th century.

Pitou van Dijck (2001) states that studies of development patterns indicate that structural characteristics of economies have a significant impact on the comparative advantages, the degree of industrialisation, and the trade orientation. She puts Suriname in the same category as other small countries at relatively low levels of economic development, well endowed with natural resources per capita or with considerable areas of arable land per capita, which tend to be specialised in the production and export of primary products. There is a lot of truth in this statement because Suriname can be characterised as a country with an underdeveloped level of industrialisation compared to countries that have fewer natural resources.

With a large public sector, also typical of developing countries, the government plays an important role in the economy.

The mining industry developed after bauxite was discovered in the East of Suriname in the 1920s. The industry has developed to a level where it now makes a significant contribution to GDP (12%), exports (76%) and government revenue (US$ 46 million per annum tax revenue between 2000 and 2006). This dominant role played by the mining sector means that the economy is heavily dependent on international markets and is vulnerable to low alumina prices. Besides being affected by external shocks, the country has also been burdened by poor macro economic management. In the past, this has amplified the effects of external shocks on the economy and has even lead to many problems, such as depreciation, unemployment, and inflation.

A decline in world alumina prices preceded each of three high-inflation episodes in the last two decades.

With fiscal revenue depending heavily on the alumina sector, a sharp decline in the alumina price leads to revenue shortfalls (Deryck and Ferrier, 2007). In combination with monetisation of deficits this leads to exchange rate depreciation and inflation. The decline in the alumina prices also tightens the supply of foreign currency in the economy, further contributing to pressure on the exchange rate. When the currency depreciates, it has a direct impact on the import costs of primary goods and subsequently on consumer prices. An increase in world market commodity prices has the opposite effect, whereby the government has an increase in revenues from transfers and taxes, paid for a large part by alumina producing companies in Suriname.

This study specifically addresses the influence of primary commodity prices (in this case alumina) on inflation in Suriname. In addition an attempt is made to identify macroeconomic policy implications.

In the import economy of Suriname, the balance of
prices (BoP) is strongly dependent on income from exports of commodities (foreign currency transfers, royalties, and taxes). One of the most conventional arguments, shared by the IMF, is that a high money stock leads to inflation. To control the money stock, the government focuses heavily on reducing foreign debt and minimising the deficit. The aim of these conventional policies is to keep the exchange rate low, thus stabilising inflation. However, recent history has shown that other factors, such as fluctuations on the international commodity market and price increases of primary import products, have caused exchange rate pressures.

Rising prices of import products result in a higher cost of imports, which is reflected in the prices of consumer products (price inflation).

More importantly, price fluctuations in the commodity market cause changes in government income. A reduced income for the government has lead to pressure on the exchange rate in the past, which caused depreciation. Depreciation of the local currency resulted in less foreign currency available for banks and importers, causing a higher level of inflation. None of the current policies implemented by the government addresses these external factors.

**Background: High to Low to High Alumina Prices**

Dougal Martin, country economist for Suriname at the Inter-American Development Bank in Washington, described the macro economic developments during the 1990s in great detail (in van Dijck, 2001), of which the following paragraph presents a summary:

World alumina prices rose and caused a boom between 1989 and 1990. The effects of large fiscal deficits and monetisation were postponed because of this boom. The foreign currency transfers by the alumina companies to the Central Bank of Suriname (CBoS), added to US$332 million, and taxes to US$167 million. With more foreign currency available, importers were able to sustain a high level of imports. In this same period economic growth was moderately present, at 2.1% per annum.

In 1990, the government was able to clear its cash deficit and not use CBoS financing through the issuing of bonds with a value of 450 million Surinamese Guilders (Sf) to commercial banks and insurance companies. Inflation dropped to 16% between 1989 and 1990. However, as mentioned before, beneath the modest growth and reduction of inflation in this period were problems inherited from the 1980’s. Due to monetisation there was too much money in circulation, resulting in a depreciation of the guilder of 30% between 1988 and 1990. By 1990 the parallel exchange rate was Sf16 per US$ 1 compared to an official exchange rate of Sf1.79.

The alumina boom did not last, and in 1991 international market prices for alumina fell. This resulted in a reduction of transfers of 30% and reduced taxes paid by the alumina companies by 15%. Nevertheless, the temporary government at that time choose to increase its expenditures in an attempt to win the nearing elections. Government owned companies were heavily subsidised, and welfare and wages of civil servants were increased.

On the BoP the current account reached a deficit of US$77 million, caused by increased aggregate demand for imported goods and a reduction in alumina exports. The CBoS had to monetise the fiscal deficit caused by the reduced income and large expenditures. By early 1992, the parallel exchange rate was almost ten times the official rate at Sf17.4 and lagging repayment of foreign debt continued.

Alumina prices kept falling (from US$182 per ton in 1991 to US$156 between 1992-1994) and government income was reduced by almost 30%. Faced with falling prices, overvaluation of the guilder, payment arrears, current account deficits and inflation, the government implemented the structural adjustment program (SAP). The government brought back a balance on the fiscal account by depreciating the official exchange rate. Depreciation meant that transfers and taxes from the alumina companies inflated in local currency terms. Besides depreciating the guilder, the government also cut its expenditures and salary adjustments lagged the rate of inflation. Since imports also declined, the current account balance on the BoP was restored. Nevertheless, the exchange rate pressures and inflation continued.

With the introduction of multiple exchange rates and the depreciation of the guilder, more confidence was lost in the local currency. This triggered a new depreciation, Sf19 for US$1, and inflation rose to almost 60% by early 1993. Beside the flight to foreign capital by the public, there was another reason why the parallel exchange rate soared to SRD100 for US$1 by the end of 1993. For tax reasons the government still used the official exchange rate of Sf1.80 for valuing imports. Once again fiscal deficits occurred that had to be financed by the Central Bank.

By adjusting the exchange rate for bauxite exports, increasing import tax and unifying the other exchange rates closer to the parallel exchange rate (Sf180), the government was able to bring down the deficit considerably by the end of 1994.

However, the government, in an attempt to increase its reserves and international currency holdings, rapidly started to buy gold and foreign currency. This action brought more money into circulation, since payment was made, of course, in local currency. This reduced the confidence of the public even further and the parallel exchange rate increased, pushing inflation to 586%.

With the restored BoP, more foreign currency, gold reserves and a unified exchange rate, Suriname was in a good position for the next alumina boom, which occurred between 1995 and 1997.
Alumina prices increased to US$193 per ton, boosting export volumes, transfers to the Central Bank, and tax revenues from the alumina industry. As was the case during the earlier boom, depreciation decreased, real wages increased, GDP rose and economic growth was present. More importantly, a current account surplus was achieved. Inflation dropped to ‘only’ 37% in 1995. Government income increased to such a level that the Central Bank was able to pay-off some of its foreign debt, and lift the credit worthiness of Suriname.

Suriname experienced another slump episode in the remainder of the 1990s, during which the effects were similar to the cycle described above. As the theoretical explanations will show in the next paragraph, these extreme levels of inflation accompanied by alumina price cycles justify the search for a relationship.

Theoretical background

Neoclassical economists argue that growth of the money stock is the source of inflation (figure 1). Money stock increases as a result of budget deficit financing, cash supply in the system by the Central Bank, and net foreign exchange inflow (remittances and transfers). The cause most focused on by conservatives is the increase in money stock, which is a result of the governments printing money to finance budget deficits. Another assumption by conservatives is that money is held only for the purposes of expenditure. The basis for this assumption is the argument that when money balances held by individuals rise, their spending also increases.

Inflation sets in when expenditures, by individual or government, rise to such a level that there is too much money in circulation. Balance of payment problems arise from the loss of competitiveness of exports and import competing goods, resulting from domestic inflation as well as the increase in import demand caused by the increase in domestic expenditure.

Conservatives therefore advise policies to fight inflation, which start with reducing money stock growth to growth of the real GDP. In addition it is advised to limit financing of budget deficits to control inflation. During the nineties Suriname experienced very high inflation driven by the monetary financing of fiscal deficits. (IDB Report, 2005). Furthermore, they advice that governments should pursue inflation targets, should reduce foreign debts, and must sterilise inflows of money into the system. The effectiveness and effects of the current policies will be discussed later in this paper.

In the small, open economy of Suriname, a low alumina price was often accompanied by inflation in the past. As was explained in detail in the previous paragraph, changes in the production volume or value of exported alumina resulted in less foreign exchange transfers to the government of Suriname and pressure to the exchange rate (figure 2).

Methodology

For this study the macro economic developments between 1990 and 2006 are most relevant. Based on these developments, the impact on the economy of alumina prices was mapped out, and the question of the effectiveness of current policies was brought into sharper focus.
Early indications showed that inflation in Suriname was often accompanied by low commodity prices, which further justified the search for the true causes of inflation.

Key macro-economic data was used for the analytical part of the research. The data included GDP figures, inflation and BoP history, the market exchange rate and alumina price trends.

In the first part of the analytical research the trends of the above mentioned data were analysed to find the relationships depicted in figure 2. The conclusions of part 1 are based on statistical tests, such as regression and analyses of variance. These tests formed the second part of the analytical research.

The findings enabled determining of the implications to the current policies, and conclusions were based on these findings and policy implication.

Result and explanations

The analyses and tests that were done support the argument that external factors indeed determine inflation in Suriname. As figure 2 shows, there must be a relationship between the exchange rate and inflation. Next, the relationship between the exchange rate changes and alumina prices had to be established.

Figure 3: Exchange rate v. Inflation

The results showed relationships (figure 3 & 4), some more than others, between inflation, the exchange rate and the alumina price. Based on the early findings, it could be concluded that there is a relationship between the three.

The statistical analysis gave the same result after which we could conclude, with 80% confidence, that there is a significant relationship between external factors, the alumina price, and inflation. A regression analysis led to the same conclusion.

With regards to the role of the balance of payment, it was necessary to look at the account most related to the alumina industry, the current account.

This account showed a relationship downwards to the trade balance, which is alumina industry related and upwards to the overall balance. Statistical tests confirmed that the relationships are present and that the trends are no coincidence.

With both relationships present and confirmed, it can be concluded that external factors, in this case the alumina price, influence inflation in Suriname (based on the data analysed between 1990 and 2006, with 1994 and 1995 data excluded from the analyses because the structural adjustment program was ongoing during this period). This challenges the neoclassical theory, that inflation is strictly a monetary phenomenon.

Figure 4: Exchange Rates

Inflation in Suriname can thus be explained as follows: When alumina prices decline, the export revenues decrease and the trade deficit increases. The CBoS receives less foreign currency transfers from the alumina companies and is less able to provide the government and importers with foreign currency for their needs. This causes a depreciation of the exchange rate. Furthermore a depreciation of the Suriname Dollar (SRD) increases the price of imported primary goods and lowers the import demand.

A decline in the alumina price results in reduced government revenue from the alumina sector and can cause a budget deficit. The government of Suriname thus comes under pressure because of its limited expenditure possibilities. In the past, the government either depreciated the currency further or monetised the deficit, causing a significant increase in the domestic money supply (NDP/DNP 2000 Cabinet under President Wijdenbosch, 1997-2001). As Dougal Martin (2001) explained, businesses and household have less confidence because of the depreciated currency and high consumer prices, which again increases the demand for foreign currency.

Ironically, the low alumina price has a relative limited impact on the alumina producing companies in Suriname. This is because the output from this sector is exported and a domestic recession in the economy has no effect on the external demand for alumina.

In their study of high inflation in Suriname, Benedikt Brauman and Sukdev Shah (1999) are wrong by supporting the conventional wisdom that high inflation is always a domestic monetary phenomenon. Their study completely overlooks external factors and their relationship to the exchange rate and inflation.

This research has found sufficient evidence that
alumina prices have an effect on inflation and the exchange rate. It means that the current monetary policies upheld by the government will not be effective. A re-thinking of the policies is necessary if the government of Suriname wants to take measures against inflation, as will be explained in the next paragraph.

Policy implications

Judging from the macroeconomic developments in Suriname during the 1990s and a Jamaican case study, wrong anti-inflationary measures can have an adverse effect and even cause inflation.

Policymakers should keep in mind that the objective of economic policies is to maximise the long run well being of society in an equitable and sustainable manner. They should focus on how economic policies affect long-term growth developments.

The current policies upheld by the government of Suriname, backed by the IMF, are based on conventional wisdom. There is a general belief that these conservative monetary policies will reduce the unpredictability of the macroeconomic environment and (relevant to this study) control inflation. These anti-inflationary measures are:
- Limited monetisation of the deficit,
- Maximum limit for debts,
- Deficit reduction,
- Limited expenditure

The biggest problem with these policies is the fact that they are based on the neoclassical explanation for inflation, which is the amount of money stock. Besides the fact that these policies do not focus on external factors causing inflation and are not pursuing economic growth, there is another reason why the government should step away from them. A maximum for debts and limited financing can cause unnecessary budget and liquidity problems for the government of Suriname in a recessionary environment.

Conclusions and Recommendations

The objective of this study was to address the influence of alumina prices on inflation in Suriname in search for the ‘true’ causes. Besides research into a possible relationship between these prices and inflation, an attempt was made to draw ‘new’ macroeconomic policy implications. The need for a shift from ‘old’ to ‘new’ is justified because Suriname has been plagued by episodes of high inflation in the recent past. The current policies do not seem to be the remedy for the illness during those years, which is the core of the problem statement. Inflation cannot be controlled by reducing expenditures, limiting debt creation, reducing the deficit or limiting government financing. These measures are devastating to growth. It is time for both the government and policymakers to step away from this conventional approach.

Recommendations

The importance of the alumina industry to the economy of Suriname is not a new discussion. It is also a fact that the government of Suriname is confronted with more balance of payment problems during periods of low alumina prices. The amount of foreign currency income from the alumina sector has an enormous impact on the exchange rate, which dictates inflation.

In her book, Pitou van Dijck (2001), correctly makes the following statement: “Foreign currency receipts are of huge importance to the economy because it determines exchange rates and therefore inflation. The combination of increased foreign exchange availability and government revenues feeds through to lower inflation, higher real wages and higher output. The appreciation of the exchange rate reduces inflation directly as Suriname’s economy is small and very open.”

Suriname’s dependency on foreign income has all to do with the import side of the economy. All these imports have to be paid with foreign currency and a reduction in the availability this foreign currency leads to inflation.

More recently, Deryck J.H. Ferrier came to the same conclusion in his study (2007): “By reviewing the impact of the B/A industry upon the conditions and volumes of the prime financial and monetary components of the financial structure of the society, it must be concluded that the financial contributions made by the B/A industry at its present level of functioning, must be considered as an indispensable means for the continuation of the society at its present level of financial and Socio-economic welfare.

In relation to the total imports on behalf of the remainder of the economy, the foreign exchange inflows generated by the B/A industry have in the past facilitated coverage of about 27% of the total annual foreign exchange demand.”

He continues his explanation with the following statement: “The most outstanding characteristic of the economy of Suriname is the high measure of dependence upon foreign inputs for virtually all economic production. All goods and services produced in Suriname have foreign input requirements, with values in the order of 30% or more of the cost price of the product.”

Both of these conclusions are in line with the outcome of this study; that changes to the government’s foreign exchange income level from the alumina industry, caused by external shocks, lead to exchange rate pressures and inflation.

Even the IMF has contradicted its own standpoint, that high money stock causes inflation, in its reports of 2005, 2006, and 2007: “Suriname remains vulnerable to exogenous shocks and has a history of sudden and highly
destabilizing policy shifts in the aftermath of shocks to global commodity prices (IMF, 2007)."

With this statement the IMF admits that external shocks cause difficulties to the economy, which goes against the 1999 IMF working paper.

Despite this acknowledgement the IMF continues in that same 2007 report: "While welcoming the steps that led to the convergence of exchange rates and greater exchange rate flexibility, the team noted Suriname’s poor track record in maintaining a free and market-determined exchange rate in parallel with measures to improve liquidity management. Therefore, the mission reiterated its recommendation to adopt the bank/cambios daily rate as the official rate (IMF, 2007)."

To suggest Suriname adopt the free market rate as the official exchange rate raises questions about the objectives of the IMF. Releasing the exchange rate from its de facto managed float will trigger inflation. This could even steer Suriname straight into a recession in case of an economic slow down in the world. It would be more sensible for Suriname to overvalue the exchange rate in case of a slow down. This would reduce the inflationary throughput and perhaps even increase foreign currency earnings from primary exports; since a recession does not affect the alumina industry (output is exported). This recommendation also shows that the IMF is not willing to accept that exchange rate pressures are caused by external shocks.

Despite all the facts presented in this study and earlier reports, the shift towards policy reform is slow. The evidence is there and Suriname’s own history has given many warnings. The current demand from China, India, and other booming economies is maintaining the alumina price around its current level. Despite this favourable outlook, the country risks getting seriously affected by the next alumina price slump, if the government fails to take the required actions.

Is there an alternative?

First, the government cannot expect growth without a proper growth-stimulating environment. The basic conditions for growth must be created and/or supported. These consist of: Infrastructure, including roads, transportation, telecommunication, and IT infrastructure.

Second, education is important to increase the schooling level of current and future working population. It should be made available and promoted even in the rural areas. The third and fourth fundamental prerequisites for growth are health-care and welfare.

It goes without saying that this all cannot be achieved without raising the current expenditure level. The government should raise expenditures to finance projects within these four categories.

There have been many discussions, reports, and studies about a stabilisation fund for Suriname. Until now, the government has not utilised this option. Apart from financing the four basic growth fundamentals, this fund, created out of revenue from the commodity industries, can be used as a buffer to absorb external shocks and reduce the effects of cyclicality to the economy.

In times of low alumina prices, the foreign currency demand from the government, banks and importers can be met out of this fund. This would prevent the exchange rate to come under pressure and avoid inflation. Besides being a buffer to absorb external shocks, this fund would create savings for Suriname’s future generations.

The government should determine what an acceptable level of inflation is without interventions. Sometimes even considering a trade-off between higher rates of inflation and economic growth might be valuable. There are examples where economies are able to grow at more than 5% per annum, despite inflation rates between 20 and 30%. In the years when those countries experienced low inflation (all less than 5.4%) the economic growth has been less than 5% as well (i.e., Argentina 1991-1993, Brazil 1965-1980/1987-1995, Turkey 1981-1987/2002-2003; from: Stability with growth; Macroeconomics, Liberalization, and development, Oxford, 2006).

This proves that even though inflation is an important indicator, it should not be exaggerated and growth is still possible if the growth opportunities are present or created and inflation stays under the threshold for hyperinflation.

Suriname has many options but the first steps should be in a direction away from current policies.

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Establishing a Regional Cluster for Biomedical Industry in Brazil: How to Attract US Direct Investments?

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In the context of globalization, the possibilities to attract foreign direct investments for the biomedical industry of Brazil in order to create a biomedical cluster have been inquired. This study emphasizes the importance of the role and responsibilities of the government, the role of the academics and the role of the industry in attracting foreign direct investments for the biomedical industry to establish a biomedical cluster. The outcome of this study is a set of policies for Brazil in order to become a global center of biomedical industry. In addition it can be stated that Brazil is a potential biomedical cluster if it is able to construct a national innovation system, based on inter-linkage and intra-linkage of foreign and local firms.

By relocating biomedical facilities to Brazil, developed countries are able to reduce R&D and production costs as well as gain market share, which supposedly will increase their margins. This will benefit societies in general, in developed as well as low developed countries, in the sense that drugs should become more affordable and more accessible moreover, drugs will be improved, because it will be more affordable to spend on R&D. For Brazil in particular becoming a biomedical cluster will increase its competitive advantage and might even compensate for the slow down of its technology industry.

The United States of America and Europe accounting for two-thirds of the world’s drug market are faced with litigation over prices, increasing marketing costs and licensing issues. The costs of developing new drugs are rising and patents on profitable drugs are expiring, moreover companies are being pressured to publish trials when their drugs fail and especially in America the public is becoming keen on monitoring drug safety. Worldwide pharmaceutical companies are being disputed for their patents and pricing policy regardless whether it is a rich or poor country, also called “profit before patients” approach (TE Sept 30th 2004, Pmrr). The big pharmaceutical companies are having a hard time defending the argument that higher profits mean more innovation. The number of new drugs approved by the FDA – a rough estimate of productivity – was only 18 in 2002, slowly picking up again to 34 in 2004 (TE Mar 17th 2005, Aobn). In proportion to what is being spent on their R&D, drugs companies must find a way to boost their productivity. More efficiency in their manufacturing processes would be a good starting point (TE Feb 18th 2005, Ph Ind.). Between 1998 and 2002 big drug companies launched 59 drugs per year on average. Between 2002 and 2006 this number will drop to 50. Moreover, generic-drugs will threaten $30 billion of annual sales in America alone (TE Dec 4th 2003, BtfBPh.). It is a matter of better control of costs. Besides R&D, Marketing and Sales overheads have soared too. In the drug industry the sales, general and administrative expenses account for 33% of the total revenue’s compared to 17% for a typical big American firm. Many firms still do not outsource routine jobs - such as making pills - to a contract manufacturer (TE Dec 4th 2003, BtfBPh.). On marketing to health-care-professionals $14.7 billion has been spent in 2004 and another $3.6 billion on direct-to-consumer advertising (TE Mar 17th 2005, Aobn). Reducing manufacturing costs of drug components such as reagents and solutions could render huge savings on drugs and drugs related research, finally resulting in cheaper health care (fig.1). Bulk production of such reagents could be outsourced to countries where production costs are lower than in the US. But the tougher challenge is to improve the productivity of R&D. It is not only the drop in number of new products but also their originality. About 40% of R&D spending by the drug industry is now on what is called “line extensions” – improving existing drugs, not creating completely new ones. Cost could be even more reduced by relocating biomedical R&D plants to less expensive locations.

Outsourcing of information and communication technology services to India and relocation of production plants of consumer goods to China have rendered a tremendous decrease in costs. Brazil, one of the five emerging economies, has not yet been described as being a possible alternative in this matter. Brazil is the third upcoming economy in the world and economic growth will be about 4-5%. Major industries in Brazil are the oil, ore and leather industry. The pharmaceutical industry is highly under represented and consists of only multinational assembly plants, leaving out the R&D part. One way or the other, the US is still reluctant to go offshore with their biomedical industry. As Brazil lies geographically close to the US, Brazil could be a strategic option for US pharmaceutical companies to invest in biomedical production plants or even in R&D centers.
How can Brazil attract foreign investors to set up a biomedical industry? The focus in this article is on FDI attractiveness and policies regarding biomedical manufacturing.

The purpose of this study is to provide a set of policies for Brazil to attract foreign investments for the biomedical industry in order to become a biomedical cluster. Based on a literature review and case studies a practical approach will be conducted:

- to identify general and industry-specific pull factors for FDI
- to investigate whether Brazil meets the identified pre-requisites
- to identify policies required if Brazil deviates from the identified pre-requisites

**Literature Review**

In the context of globalization, outsourcing strategies of foreign investors have been selected to strengthen economies and to gain competitive advantage. Push factors are the drivers of such Multinationals (MNE) to relocate parts of their business to other countries and pull factors are ways of enticing foreign investors to get a stake in the host country. In this context clustering of high tech industry in one location has shown to render competitive advantage. A specific part of high tech industry is the upcoming biomedical industry of which investors are eagerly waiting for the big boom.

**Push factors for high-tech FDI**

The main reason why MNE relocate to developing countries is lower labor cost, however this is not by far the only reason why. To merely appear on the list of potential host countries for suitable R&D location the basic requirements for a developing country are described in terms of infrastructure, education and innovative capability. More advanced criteria to determine the MNE’s final choice are: the presence of investment promotion agencies in order to shortcut bureaucratic procedures. This is seen in Costa Rica and Singapore. It has been mentioned that developing countries with an Investments Promotion Agency (IPA) were able to attract 30% more FDI than countries without an IPA (Beausang, 2004).

Needless to say, that the effectiveness of such strategies highly depends on the organizational structure and financial resources of the IPA. Depending on the type of industry other incentives like financial subsidies, tax holidays and indirect incentives such as accessibility to free trade zones can be added to this list. These are of course the “push” factors from the MNE’s point of view. However these in it self are not sufficient to invest in a developing country. The so called “pull” factors have more to do with the host countries ability or potential to attract FDI’s and some are quite specific depending on the location or policy of the country. (Beausang, 2004)

**Pull factors for high-tech FDI**

For a potential host country the mere fact that it opens up to FDI is not enough to attract FDI’s. The country itself should have a broad vision towards their aim of attracting FDI’s. Part of this is a well thought-out strategy of how the FDI will benefit the country and what has to be done to attract them. The Singapore miracle is a clear example of a visionary based strategy meticulously carried out to render returns within a 10 years range. Singapore is the second largest location for FDI in Asia and it receives the most high-tech investments. Its openness to trade and financial flows, tax incentives and pro-active FDI promotion programs have been the major factors for attracting MNEs from Europe, Japan and the US to Asia. Moreover, the heavy investment in public infrastructure and in human resource development should not be underestimated in this matter (The World Fact Book, Singapore: www.cia.gov, 2005).

In its efforts to court IBM to transfer its assembly plant from San Jose to Singapore, compared to other competing hosts, Singapore’s competitive advantage was to a large extend determined by the speed, efficiency and flexibility of the government’s response (Beausang, 2004). It all started early on in 1961 when the Economic Development Board (EDB) was established to coordinate specific FDI policies. In the 1970’s and early 1980’s the Singapore government seized the opportunity of becoming a R&D host, when the electronics industry started to invest offshore. Besides training programs at the undergraduate and postgraduate level as well as immigration policy, increasing emphasis was placed by the Singapore government on enabling support industry, transport and communication infrastructure as well as skill development programs, which were part of a deliberate cluster promotion strategy requiring considerable coordination between various governmental agencies. The three phases that can be distinguished in the implementation of Singapore’s strategy to attract R&D are:

- creation of a cluster of related industries together with Investments Promotion Agency
- formation of alliances between Singapore R&D and MNE’s R&D
- creation of a regional cluster

Regarding the third phase a very advanced incentive program was launched, which comprised the regional headquarter scheme, international procurement office scheme, international logistics center scheme and the approved trader scheme. This promotion program was to encourage reconfiguration of MNE’s operations on a regional basis, because of rising labor and land costs. (Beausang, 2004)
Furthermore, Singapore developed a National System of Innovation (NSI) to avoid polarized development, one of the risks of the clustering strategy. Polarized development is a skewed situation of on the one side development driven by MNE activity and on the other side the rest of the country remaining unaffected by this localized development process. This construction has two aspects: one is centered close to the R&D activity of the MNE and the other is independent of such activity. The main purpose of this is to render diffusion of technological innovation. For this the EDB came up with the Local Industry Upgrading Program (LIUP) in 1986, a linkage program to upgrade, strengthen and expand the pool of local suppliers to foreign companies, by increasing their efficiency, reliability and international competitiveness. (Beausang, 2004)

Another program of the EDB was to support SME by creating the Small Enterprise Development Bureau, followed by the SME Master Plan, to promote and develop selected innovative SMEs. Key to the process of linking and technology transfer is physical relocation of small firms to areas adjacent to industrial zones. In addition to these programs, over the years contractual buyer-supplier arrangements have also been developed. Similar NSI programs have been conducted as well in other countries such as South Korea, Malaysia, Ireland and Costa Rica. To create a sustainable NSI around a cluster it is important to achieve broad capabilities that can be leveraged to support a wide range of industries, thereby strengthening the host country’s overall industrial production capability and flexibility. (Beausang, 2004)

Besides building on MNE’s R&D activity it is of eminent importance to work on the intra-local linkages. The effects can be described as a direct effect of stimulating interaction between the various local companies and encouraging innovative efforts. Indirectly, the innovative efforts enhancing host country’s R&D potential will in turn facilitate interaction with MNEs, thereby reinforcing national innovative capability. An example of the direct effects of intra-local linkages on NSI creation were seen in South Korean high-tech industry, which was built on foreign technology forms that promoted local control. (Beausang, 2004)

**High-tech clusters**

Agglomerations of companies are generally divided into clusters of businesses tied primarily to place location factors: firm-region (Silicon Valley) or to each other: firm-firm (production chain supplier, competitor, or affiliate). The strongest bonds embedding firms to an area involve both types (Walcott, 1999). According to Porter (1998) there are three types of clusters, namely traditional (e.g. agriculture, tourism), emerging and declining clusters that imply different kind of policies. He stresses that many clusters include governmental and other organizations such as universities, standard-setting agencies, think-tanks, vocational training providers, and trade associations, which provide specialized training, education, information, research and technical support. The synergy effect of a cluster can be found in the linkages among cluster members resulting in collaborative advantage by raising mutual awareness of local strengths and shared vision of business growth (Stoering, 2004).

Based on this concept, the “Cluster Initiative Greenbook” presented at the 6th Global TCI Conference in Gothenburg, Sweden September 2003, offers a summary of current practices in organizing and implementing cluster initiatives around the world (Sölvell et al, 2003). Cluster Initiatives (CI) are organized efforts to increase growth and competitiveness of clusters within a region, involving cluster firms, government and/or the research community. In the last decade Cluster Policy has gained increasing recognition as a central feature of microeconomic policy, linking to industrial, regional, SME, FDI and research and innovation policies, opposed to the spontaneous process of cluster emergence.

The South Korean technology industry was based on intra-local linkages to strengthen the NSI by stimulating interaction between the different participants of the system encouraging internal innovative efforts. Cutting edge foreign high technology was imported, however foreign direct investments were only allowed when there was no other way of getting access to technology. Very strict FDI policies were conducted and foreign majority ownership was not permitted (Beausang, 2004).

In the state of Manaus, Amazonia’s biggest city, Brazil had created a Zona Franca (low-tax zone) to convince companies that being located in a remote area deprived from raw materials, suppliers and consumers is ignorable. The reason to do this was to reduce heavy dependence on imported consumer goods, especially expensive electronics, by setting up a industrial park in the middle of nowhere. The effect was a rapid growing Manaus, but at the same time creating an economic failure. This high tech cluster turned out, with a few exceptions, to be not much more than an assembly line. The clustering of firms and suppliers that is needed to create a self-sustaining industrial center failed to materialize. (TE 2000, Bitj)

The importance of clusters implies new roles for government at national and regional levels. In the global economy sound macroeconomic policies are necessary but not sufficient, hence the government’s role is to ensure appropriate microeconomic foundations as well as creating an environment that encourages upgrading of clusters through appropriate policies in areas such as competition, Intellectual Property Rights, taxation and the regulation of product quality, safety and environmental impact (Porter, 1990). Cluster initiatives emerge from three distinct policy fields (Sölvell et al, 2003):

- Regional, industry and SME policy
- FDI attraction policy
- Science, research and innovation policies
Opposed to traditional cluster policy where in principle a central government is the decisive and implementing body, in the cluster initiative local participation of different institutions contribute to the local development of the cluster.

**Biomedical cluster: Singaporean model**

A biomedical cluster comprises biomedical firms attracted and bound to a region, to their location within it and to each other (Walcott, 1999). Several biomedical clusters have emerged around the world, on national as well as on regional level. To illustrate common and specific requirements for such biomedical centers the case of Singapore will be reported here.

As part of its knowledge-based economy strategy, Singapore has proclaimed its national biomedical sciences strategy in June 2000. For this almost US$2bn has been allocated to fund new research institutes, two university faculties, training in life sciences, and tax incentives for multinational pharmaceutical companies and national biotech start-ups. Their aim is to become a biomedical R&D cluster, with world-class capabilities across the entire value chain. One institution was given the responsibility of setting up the biomedical science cluster. This was the Biomedical Sciences Group (BMSG), part of the EDB (Economic Development Board), who is responsible for the specific FDI policies. This is in close collaboration with the Agency for Science, Technology and Research’s (A*Star) Biomedical research Council (BMRC). (Tong, 2003).

- The BMSG facilitates the entry of foreign companies into Singapore by linking them with suitable research bodies and support services and nurtures the growth of local start-ups through a mix of incentives and grants.
- The BMRC is the umbrella of five local research institutes: the Bioinformatics Institute, Bio-processing Technology Center, Genome Institute of Singapore, Institute of Molecular and Cell Biology, and Institute of Bioengineering and Nanotechnology. The Singaporean model encompasses two ways of constructing a *National System of Innovation* (NSI). One is building on MNE’s R&D activity, through the LIUP, a linkage program to its FDI targeting strategy. The other one is forming linkages between local institutions (intra-local linkage). Singapore combined its openness to MNEs with upgrading of local SMEs. The benefit of this combined strategy is that it allows an influx of technological innovation and at the same time creates an independent local industry of suppliers. (Beausang, 2004)

To fill in the top positions Singapore was able to attract big names in biomedicine and biotechnology from the US and the Europe. There are also special recruitment programs to bring in hundreds of scientists and technician to staff the five public research institutes. Additionally, Singapore’s infrastructure has been described as one of the best anywhere in Asia, the incentives are good, and most people speak English. Moreover, there is a proper enforcement of intellectual property rights, which is very important to biomedical companies. Singapore’s laws ensure full compliance with the World Trade Organization’s TRIPS (Trade-Related Aspects of Intellectual Property Rights) agreement. Also has Singapore been ranked as having the best IPR protection in Asia since 1997. EDB incentives include subsidized facilities and infrastructure, 5-10 year tax holidays, and certain exemptions for expenses of expatriate staff and capital equipment. (Tong, 2003).

An area of 160 ha at the Tuas Biomedical Park has been designated for setting up manufacturing facilities, another 100 ha is available and the 194 ha research complex called Biopolis, which houses the BMRC’s five institutions and R&D laboratories from pharmaceutical companies. This complex consists of seven linked buildings, and access to central facilities such as DNA sequencing, mass spectrometry, a library and auditorium. (Tong, 2003).

The US Commerce Department’s Office of Technology and Policy addresses several reasons for the likely success of Singapore’s biomedical venture:

- The EDB’s flexibility in adapting policies and incentives to global market and industry changes
- The agency’s continuing interest in forming partnerships with MNEs.
- Singapore’s pragmatic approach to ethical issues, may allow for advances in areas banned by US policies
- Faster approval of new drugs for overseas distribution

Singapore’s biomedical industry had an increase in manufacturing output of 3.2% already in 2001worth US$3.67bn and in 2002 output growing to 7%. The number of people employed in the biomedical manufacturing sector by the end of 2002 was 7117. (Tong, 2003). The government’s target for 2010 is to hit US$12 bn and to have created 1000 PhD-qualified researchers from Singapore. (TE, 2004: Smwap).

There are different motives for foreign investors to invest in an industry of another country. Market seeking and efficiency seeking are two main approaches. Latin America has a long history of FDIs and the USA has a key role in this. Globalization has induced emerging economies recognized by the US and other developed countries. These countries have been identified as highly potential options to invest in.

**Brazil, a potential candidate**

Brazil, a former colony of Portugal, became independent in 1822. In 1985, after half a century of military intervention in the governance, power was peacefully transferred to civilian administration. Not only is Brazil the largest country of South America, it also has the largest economy in South America and the second largest in Latin America. Besides development of the interior,
industrial and agricultural growth is the main sector that is being pursued. Its vast natural resources and a large labor pool make it one of the leading powers regionally and one of the five emerging economies globally. In 2000, Brazil accounted for 56% of all foreign direct investment flows to South America. Brazil is also a key player in the design and development of the FTAA (Free Trade Agreement), which is expected to be the world’s largest regional trade block. (The World Fact Book, Brazil: www.cia.gov, 2005)

Brazil once was known for its growth rate in 1958 of 11%, that increased to 14% in 1973, which was among the highest worldwide (TE Feb 20th 2003 FfF). The public debt was almost doubled during the Cardoso administration reaching 56% of GDP. In August 2002 the IMF issued a loan of another US$30 billion. Brazil is already using 91% of its export earnings to service its foreign debt. One way to fix their finances is by increasing foreign investments. If investors regain confidence in the government, the real will recover and the interest rates will fall, making the cost of servicing the debt more bearable. Lower interest rates and an increased willingness by both foreign and domestic banks to lend, would boost the economy. This would encourage multinationals to resume their investment programs in Brazil, which would further boost economic growth. However, the tax and capital spending reforms of the Cardoso administration did not prevent the Brazilian economy from panic shocks and Lula has the choice to continue with the fundamental reforms that Cardoso left unfinished. This would allow him to target government’s resources more effectively and to increase the economy’s underlying growth potential as well as the tax revenues (TE Feb 20th 2003 FfF).

Brazil has a high external debt (58% of its GDP) and with current measures taken by the administration of President Da Silva, total debt has been stabilized. This as such is a tremendous turn in the monetary history of Brazil however, it is just the beginning and the country now has to reduce the debt by extending its production and exports. Mining, agriculture and refining are their major sectors of subsistence however, the pharmaceutical industry still has a lot of latent potential to be exploited. For this Brazil is in need of more research and manufacturing plants moreover, Brazil wants to attract know-how, technology and investments.

**Requirements and eligibility**

**General pull factors to attract FDIs**

According to Michalet (2000), who studied strategies of MNEs, it appears that for most host countries to be put on the shortlist of foreign investors two sets of variables are to be considered: the institutional background and the economic and social background. These two sets form the prerequisites for a country to be attractive to invest in.

**Institutional background (Michalet, 2000)**

Political and economical stability is the first to begin with. As MNEs are planning to operate in a host country for a medium to long term period, they need to outweigh the risk of investing against their investment return and foreign exchange for the repatriation of profits. Above all the safety of their expatriates should be guaranteed.

The legal and regulatory system should be reliable in the sense that it is stable, transparent and non-discriminatory. In case of conflict, an efficient non-corrupt judicial system is required. At a minimum, international arbitrage has to be permitted by law.

Bureaucratic procedures and negotiations in combination with institutional rigidities are no longer tolerated, as a global strategy is no longer compatible with wasting time dealing with numerous different and uncoordinated services. The need for investments promotion agencies (IPA), in order to facilitate foreign investments has been described by Wells and Wint. The “one-stop shop” should be a single organization in a country to have responsibility for conducting or coordinating all that is related to the entry or supervision of FDIs. (Facilitating foreign investments: www.fias.net, 2005)

**Economic and social background (Michalet, 2000)**

Foreign investors consider economic and social background important in order to decide what is needed to start a profitable business and which factors are offered, by the host country. In this regard there are five groups to be distinguished.

The market size should be large and it should be a growing regional market. Access through trade agreements is a big plus, i.e. small domestic markets like Portugal and Ireland do provide access to the European Union and so did NAFTA increase Mexico’s attractiveness as an FDI location. The importance of a growing market has more to do with already saturated home markets. Communication and transportation

The fact that host countries can be located across oceans or even across continents does make efficient communication and proper transportation systems indispensable. To efficiently operate distant subsidiaries in the rest of the world, MNEs need to be able to communicate on a day to day basis.

Until the 1980’s cheap labor was playing a determinant role when most MNEs were following a vertical outsourcing strategy, however nowadays availability of qualified people is more important, since the technology used on the new plants set up abroad are top notch and special skills are required.

Another dimension of a country’s attractiveness value is the presence of efficient local support industries. Their
capacity should meet the needs of subsidiaries in the sense of technical specification, quality for product and delivery time. A new type of MNEs is emerging: the “network” enterprise or “virtual” enterprise.

Privatization programs are mainly important with respect to MNEs buying a public enterprise to acquire market share. This is especially so in the case of sectors where economies of scales are important, such as chemicals, electricity generation or luxury hotels, where there is only room for a few players. Fiscal incentives seem to increase a country’s attractiveness only for a few firms. There are two major points in this regard: the first one is that fiscal incentives cannot replace a country’s lack of attractiveness, except for financial speculative investments. The second one is that in the case of competing for the same investment the fiscal incentive can be the icing on the cake.

Specific pull factors for FDI in biomedical industry

Regarding the specific requirements for biomedical industry investments, Singapore has proven to be able to attract MNEs like Eli Lilly, Novartis, Merck, Wyeth and Pfizer through a concerted effort and meticulously designed FDI targeting strategy (Tong, 2003). For this reason the Singapore approach will be used as a benchmark.

Long-term planning and investments promotion agency

Singapore started with a clearly formulated vision almost 30 years before the operation of their plan and the establishment of the EDB, the investment promotion agency (IPA). A study by Wells and Wint (1990) shows that 30% more FDI were attracted by developing countries that did have an IPA in the US, compared to countries that did not have an IPA. MNEs prefer real one-stop services to tedious entry procedures involving many different services. (Beausang, 2004). Furthermore, the Singaporean model encompasses the construction of a National System of Innovation (NSI):

Building on MNE’s R&D activity, through the LIUP (a linkage program to its FDI targeting strategy)

The other one is linkages between local institutions (intra-local linkage). Singapore combined its openness to MNEs with upgrading of local SMEs. The benefit of this combined strategy is that it allows an influx of technological innovation and at the same time creates an independent local industry of suppliers.

Liberal bioethical regulations While in the US embryonic stem-cell cultivation has been banned and cloning work is no longer allowed in the UK, in Singapore such research is allowed within acceptable ethical limits.

Education of people

By 2010 the aim is to have created 1000 PhD qualified researchers from Singapore. A special program has been introduced to allow prominent scientists to keep two labs, one in Singapore and one in their home country. (TE 2004, Smwap) Additionally, in its effort to attract FDIs, Singapore compensates for shortage of land, markets, raw material and scientists by pouring lots of money into special programs. Pull factors considered by the US Commerce Department’s Office of Technology Policy to contribute to the Singaporean success are (Tong, 2003):

- The EDB’s flexibility in adapting policies and incentives to the global market and the industry changes and its steadiness despite economic and sector oscillations.
- Continuing interest in forming partnerships with MNE and its ability to respond quickly to market forces.
- Pragmatic approach to ethical issues
- Faster approval of new drugs for overseas distribution

Eligibility of Brazil

Meeting the identified requirements can be readressed as: Is Brazil willing and able to establish a regional biomedical center. Several different representatives of the Brazilian government and industry have stressed upon the willingness of Brazil becoming a biomedical cluster. Whether Brazil is able or not to become a center of biomedical industry, will be based on the following facts.

Brazil has the economies of scale with a total population of about 180 million people. Brazil is also member of the MERCOSUR, a trade agreement formed in 1991 linking Brazil, Argentina Paraguay, Uruguay, Chile and Bolivia. This implies access for the foreign investor to the Brazilian domestic market as well as access to the other member countries of the MERCOSUR. Brazil has an established infrastructure because of the already existing industries, which proportionally contribute to its total GDP of US$580 billion per year. The figure-head of industry: Sao Paolo state, the so called economic powerhouse of Brazil, contains more than 700 corporations, a result of dismantled laws, tariffs and taxes, installation of so called “easy state” laws, rendering less strict environmental and labor controls. However, with the economic growth induced through increased private investments, came severe environmental damage, labor unrest and foreign debt. (Hodal, 2003)

Structural reform programs have been started by the administration of Fernando Henrique Cardoso - Brazil’s longest serving democratic president - and it seems that they will be followed through by the current administration of Luiz Inacio Lula da Silva (Lula). The programs that were successfully implemented by the Cardoso regime were basically aimed at welfare, education and health, whereas reforms of pensions, tax system, labor laws, policing and justice have not been completed yet. (TE 2003 mob). If
these fundamental reforms can be pushed through it will probably allow Lula to target government’s resources more effectively and to increase the economy’s growth potential as well as the tax revenues (TE 2003 Ft). The “Fume Zero” program (scheme to ensure meals for the poor) (TE 3003 Tsmad) will enable to maintain social stability, which will keep stability of the local market. According to the latest prospects and country reports Lula’s efforts to keep socio-economical and political stability seems to be successful so far (TEIUL 2004; Country Report: Brazil at a glance 2004-2005).

Brazil has around 200 universities of which 168 medical schools. Their technical programs are already providing the technical industry with highly qualified people. Since 2003 Brazil has the 11th largest pharmaceutical industry in the world. (Interview with William Fernandes Matos, Commercial Attache in Suriname).

By conducting a large-scale high impact AIDS program, Brazil has clearly demonstrated their potential to become a center for biomedical industry. The AIDS program helped to curb the mortality rate and includes free treatment with a cocktail of 12 drugs, of which 10 not patented in Brazil are made locally and cheaply. The two other patented drugs are imported by the government costing 39% of the US$303 m it spent on AIDS drugs. For this matter two other drugs are being copied and cheaply produced by government labs. Another example of producing cheaper drugs was the case with a certain drug tested in India where the brand drug was priced US$120 opposed to the generic drug of US$10 and it showed that both drugs worked more or less the same. (TE 2001, Acfhp).

The wide biodiversity of the Amazonian forest includes numerous undiscovered potential medicinal plants that need to be investigated yet. Making a raw biological discovery a marketable product has been done by Dr. William Gerwick and Dr. Eduardo Ortego, in Panama. They invented a new fluorescence assay that did not involve radioactivity with the use of tagged parasites. This assay is now used in other developing countries and will be included in a drug-discovery kit of the National Health Institute in the US (TE 2005 Tsote). In this respect SME biomedical start-ups could be part of the supporting industry, in close collaboration with the university. One such initiative is the Biominas Foundation, an institution founded in 1990. With support of the Multilateral Investment Fund (MIF) it is helping to enhance small biotechnology companies in Brazil in the state of Minas Gerais. It is the only Brazilian entity exclusively aimed at the growth of a sector in areas of health and environment. (IDB Brazil, March 2002).

A seemingly everlasting issue between Brazil and the US is the enforcement of patent laws (TE 2001, Acfhp). Nonetheless an accord on patents has been reached between Brazil and the US in 2001. Under this agreement, the complaint against Brazil’s patent and compulsory licensing laws filed with the WTO would be dropped by the US, allowing Brazil to import or locally produce pharmaceuticals. Brazil in return, will give ten days notice before deciding to import or produce goods or technology under so-called compulsory licenses (Chemical Market Reporter, 2001). Remaining issues regard crime, inadequate transportation, shortage of energy, and quality of the infrastructure.

**Recommendations**

**Recommended Policies**

The Brazilian government, consulting together with the academics and industry, should primarily start to envision how it is going to institutionalize the biomedical industry in general. By prospecting its position in the next five to ten years, Brazil should make an inventory of the core biomedical industry and supporting industry within Brazil. This is to evaluate which MNEs should be attracted and which local companies should be encouraged. Moreover, the Brazilian government should work their way to independence of foreign investments by enhancing local industrial competencies, so that they can become self-sufficient. Special programs should be designed to direct this long process in a consistent way and continuity should be guaranteed by consecutive administrations. With this design IPAs should be identified and trained, as they are supposed to know what the government’s vision is and what their mission is.

**Policy regarding FDI for the biomedical industry**

In addition to the already existing FDI policy a few recommendations will be made here. First of all there should be incentives for any active influx of innovative technology, R&D, training or education to benefit the country. Products should be available on the local market. IPR should be respected and patent laws should be enforced however, agreements regarding terms, conditions, exceptions and deviations of this should be transparent and upfront. This applies also to agreements on how to settle legal disputes. MNEs should actively participate in local linkage programs and academics. Public assistance of MNEs should be encouraged not only to benefit the society, but also to enable frictionless embedding of the MNE. In this respect, special language and cultural programs should be available to expatriates and their families to enhance social integration. Specific privileges should be considered to attract key scientist and MNEs should be able to have one-stop-shops in the form of IPAs.

**Policy regarding SME**

To strengthen the national innovation system SMEs should participate in intra-local linkage programs. SME should be encouraged to increase their quality standards and quality control up to international standards. Subsidies or
grants should be available to collaborating SMEs and universities. SMEs with high potential should be identified and linked to MNEs’ activities. Special subsidies should be available to SME and university programs for investigation of Amazonian medicinal herbs and plants. Discoveries and findings should be registered with a local patent bureau. Entrepreneurial promoting agencies (EPA) should coordinate and guide SMEs.

**Policy regarding academics**

Universities should include special curricula focused on research supportive of the biomedical industry. Scholarships should be awarded to excellent students at different levels (BSc, MSc and PhD.) and career planning should be available to encourage choosing a study in the field of biomedical sciences. Incentives should be given to linked-groups or research teams for innovative discoveries. Universities should participate in linkage programs either with SMEs or MNEs. Subsidies should be available for studies on tropical medical plants and herbs, inventions on cost reducing techniques and inventions on techniques reducing chemical and radioactive waste.

A final remark regarding the initiative of creating a biomedical cluster by attracting MNEs and upgrading SMEs is the following: No matter how beneficial this development may be, it should always be executed with sustainability in the back of the mind. In this matter the government, the industry, the academics as well as the society hold full responsibility to refrain from involvement in any activity that will cause major environmental damage either instantly or on the long run, induce bio-safety hazards or violates bioethical standards.

**Conclusion**

The drivers for Brazil to become a biomedical cluster are economical growth, political power and social benefits. The main requirements to achieve this status are a clear vision of Brazil’s own position in the near future regarding biomedical industry; a well designed National System of Innovation Program; and guaranteed continuity.

Key policies for Brazilian government and industry regard:

1. One-stop shops for foreign investors (IPA)
2. Combined inter-linkages and intra-linkages strategy
3. Inward technology transfer
4. Upgrading of local companies
5. Reinforcement of collaborations between industry and academics
6. Strengthening and enlargement of pool of specialists
7. Research on tropical plants/herbs in university programs

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A Study of Business Development Professionals’ Self Definitions of their Roles in Global High Technology Companies

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Business developers are increasingly sought in job postings, but the definitions of this function vary widely, many equating it with aspects of the sales role. The purpose of this study was to begin stabilizing the business development concept by using structured interviews of 14 ‘business development’ professionals in global high-technology (telecommunications and related software) companies to investigate how they describe their role, and how they see it as different from sales. The interviewees reported an overall view of business development quite distinct from their perception of sales—across important dimensions such as time frame, goals, and incentive structures. Business development was especially seen as focusing on initiatives involving uncertainty and newness, i.e. new markets, new product combinations, and new types of sales channels.

There are many conflicting descriptions of the ‘business development’ (BD) function in the popular literature. Furthermore, job postings for “sales” positions frequently describe them as focusing on BD. As Kind and Knaphausen-Aufer (2007) note, “the term ‘business development’ is a buzzword that business practitioners very often use” (p. 177) and “‘business development’ … is one of those terms used by everybody, but nobody really knows what it means (p.176).

Therefore, in order to begin stabilizing this concept of a BD role, we studied how a small sample of business development professionals would define their role and its concomitant professional characteristics, and whether they would express a consensus on how their roles differ from sales.

This paper is organized as follows: we review popular literature and academic sources on BD and concepts relevant to it such as intrapreneurship, technology management, and corporate innovation strategy; we outline our research design, which is based on qualitative methods; we present our results in several subsections; and in a conclusions section discuss these results and how they compare with those seen in a recent study of the BD function in the biotechnology industry.

Review of Literature

In job postings there are often conflicting descriptions of the BD role, especially with regard to its overlap with sales. For example, Monster.com (2007) published an advertisement for a “business development manager”; however, in the ad’s body the job was described as a software sales position. This advertisement appears in appendix II.

Popular literature in this area is also confusing. For example, according to Beam (2006), in his article on sales in the management consulting business, the BD process is about “lead generation” and “managing a list of your prospects, also known as your pipeline” (p. 18). Other authors refer to BD as a kind of new sales. Sparks and Butler (2001) in their book “Business Development is Everyone’s Business – a Motivational Guide to Getting All Employees Involved in Your Sales and Marketing” described BD as networking activities leading to new sales generation. For example they describe how a customer care manager for a company referred a neighbor of his to a company sales person. A www.youtube.com video titled “Business Development with CEO Network Partners” on www.youtube.com dated June 24, 2007 (viewed April 15, 2008) also defines business development as a networking activity and give the example of retail small business owners like printing shops giving out their business cards at local business clubs like Rotary or Kiwanis.

Two other examples from the internet indicate the breath of definitions, but also some possible convergence toward a focus on inter-organizational relationships. Best selling E-commerce guru and blogger Seth Godin (2007) defines BD as a class of marketing activities: “Licensing, affiliates, franchises, partnerships, traffic exchanges, joint ventures and co-promotions live in a netherworld. While they are all important marketing techniques, they often come under the rubric of business development, a department where there is little structure and few rules.” The well known Internet folksonomy Wikipedia.com (2008) notes that “business development involves evaluating a business and then realizing its full potential, using such tools as marketing, sales, information management and customer ser-
vice.” More specifically, it also notes that “especially in technology-related industries, business development often refers to creating and managing strategic relationships and alliances with other, third party companies.”

With regard to business development as a specific role, Kind and Knyphausen-Aufser (2007), as cited above, specifically noted the relative vagueness of this concept, and noted that “few academic studies deal with the term ‘business development’” (p. 177).

In their path breaking study on the BD role, they conducted interviews with designated BD managers and directors and “members of the management board who were responsible for all tasks related to BD” in small early stage German biotechnology companies that “concentrate on the research and development of new drugs (product companies) and/or on the development of new technologies that help other companies in their research and development of new drugs (platform companies).” (p. 181). They also based their conclusions on a review of corporate documents, and on the six months Kind worked as an assistant in the “Deal-making & Strategic Partnering” unit of Burrill & Company, a biotech consulting and venture capital company located in San Francisco, California in the U.S.A.

Their study found that BD practitioners tended to define the tasks of BD in terms of three categories: refilling the research pipeline and the partnering of projects, commercialization of products and technologies, and network-building and pre-negotiation of deals (p. 182). They further crystallized this with respect to the biotechnology industry as: “a business function which has been widely established in biotechnology companies. Under the strategic guidance of top-management, its principal task is to prepare and realize input, throughput and output deals… creating value and revenue potentials for he company, developing products and technologies so that they can be commercialized, building relationships with potential partners, customers, and other stakeholders, and maintaining and enhancing those relations in the interest of the company … as we have seen so far partnering and deal making are at the core of the BD function(p.185).”

Kind and Knyphausen-Aufser conclude that BD involves a three-step process over time involving Step 1 Identification (screening for information and networking), Step 2 Evaluation (data confidentiality, due diligence, and analysis and selection of partners), and Step 3 Negotiation (convincing, terms and conditions, and R&D design) (p 186).

Several of their conclusions (especially their emphasis on relationship building and deal making) are similar to what the current authors (one of whom, Shavit, is a BD in the telecommunication industry) anecdotally understand to be two key areas of BD, relationship building and deal making.

However Kind and Knyphausen-Aufser’s focus on the biotechnology industry with its emphasis on pre-product sales revenue generation via licensing of platform technologies, and their study’s consequent use of very small R&D stage companies all likely impacted the roles that were emphasized by interviewees and possibly also the relatively operational rather than strategic nature of the tasks cited for the role. For example their quotes of interviewees place BD in the realm of “business operations, project definitions, … the relationships with the customers are very important since they normally order large amounts, …strategy is mainly developed by the CEO and senior Management team; those are seven people in our company that do not come from the BD” (p. 184). They conclude “... BD is not equal to strategy making; it is much more an operational activity that depends on orientation guidelines provided by the management board” (p. 194).

In summary, Kind and Knyphausen-Aufser’s results are important for establishing that a strong concept of BD as a role exists at least in the biotechnology field and that it is seen as emphasizing relationship building and deal making.

The specific connection between partnerships and effective business development in technology is also made by Karol, Loeser, and Tait (2002) who describe the “new business development” process in DuPont, where the process is a series of steps that address: the target customers, the value proposition, the program objectives, the business model, the strategy, the development plan, and the business case (Para. 3). The authors emphasize the importance of alliances in the NBD process as a solution for the technological and business capabilities gap. “NBD by its very nature takes a business into new areas, and the time and resources to fill all gaps internally is often perceived as prohibitive. Partnering then becomes the only viable option and at this point the critical issue becomes selecting the right alliance option and the best partner” (para. 6).

Turning from specific discussions of the business development role in biotechnology and science, there are references to somewhat similar skills in literature from fields such as strategy, technology management, innovation management, and recently in the field of “intrapreneurship” or corporate internal new ventures.

Vanherbeke and Peeters (2005) describe a corporate strategic process – with goals akin to some but not all of the BD goals cited by Kind and Knyphausen-Aufser - that develops new corporate competencies which then help the corporation to create new internal ventures – entire new lines of business- and to stay profitable for the long run.

MacMillan and McGrath (2004) define technology management and “technology development managers” as the means for generating new corporate ventures. In their view, the role of “technology development managers” is to drive new revenues by leveraging significant new technology and business components, such as new products, new channels, new partners, and new target markets. They also identify three major roles:
1. Identification and screening of opportunities. This stage includes a market analysis and validation, discussions with prospects, and preparing of a mini business plan
2. Introduction of fruitful opportunities into the market.
This step includes product introduction to prospects, proof of concepts trials, and development of required features
3. Managing the takeoff of the businesses. In this stage the company needs to introduce the new business into its mainstream, and for example, to transfer accounts from the technology management teams to the sales teams

This last point is important to the framing of the current study in that it distinguishes the role of the technology development manager from that of sales. This view of sales as a later more programmed stage is also consistent with the view of Miller (2006) that the sales function is “a definable, repeatable process that can be tracked, planned and managed” (p. 13).

In the related field of innovation and corporate strategy, Ringo (2007) described the innovation process in IBM as including a similar qualification process as described above by MacMillan and McGrath (2004).

Finally concepts that encompass many of the stated goals of BD also appear in the context of intrapreneurship and corporate innovation. For example Antonic and Histrich (2003) defined intrapreneurship, as “entrepreneurship within an existing organization” (para. 4), and included within it business venturing, product/service innovation, process innovation, and other types of innovation. They emphasize the ability to deal with uncertainty as paramount, and cite eight dimensions of intrapreneurship: new venture, new business, product/service innovation, process innovation, self-renewal, risk-taking, pro-activity, and competitive aggressiveness.

Research Design

The purpose of this study was to clarify the role of business development, its job characteristics, and to compare its roles to sales. The study questions were as follows:
1. How do BD professionals perceive their own roles?
2. How do BD roles differ from the roles of sales professionals?
3. What are the self perceived characteristics needed for effective performance of the BD role?
4. How do the self perceived characteristics of BD professionals relate to those that have been posited for intrapreneurs?

Cooper and Schindler (2006) note that the objective of “case study” interviews is to obtain multiple perspectives of phenomena, particularly in the early stages of qualitative study of emerging professional fields or roles. They suggest that it is a good practice to pick 4 to 15 different organizations, or participants in order to cover the research topic widely enough (p. 217).

The current study utilized interviews with persons who had previously identified themselves via LinkedIn.com (a popular social networking community for business professionals) as having responsibilities primarily associated with the BD function. This sample was comprised of business professionals from global technology companies, with headquarters in Europe, Israel, and North America.

The interviewees were recruited by identifying all Level 1 contacts from the LinkedIn account of one of the authors (Shavit) that met the above criteria. Out of 26 professionals so solicited, 15 agreed to be interviewed, and actual interviews were conducted with 14. The interviewees represented a mix of different locations and company sizes, ranging from 10 employees in the smallest to over 20,000 in the largest, but most came from medium size organizations (500 to 5000 employees). They were all male. 13 out of the 14 interviewees had the term Vice President or a Director in their job titles, and thus likely were higher in rank and more “corporate” in their experience and perspective then the BD professionals studied by Kind and Knyphausen-Aufer (2007).

Eight of the interviewees had the phrase “Business Development” in their titles, while two others carried both Business Development and Sales in their titles. Two of the interviewees were business unit general managers who managed BD personnel, one carried a sales title, and one was formally designated as a product manager.

The questionnaire for the interview was composed before the interview; however it was modified following the initial four interviews. The major change was to add a sales topic as a major point of interest, specifically how sales’ role compared with the perceived BD role. The final questionnaire is provided in Appendix I. Interviewee responses to questions were recorded via note taking and following the interviews, were entered into a confidential data base. To reduce potential bias, most questions were asked as open ended questions, with verbal follow-up questions to obtain elaboration as needed. In two cases, the interviewees confidentially shared copies of their compensation scheme, which were used to cross-check their statements about their job priorities.

The setting for the interviews was conference calls which lasted 30 to 60 minutes. Following the interviews, emails were sent to the interviewers in order to clarify points that were not adequately covered during the interview.

Results and Discussion

We describe first the reported general components of the BD role, as well as the variability we observed. We note how these descriptions tended to track into two job types, but with several hybrids, apparently reflecting various reasons of individual history, rank, place in the company’s organization, the particular challenges a company is facing in its history, and sometimes the stage and success of a BD initiative. Finally, we address how the interviewees’ definitions of the BD role compared to their perceptions of the sales function in their organizations. These findings are summarized in Table 1.

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Table 1. Executive BD Role vs. Operational BD vs. Sales Function.

<table>
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<tr>
<th>Topic/Role Categorization</th>
<th>&quot;Executive Level&quot; BD</th>
<th>&quot;Operational Level&quot; BD</th>
<th>BD’s Perception of “Sales Function”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Essence of role</td>
<td>Develop new market or territory, initiate new technology development or acquisition, develop strategic partnership, mergers and acquisitions</td>
<td>Develop new market segment, develop a new type of channel, find first customer(s), manage partners, redefine existing product</td>
<td>Follow an existing and well-defined sales process.</td>
</tr>
<tr>
<td>Typical Title</td>
<td>VP BD reporting to the CEO and located at the headquarters</td>
<td>Director for BD, frequently located in a regional (e.g. USA or Asia) office, Reporting to VP marketing, VP sales, or VP BD</td>
<td>N/A</td>
</tr>
<tr>
<td>The environment</td>
<td>High level of uncertainty about the technology, product, market, alliances, and business model.</td>
<td>Uncertainty about pricing, product specs, and alliances. Usually a defined territory and market.</td>
<td>Clarity about the target market, business model, pricing level. Use established partners.</td>
</tr>
<tr>
<td>Analysis of the industry ecosystem</td>
<td>Broad analysis is usually done by BD long before sales appear</td>
<td>Analysis is done by BD or marketing in a well defined area (market segment and geography)</td>
<td>Analysis is done on the prospect only, locally</td>
</tr>
<tr>
<td>Definition of Key Goals/ Milestones.</td>
<td>Broad definition of goals such as new technology introduction, acquisition process completion, develop exit opportunities</td>
<td>Sign purchase order for prototype or trial, sign partner/channel agreement, receive order from first production customer or new channel.</td>
<td>Customer contract and revenues in a well defined territory, target market, and product</td>
</tr>
<tr>
<td>Incentives</td>
<td>Bonus linked to the company performance</td>
<td>Bonus linked to the specific milestone goals (quarterly)</td>
<td>Commission structure which is explicitly linked to the quarterly revenue goals.</td>
</tr>
<tr>
<td>Duration of a typical engagement</td>
<td>Long term, usually 2-3 years.</td>
<td>Medium - Long, usually 1-2 years. Many times handover to sales is done after the first few sales</td>
<td>Relatively short (several months)</td>
</tr>
<tr>
<td>Impact of an engagement</td>
<td>Potential of acquisition or exit. Significant long term implications.</td>
<td>The new channel/segment can ultimately increase revenues by 20%-30%; however most BD projects are initially small in size.</td>
<td>The transactions varied in size and importance</td>
</tr>
<tr>
<td>Type and purpose, of inter- organizational relationships</td>
<td>Small number (1-4) of key business and technology alliances with relationships done at the highest level (CEO, founder). Focus on longer term synergies beyond creation of new sales channels.</td>
<td>Partnership relationships (even with first customers); with focus on creating enduring channels and new segments.</td>
<td>Based on vendor-customer and personal relationship model. If a formal partnership is used, it is done with opportunistic view</td>
</tr>
<tr>
<td>Failure rate</td>
<td>Failure rate is related to the trust between the CEO and the BD executive</td>
<td>BD project has relatively high failure rate; this risk is in line with new business venture success rate</td>
<td>The sale effort in an established market has usually higher success rate</td>
</tr>
</tbody>
</table>

Components and Focus of the BD Role.

The interviewees defined the typical components of the BD role as follows: perform a market analysis, identify a target market segment, find the first customer(s), engage with the right channel/partner, define the business model, and define the product at a high level. Twelve of the BD’s in the sample mentioned most or all of these components as part of their role.

With regard to the job of engaging with partners and channels, three of the interviewees reported a some structured and confined role, such as developing new business from existing channels in a market, while 11 others reported a more broad role such as being tasked to identify and engage with new channel in the same markets, or finding new channels for new markets and/ or products.

Nine of the BD’s emphasized their role in the product and technology area. This is described below, ordered by the complexity level of the product change:

1. Define a new application based on the same platform, or a significant customization;
2. Provide feedback on the requirements a designated new market would have for the same product;
3. Partner with a vendor in the value chain, who provides all or part of the solution;
Two Types of BD Roles

Interestingly, the research participants’ responses clustered into two basic BD types or levels, which in turn have a significant impact on how they view and individualize the general BD role:

“Executive Level” BD A minority (3 of the 14) of the BD interviewees are high level executives who pursue top level corporate objectives, such as the creation of long term key strategic partnerships and the development of acquisition and exit opportunities. This group reported that they focus more on technology and products, including identifying and championing totally new markets, and less on sales channels and the sales mission. They maintained trusted and close relationships with the CEO, chairman, or President. Usually there is only a single person in such a position in a company or business unit.

“Operational Level” BD This group (the other 11 BD interviewees) tended to define themselves as separate from but supporting the overall sales mission through the development of new market segments, new type of channels, and the specification of appropriate product feature sets for a specific new market (or submarkets related to existing markets) that higher management has decided to pursue. These individuals report more focus on market segmentation and customer categories. Several of these operational level BD professionals were located away from headquarters, and some reported to a region’s (e.g. the United States) general manager or top executive. These away-from-headquarters BD’s reported that their jobs focused on the initial stages of developing a new product variation geared to the preferences of customers in that region.

A good example of the way the BD’s type appeared to affect how they view the general BD role was in the area of key goals and milestones. The Operational Level BD’s more emphasized signing channel agreements and the acquisition of first paying customers as key to the success of their initiative, while the Executive Level BD’s more emphasized broad definition of an initiative’s goals and acquisition of high level technological competencies as drivers for success. The reported difference between the two BD types may also be related to individual differences in professional backgrounds. For example, one of the interviewees whose responses defined him as an Executive BD type, started as an engineer and moved on to product management, marketing, sales, and finally started his own company as an entrepreneur. Later, he sold his company and eventually became an executive vice president, reporting to the CEO of the acquiring company, and mostly now performs strategic acquisitions. The wealth of his professional experience facilitates his current position. Another interviewee whose responses we characterized as a hybrid of the Operational Level BD type and the sales role, started as a product manager who became a sales engineer, and now has a BD title and the mandate to introduce an existing product to a new market.

Three of the respondents noted various hybrid roles in their current or past positions, such as Operational Level BD combined with sales responsibilities, and mixtures of Executive Level and Operational Level type BD roles (e.g. engaging in channel search while simultaneously engaging in significant redefinition of a product). Some respondents saw this as part of a progression where the BD follows the development of the new product or market initiative though its various increasingly operational stages. Beside the hybrid BD roles, some interviewees mentioned that initiatives that started out as operational BD efforts – e.g. developing a new market segment for an existing product – would occasionally morph into business ventures that marked significant shifts in company strategy, with continuing changes in their personal roles.

Differences Between BD and Sales

The difference between BD and sales is an area of confusion, particularly in the popular literature, and is undiscussed in the sparse academic literature on BD.

While interviewees indicated a number of subtle variations among BD roles, they tended to be more definitive or “black and white” in distinguishing BD from sales. A complex of differences is noted in Table 1, but especially include: 1) the essence of the role as dealing with “newness” and its requirements for creative business models, solutions and modifications vs. following an existing well understood sales process with defined products, target niches, and channels; 2) the aggregate focus on markets, technology, and channel vs. individual customer level transactions; and 3) the broader incentives and measures of performance vs. explicit commission schedules. All of these distinctions are consistent with the practitioner view championed by Miller (2006) that the sales process should be well defined and predictable.

The process duration or time frame of projects was also repeatedly mentioned as a difference between sales and BD, and perhaps is most illustrative of the dramatic differences interviewees saw between BD and sales. While respondents stated that a sales process usually lasts from few months to one year, they saw BD efforts in much longer terms, sometimes taking more than two years to achieve their desired results.

Interviewees attributed this time frame difference to various factors, including the trial and error nature of new business initiatives (e.g. finding the right product characte-
istics, pricing, etc., for the right segment, and the right partner to reach that relationship), and the time needed to build effective trusting high level inter-organizational relationships leading to formally specified business partnership arrangements. It was noted that the BD role is to focus on the development of such inter-organizational relationships, based on the perceived synergy between a company and its future channel or partner, even with the possible revenues still years away. In comparison, it was noted that incentive structures for sales professionals meant that they will invest in the development of inter-organizational relationships only when it helps them with an immediate sale, and when the immediate sale is no longer active, they tend to drop the relationships.

Interviewees noted several areas of seeming role overlap between BD and sales:

• Sales and account management for a new or evolving strategic account.
• Initiation of sales in a distinctly new (for the company) geographic region, e.g. Asia vs. the USA.
• Initiation of sales using a new product
• Channel management

Several of the Operational Level BD’s noted that this apparent overlap exists because many of the activities performed by them early in the development of a BD initiative such as work with channels are similar in at least the subject matter to those done by sales professionals at a later and more programmed point in the cycle, and in fact are usually turned over to mainstream sales departments within their organizations. For example activities involving channel relations move from the BD role to those of the sales function as they move from creation and negotiation to management and maintenance.

However they noted that the subtlety and time dependence of the above distinctions, compounded by the various popular definitions that sometimes label sales as “business development” caused confusion particularly among recruiters and human resource managers whose task is typically to find a new sales professional who can develop more business.

Some of the interview responses on sales vs. BD also seemed reflective of typical intergroup stereotyping and resentments. For example, some of the respondents referred to BD as a “nicer” or more prestigious job description than that of a sales job. There were also complaints that some sales professionals viewed the BD professional as someone who can create the initial relationship, but cannot close an actual sale, or “incorrectly” viewed the BD role as doing “lead generation”, a role the BD’s viewed as part of the marketing function.

Self Perceived Characteristics Of BD’s

The study also asked about the characteristics of an effective BD professional. The interviewees defined the distinguishing professional and personal characteristics of BD as follows: business orientation, creativity, perseverance, strategic view, technical background, and communication skills. Most of the participants identified the ability to initiate new ideas and efforts -- new markets, product extensions and even new product/service combinations defined by relationships among organizations -- as among the most important parts of the BD role. Some of the interviewees referred to BD as “creating something new,” “identifying a new product mix,” “finding a different type of channel,” and so on. Most of the interviewees defined the BD creativity on the market side. Though some related it to product creativity, most described the product changes as driven by the market needs.

Many of the participants also mentioned the uncertain business environment in which BD’s operate and the need to cope well with frequent changes. Some also mentioned specific intellectual challenges related to this environment such as “building a new blueprint,” “identifying a new business model” involving a complex value chain between companies, and so on.

Comparison Of BD Self Descriptions With Concepts From Intrapreneurship, Technology Management, And Corporate Innovation Strategy

Antonici and Hisrich (2003) who focused on intrapreneurship, also emphasized the ability to deal with uncertainty, and as noted earlier, eight dimensions of intrapreneurship: new venture, new business, product/service innovation, process innovation, self-renewal, risk-taking, pro-activity, and competitive aggressiveness.

Some of these are personal characteristics that might well also be seen in a successful sales professional, e.g., business orientation, maintaining relationships, and negotiation skills, as well as skills like “network building and negotiation” cited in Kind and Knyphausen-Aufser (2007) (p. 187- 188). However most of the dimensions seem to especially track the BD features implied by the current study such as creativity (needed in unstructured situations), perseverance (needed to accompany the longer time perspective) and technical skill in product and process innovation (crucial when product modifications or new technologies are required).

Likewise the function and characteristics reported by the interviewees also showed some similarity with concepts in corporate innovation strategy (Ringo, 2007) and “technology development management” (MacMillan and McGrath, 2004) with their emphasis on such themes as opportunity analysis and managing the takeoff of new initiatives. Interestingly also the work of Vanhaverbeke and Peeters (2005) on innovation and the corporate strategic process emphasizes tasks such as building new corporate competencies and lines of business akin to the focus on technology competencies and championing totally new markets reported by Executive Level BD respondents.
Conclusions

The goal of this study was to clarify the BD role and in particular to differentiate it from the sales function. The research found significant differences between sales and BD professionals in their roles, personal characteristics, and required experience. The typical BD role involves dealing with strategic growth areas for a company, taking on longer projects, and developing strategic alliances. People in the BD role must have a broad view and extensive experience in many areas.

The findings also revealed that there are two types of BD roles: Executive Level and Operational Level. While the Executive Level of BD appears significantly different from sales, some of the Operational Level BD professionals described themselves as working closely with sales people. Some even assume a hybrid role. The Executive level BD’s by contrast reported working closely with the CEO or the head of a business unit to ensure alignment of these BD activities (e.g. initiating a new technology co-development alliance) with the corporate strategy.

It should be stressed that this was an exploratory study of a small sample and especially that there were only three respondents reporting an Executive Level BD type. However their descriptions of their role were so different from those of the Operational Level type, and so different from the consistently non-strategic role that Kind and Knyphausen-Aufser (2007) reported in their study of BD’s in small early stage biotechnology companies, that we felt their perceptions were worth reporting.

In this regard we would note that in comparison to Kind and Knyphausen-Aufser (2007), the current research was done in a different industry setting (telecommunications and related software) typified by complex intercorporate technology value chains; and involved respondents from much bigger companies characterized by existing product revenues, far flung operations, and large hierarchical organizations. These size, growth stage, and complexity differences might well explain our finding of an additional more strategic/ executive type of BD role. In any case, more interviews done in more industry settings and with a greater variety of companies will be needed to flesh out the emerging role of “business developer” and the forms it takes.

Several other areas are suggested as topics for further research. First, it would be important to document the measurement of and milestones for BD success. Also, if BD continues to emerge as an important job title, and begins to be recognized as a separate discipline, it would be of interest to apply project management and engineering control theory concepts to the management of BD efforts, especially the detection and correction of problems. Finally, it would be desirable to investigate in more depth the hiring criteria and compensation structures that are used for BD professionals, and their relation to the BD role.

References


Appendix I – Interview Guide

The authors used the following interview guide as a flexible structure throughout the interviews process. The questions evolved based on the responses. The major changes that we implemented during the interviews include more focus on the differences between BD and sales, and less focus on the specific BD projects.
1. The name of your organization, your title, and reporting relationship?
2. How do you define the BD role(s) – in general and in your company?
3. How is BD different than the sales function in your organization?
4. What are the personal and professional characteristics of an effective BD professional?
5. Would you characterize BD as a strategic or tactical function within your company? Please explain.
6. Describe your interfaces with other internal and external functions.
7. Describe a successful BD project you have participated in.

Appendix II – Listing on a well known jobs website of a sales oriented “Business Development” position (identifying information was removed)

<table>
<thead>
<tr>
<th>Business Development Manager</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company:</td>
</tr>
<tr>
<td>Location:</td>
</tr>
<tr>
<td>Status: Full Time, Employee</td>
</tr>
<tr>
<td>Job Category: Computers, Software</td>
</tr>
</tbody>
</table>

Description: Asset Optimization - North America Software Sales. Develop pipeline and generate sales revenue for our ______ services and software. Focus will be on environmental, health, and safety information systems consulting, and various software applications to support ____, including ___process safety software - within the energy market (oil & gas, petrochemical, power).
Qualifications:
5 years of sales experience in technology / software - developing and maintaining sales pipeline.
Incumbent will need to have sales training in sales processes, conceptual selling/closing, sales strategy, account management responsibility.
Must be willing to travel 50 - 70% of the time and be able to demonstrate team initiative.
Degree not required - however must have sales and services background.
Must be eligible to work in US (no sponsorship available).
Preferred:
Experience selling environmental, health, and safety information systems. Knowledge of energy market - oil & gas, petrochemical, power - fossil or nuclear.
Salary/Benefits: Salary commensurate with experience
In addition to competitive pay and bonus programs, __ offers comprehensive benefits including medical, dental, vision, 401k, and tuition reimbursement, among many others.
Job Location: _____________
Optimal Ownership Structures in the Bauxite Industry in Suriname

Alvin O. Venetiaan, FHR Lim A Po Institute for Social Studies, Suriname

This research deals with the potential financial benefits for the host country as a function of various forms of ownership in the bauxite industry in Suriname. Suriname has been leaning on the bauxite industry with alumina representing 46% of Suriname’s total export value in 2006. Suriname stands before an important decision regarding the reserves in the Bakhuys area. The foreign Joint Venture companies active in Suriname’s bauxite industry have shown interest in exploring these reserves, but Surinamese public opinion is shifting in favor of a business model with more Surinamese control to enable an increase of benefits for the nation. The aim of the research is to investigate what the optimal form of ownership is from the viewpoint of Suriname, with respect to the financial benefits.

Introduction

Suriname has been leaning on mineral exploitation and more specific the bauxite industry for the major part of the 20th century. Even though the dependence of the country on income from the bauxite industry has dropped, it is still a very important sector with 21% of the direct tax receipts in 2005 (Torres et al., 2006). Alumina represents 46% of Suriname’s total export value in 2006, reduced from 55% in 2002 (Torres et al., 2006), thanks to developments in gold and fuel oil. The bauxite industry in Suriname is currently populated by a joint venture between Suralco (55%) and BHP Billiton (45%), active in exploration and mining (BHPB), and refining (Suralco). The Joint Venture produces 2.2 million tons of alumina per annum and sells this on the world market to Smelters in Europe and North America. At the end of this decade the bauxite reserves under the current license of the government are projected to be depleted. Reserves not under the current license in the Bakhuys area seem to be the logical next step for the industry. Suralco and BHP Billiton have shown interest in exploring these reserves in the near future and for years to come. The public opinion in Suriname however, is shifting towards a business model for the future of the bauxite industry with more Surinamese control and ownership, derived from the theory that greater participation in exploitation of its natural resources will increase the benefits for the country as a whole. This will of course impact the time allotted for negotiation between the Joint Venture partners and the government, therefore possibly impacting the continuity of the Paranam facilities and the revenue income from the bauxite industry for a certain time period. This would not only be a problem for the Joint Venture partners and the people they employ, but the government would face a serious decrease in tax income, affecting its financial position significantly.

Problem Statement

The current form of ownership of organizations active in the Bauxite industry in Suriname, is not perceived as optimal regarding financial benefits for Suriname as the host country, by a majority of the public opinion. The main research objectives are to first determine what financial benefits accrue to Suriname given the present ownership structure, next to determine whether benefits can be increased by a change in ownership structure. Finally to develop policy recommendations on (a) feasible ownership form(s) in the bauxite industry that will result in optimal financial benefits for Suriname as host country

The Hypotheses that will be tested in this article are the following:

H₀₁: The current Joint Venture business model in the bauxite industry will reap the best overall benefits in the future for Suriname as a host country

H₀₂: The current Joint Venture business model performs at or beyond international performance measure for profit generation from the mining industry

Theoretical Background

There are several ways to classify corporate ownership forms but this paper limits itself to a classification based on who the owner is (who partakes in the investment risk of the enterprise). The three main categories of interest for this paper are government ownership, private ownership and public ownership. Profit retention for a local economy is believed to be dependent on whether the owner is a resident from the host country or a foreign entity. In theory a foreign entity is entitled to retrieve all profits from a business out of the host economy, which would leave zero for profit retention from the local economy’s point of view. Profit generation is also believed to have a relation with form of
ownership. State owned companies are often believed to be less profitable, are more prone to political influence and are often not run cost effective.

Profit retention

There are various options for host countries to ensure a sufficient level of profit retention from economic activity within their area of control. First a government is in a position to determine what kind of taxes and royalties apply to economic activity. Suriname applies corporate taxes at a 36% rate, which is among the highest in the region according to a KPMG tax survey (KPMG, 2006). Secondly the level of employment generated and the total amount spent on wages and other manpower related costs in the host country. The Surinamese bauxite industry labor cost is at the higher end of the ‘low income’ countries (US 12.50/hr). The contractor cost however, is at the lowest end (US 4.00/hr). This limits Suriname in the contribution to the economy from the bauxite industry. Next option is the amount of cost made in the local economy through purchasing goods and services, which is a way of profit retention since the value of the goods/services rendered will remain in the local economy. For the Surinamese Bauxite Industry most of the labor, contract work and rental equipment is taken care of by local companies or people. The high value services however are often ‘imported’ (Consultancy, engineering, construction control), because expertise is not available in the local economy. The shipping, marketing and sales portion is also completely ‘imported’ apart from local piloting and shipping agency services. This is a significant cost portion which is charged back to the joint venture by the corporate organization that takes care of this. Supplies taken from the country are only bauxite and fuel oil, while a significant portion of the supplies of high value is imported (caustic, chemical supplies, material supplies).

The fourth profit retention tool is the portion of the profits that is re-invested in the enterprise. To make an assessment a comparison of the investment climate of Suriname with other countries is done using a World Bank comparison report (World Bank, 2007). The report shows that Suriname ranks 142 out of 148 economies for ease of doing business (World Bank, 2007), behind region members Guyana (104), Dominican Republic (99), Jamaica (63), Puerto Rico (28) and before Haiti (148). The last profit retention tool is the percentage of local ownership in the enterprise. This doesn’t necessarily have to be a controlling stake, but it ensures that part of the profit flows back into the local economy regardless of how much of the previous forms of profit retention is applied in the value chain. The downside is that the local entity will have to assume part of the risk upfront and will also be part of losses in the case of less successful periods.

The relation between form of ownership (local vs. foreign) and profit retention

In the case of foreign ownership of a business entity, it is clear that there will be a portion of the profits repatriated to the home country of the foreign investor. Advocates of foreign investment tend to overlook the effect of profit repatriation in favour of the positive effects the foreign direct investment can have on a host’s economy. The influx of capital will generally have a positive effect on local employment and will generate some additional spin off dependent of the size of the investment. Other benefits are usually exchange of technology and operating practices which is often difficult to value.

Initially foreign investment also improves the Balance of Payments for the host economy, especially if local purchases are made. As the business starts to make a profit later on however, the repatriation of profits will negatively affect the Balance of Payments, since capital will flow out of the host economy. If there is a large imbalance between the inflow of foreign investment and the outflow of profits, the host economy will stop benefiting from the foreign investment made. When this considers a non renewable resource like bauxite, there will be a detrimental effect on the long term economic potential of such an economy. Critics of multinational corporations believe that host countries lose control of valuable resources and miss out on important profits of their own resources in favour of multinationals. This supports the idea that there could be a benefit for the host country by partaking in ownership, as a tool to keep some of the profits in the host nation.

Profit Generation

The profit generation capacity of an economic activity is characterized by its financial performance. In the literature discussing the financial performance of enterprises there are several indicators used to measure the success of the company to make a profit or sustain viability, but none of these indicators will tell the complete story by itself. Work from several authors was reviewed, to enable a choice which would best fit the purpose of this research. Omran (2004) used an elaborate method to assess the performance of Egyptian firms. This method uses a normalization method in order to correct for inflation influence and looks at all factors influencing financial performance. The profitability ratios and Payout ratio are the lagging indicators, while the rest of the indicators (operating efficiency, Capital Expenditures, Output, employment, Leverage and Financial risk.) are of a more leading nature. They therefore represent the future performance potential and strength of the business. For the purpose of this research this method has the better fit, since it takes into account both the actual financial performance, but also the factors believed to lead to sustainable financial health and performance.
The relation between ownership structure and corporate performance

The literature search on this subject resulted mostly in studies focused on the effect of privatization of SOE in emerging or developing economies. The literature review shows different results for the various economies, which suggests that the relationship in Suriname will have to be researched in order to enable assumptions on ownership structure and firm performance. The results agree mostly on the improvement of firm performance as state ownership decreases when comparing privatized companies with SOEs. There is no evidence found of apparent relationship between foreign or local ownership, except for a weak negative relationship in China. The results of the effect of ownership concentration on firm performance are different for the economies looked at in this review.

The Bauxite Industry

Bauxite is mainly used for the production of alumina (Refining), which finds its use predominantly in the production of aluminum in smelters. The production of bauxite in Suriname is in the order of 3% of the global production, while its reserves are 1.7% (ranked 9th) of the world's known reserves. This places the importance of Suriname in the bauxite industry in perspective. The industry is dominated by multinational companies like Rio Tinto/Alcan (Australia, Canada), Rusal (Russia), Alcoa (US) and BHP Billiton (UK, Australia). The major activities of these companies are in the mining, refining and smelting sectors of the product chain, while ownership in downstream processing is much more dispersed.

In Suriname, Suralco has been active since 1916, while Billiton started operations after World War II. In the 1960s an integrated bauxite/aluminum industry was started up at Paranam (Suralco, 1996) and Suriname added alumina and aluminum to its export products. The industry made very good returns in the 1970s and Suriname decided to increase the taxes specifically for the bauxite industry from 30% to 39% (Suralco, 1996). The levy was discarded during the downturn of the alumina market in the 1980s as part of an effort to maintain the competitive position of the Surinamese bauxite industry.

In 1984 the BMS and Suralco signed a joint venture agreement based on a 45/55 split of the alumina industry (Suralco, 1996). The aluminum portion (hydro facility and Smelter) would remain 100% Suralco. The aim of the joint venture was to share in the Capital cost of developing the mining areas for the years to come, in a time of downturn in the aluminum market. The current capacity of the refinery is reflected in the performance of 2006 (2.15 Mtons) and 2007 (2.18 Mtons).

Bauxite Industry and Profit Retention

A comparison can be made between Suriname, Guyana and Jamaica with respect to the ownership structure in their respective bauxite industries and the effect on profit retention.

Suriname did not take part in the ownership, but relied mainly on taxes for profit retention purposes. One can make a case that Suriname missed out on income up to when the bauxite levy was introduced in the 1970s, but the country was able to attract investments for an integrated industry that was operational in 1965. Suriname increased the taxes in the 1970s to increase the level of profit retention, but discarded this in the 1980s during the recession of the aluminum market.

Guyana was the first country with a sizable bauxite industry in the Caribbean, but the industry went downhill after nationalization of the industry in the 1970s in an attempt to increase profit retention. Most operations did not survive the downturn in the 1980s and the alumina refinery is still not being operated today. The current bauxite production is quite low compared to Suriname and Jamaica given the fact that the reserves in Guyana are 50% higher than Suriname’s. One can argue that Guyana went too far in its attempt to improve profit retention, thus damaging the profit generation capacity of the industry.

Jamaica has by far the larger reserves of the 3 industries compared and has the most operations active. The government purchased control of both the mining and refining operations to increase its control over the strategic resource and increase profit retention of the industry. In addition a levy was introduced in the 1970s, which weakened the competitive position of the Jamaican operations. Jamaica was only able to attract capital investments in order to improve the operations efficiency until after the levy was suspended around the turn of the century. Compared to Suriname and Guyana, one can argue that a better path of profit retention was followed, but not without consequence. Suriname did not experience a shutdown of the mines or refinery in the 1980s, while the Jamaican output was significantly reduced. Jamaica was not able to attract expansion investment capital till after 2000, while Suriname was able to improve output since 1995.

Research Methodology

In order to answer the research questions, the financial performance of the Surinamese bauxite industry is compared to other companies operating in the global minerals market. A second comparison is done between the bauxite industry and Surinamese firms to derive performance characteristics for local firms. To enable a proper assessment of performance and due to availability of data, a period of 7 years was chosen from 2000 – 2006. Annual reports or equivalent numbers were used as input source.
The research samples

In order to get a reference point for good financial performance, the world market was assessed for companies in the mining and refining of base metals. The mining and refining market is being dominated by a number of multinationals of which most process several minerals (iron ore, oil, copper, gold, bauxite, etc.). The world alumina market was 74 Mtons in 2006, while the sample used represents about 28 Mton of alumina production in 2007.

In the Surinamese economy there are relatively few companies that publish financial statements. To enable the assessment of financial performance versus ownership structure, the companies that do publish financial statements were assessed, regardless of their type of industry. Due to the limited amount of publicly available financial statements of Surinamese companies, this sample is not a representative sample of the Surinamese company population. The results in this comparison will therefore mainly say something definite about the companies which are part of the sample, but can only give an indication with respect to the company population in the Surinamese economy.

Comparison Financial Performance

First the Surinamese bauxite industry is compared to the international companies to enable a conclusion on its performance compared to the main players in the world market. This is done by averaging the parameters defined in the chosen methodology (Omran et al., 2004) for the period 2000 – 2006. For this comparison the assumption is made that the USA Consumer Price Index can be used to account for inflation in the global market, since the major part of trade in base metals is denoted in US dollar currency. The means per company are compared to the Surinamese bauxite industry, using a 2-tailed t-test for a 95% confidence interval.

The procedure is repeated for a comparison between the Surinamese sample of firms and the Surinamese bauxite industry.

Calculations for the optimal form of ownership

The procedure chosen for this assessment is the net present value method, where an assumption is made on the applicable interest rate and necessary investments for Bakhuys bauxite exploitation. For the predicted future performance the ratios are used based on the gathered data for the different owners in the Surinamese economy. This assessment is done from the view point of the Surinamese economy, taking into account all capital flows that remain in the national economy, with the assumption that the profit generation capacity of the industry only changes when ownership increases beyond 50%. The assumptions for the net present value calculations are summarized in Table 1. Inherent to these assumptions is that a Surinamese entity has the capacity to handle the investment levels required. In addition the influence of swapping mining rights for part of ownership will be looked at, since this is quite common in similar cases.

Table 1: Assumptions for NPV Calculations

<table>
<thead>
<tr>
<th>Metric</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rate</td>
<td>10%</td>
</tr>
<tr>
<td>Capital Necessary for Bakhuys</td>
<td>USD 500,000,000 all in year 0</td>
</tr>
<tr>
<td>development.</td>
<td></td>
</tr>
<tr>
<td>Refinery/Mining Assets</td>
<td>USD 600,000,000; the possibility of swapping this for free bauxite mining</td>
</tr>
<tr>
<td></td>
<td>exists</td>
</tr>
<tr>
<td>Income Tax</td>
<td>36% for the assessed period</td>
</tr>
<tr>
<td>Sales</td>
<td>Constant for the assessed period</td>
</tr>
<tr>
<td></td>
<td>Average of the current Joint Venture performance 2000-2006</td>
</tr>
<tr>
<td>EBIT/Sales</td>
<td>Constant over the assessed period</td>
</tr>
<tr>
<td></td>
<td>only dependent on owner majority share</td>
</tr>
<tr>
<td></td>
<td>Average of the ratio of the sub samples assessed for 2000-2006</td>
</tr>
<tr>
<td>Annual Capital expenditures</td>
<td>Constant over the assessed period</td>
</tr>
<tr>
<td></td>
<td>only dependent on owner majority share</td>
</tr>
<tr>
<td></td>
<td>Average of the ratio of the sub samples assessed for 2000-2006</td>
</tr>
<tr>
<td>ratio of Capex/Sales</td>
<td></td>
</tr>
</tbody>
</table>

Results and Discussion

Comparison Sample Multinationals and Surinamese Bauxite Industry

The multinationals are of course much larger companies than the Surinamese bauxite industry, so some of the numbers are naturally many times higher than the bauxite industry (Sales, Profits, employees, etc.), that is why it is of importance to focus on the ratios. The Profitability comparison is shown in Figure 1. The ratio of EBIT and Sales of the Surinamese bauxite industry runs considerably higher than the average of the multinationals until 2005. The graphs in Fig. 1 and 2 summarize the trends of the ratio indicators for the Surinamese bauxite industry and the multinationals. In short the trends show that the Surinamese bauxite industry compares or exceeds (earlier years) the average of multinationals regarding profitability. This leads back to research question 2 in 1.3.2 referring to the comparison of the performance of the current joint venture to international performance measures. Hypothesis HQ-2 was drawn up to test this question. Given the results presented here the Hypothesis can be accepted.
Comparison Sample Surinamese Firms and Surinamese Bauxite Industry

In this comparison all numbers are being taken into account since this will be the basis for projecting the performance of different ownership structure in the Surinamese bauxite sector. In order to enable an overall indication, the average of the Surinamese sample will be used, even though it was stated earlier that this is not a representative sample.

The trends comparison in Figures 3 and 4 show most evident that the scale of the bauxite industry is a lot higher than the average of the Surinamese sample, which is evident in the comparison of Sales, Profits, Employment and Capital expenditures (Table 3). The ratios for profitability and operating efficiency are strongly in favor of the bauxite industry, while the ratio in capital expenditure is higher for the Surinamese sample. The Surinamese bauxite industry runs a lower leverage and risk than the average of the firms in the Surinamese sample, which is consistent with the observation in the comparison with multinationals.

NPV Projections for different ownership structures in the Surinamese Bauxite Industry

The information in table 4 summarizes the relevant ratios used in the NPV calculations.

NPV Calculations at constant sales

As mentioned earlier calculations were done for 2 cases:
1. All capital investment has to be paid for in cash, both for Bakhuys as for acquiring a stake in the current joint venture.
2. Only Capital for Bakhuys development has to be paid for in cash, the rest is traded for bauxite mining rights

First it needs to be said that the performance of the public or private Surinamese companies is such that they could not make a profit as the Surinamese ownership would increase beyond 50%. All the NPV calculations came back negative, mainly due to the high annual Capex to Sales ratio exhibited in the sub sample of private sector firms in Suriname. For a model with flat sales, capital expenditures at such a high rate are too heavy a burden. Therefore in the rest of this assessment, only Surinamese government ownership will be taken into account. The results for case 1 are presented in Figure 5 showing a steady decline of NPV.
for the Surinamese economy as ownership increases. Figure 6 shows the results of the NPV calculations for Case 2, in which the cash capital expenditures are lower for the Surinamese economy. The graph shows no clear sign of an optimal form of ownership, but government participation up to 45% yields just as good results as zero Surinamese ownership over a 25 year assessment period.

Table 3: Comparison Surinamese Bauxite Joint Venture and Surinamese Firms

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Current Joint Venture</th>
<th>Public Companies</th>
<th>Government Controlled</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Sales [USD]</td>
<td>379</td>
<td>379</td>
<td>379</td>
</tr>
<tr>
<td>EBIT/Sales</td>
<td>0.37</td>
<td>0.17</td>
<td>0.34</td>
</tr>
<tr>
<td>Acquiring Assets Current Joint Venture [USD]</td>
<td>600</td>
<td>600</td>
<td>600</td>
</tr>
<tr>
<td>Capex for Bakhuys development [USD]</td>
<td>500</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>Time period [yrs]</td>
<td>25</td>
<td>25</td>
<td>25</td>
</tr>
</tbody>
</table>

C - Confirmed = There is no significant difference between the 2 means
X = There is a significant difference between the 2 means

NPV Calculations with Sales growth

If an allowance is made to introduce sales growth into this model at the same rate as observed in 2000-2006 for the Surinamese bauxite industry the picture changes for case 2. Real Sales grows 50% over a 7 year period. If Case 1 and 2 are run, but for Sales with an annual growth rate of about 7%, the result for Case 1 doesn’t change significantly with respect to the optimum Surinamese ownership percentage, but Case 2 does show optimum returns at a significant Surinamese ownership level (Fig. 7).

With the NPV calculations using the performance measures of the different ownership forms for the Bakhuys bauxite deposit scenarios an answer can be formulated for research questions 1 and 3. These answers however are not absolute since the sample of the Surinamese firms is not considered to be representative, but will serve as the best estimate for the purpose of this research.

Table 4: NPV Calculation parameters

Research question 3 regards the comparison with international measures of the expected profit generation capacities and profit retention levels for the different types of ownership in the Surinamese bauxite industry. The results presented here give an answer to that question in the sense that for ownership structures based on the current joint venture, government ownership or a mixture of those 2 will result in benefits accruing to the Surinamese economy at or beyond international performance measures. This is not the case for ownership structure based on the Surinamese public companies.

Research question 1 regards the main question in this thesis, whether there is an optimum form of ownership for the Surinamese bauxite industry when it comes to returns to the Surinamese economy. A hypothesis H0.1 was drawn in order to test this, implying that the current joint venture ownership structure will reap the best benefits for the Surinamese economy. Given the results presented here, this hypothesis cannot be accepted, since it only holds for case 1.
The assessment of the Surinamese Bauxite industry with the foreign ownership joint venture shows that for the observed period 2000-2006 the profits retained in the Surinamese economy averages about 21.8 % of Sales. Of this 13.2% is from corporate income tax and 8.7% from annual capital investment. This a total of 59.7% of profits retained in the Surinamese economy.

**Profit Generation Capacity Comparison:**
The current joint venture active in the Surinamese bauxite industry performs at or beyond the observed financial performance of the sample of the multinationals. The results show no major difference in the comparisons with multinationals with a government controlled ownership or multinationals with public ownership when it comes to profit generation capacity.
The scale of firms in the Surinamese sample is of a far lower magnitude in all categories (profits, sales, capital expenditures, employment). The profit generation capacity of the firms in the Surinamese sample is significantly lower.

**Optimal ownership structure:**
For the model with constant Sales the returns are optimal for the Surinamese economy with the current joint venture structure, unless investment cost can be lowered by swapping bauxite mining rights. For the model assuming Sales growth at the rate observed in 2000-2006 there is an optimum in returns, at the maximum Surinamese participation at which the performance of the enterprise is not influenced. In this model this optimum was observed at 45-50% Surinamese ownership

Given all the separate conclusions, this research has shown that there is value in partaking in the ownership structure of the Surinamese Bauxite Industry for a Surinamese entity when it comes to improving returns for the Surinamese economy. The returns will only be improved from the current ownership structure under...
specific circumstances regarding the level of initial investment required and the expected growth of Sales.

The method chosen to assess the optimal form of ownership in this research can be used to determine the strategy when it comes to attracting foreign investment in Suriname and making decisions on predicted performance and returns. Both the current joint venture partners as well as the Surinamese government should consider the option of Surinamese part ownership for the Bakhuys deposit. The research has shown that it is not optimal without the current joint venture partners involved, but that there can be improved returns for the Surinamese economy under specific circumstances.

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http://www.mineralszone.com/minerals/auxite.html
A Location Specific Model to Determine the Benchmark Criteria for Mining Operations in Suriname: Factors that Influence the Ability to Mine Bauxite at a Competitive Cost per Ton

Dennis L. Brunings, FHR Institute for Social Studies, Suriname
David Dingli, Maastricht School of Management, The Netherlands
Arthur Sybrandy, Maastricht School of Management, The Netherlands

In today’s world the term “benchmarking” is widely used when talking about competitive performance. Companies often take to “benchmarking” to ensure that they remain competitive. Benchmarking as such does not determine whether the company’s position relative to the benchmark is good or bad; the latter depends on interpretation. Benchmarking in the mining industry entails operational benchmarking of processes. Therefore, the term “best in class” does not substitute for “being an appropriate benchmark,” because “best in class” refers to the best results, while appropriate benchmarks implement the “best processes.” Based on this distinction, this paper deals with the question of “how to set benchmarks” for the mining industry in Suriname. Utilizing field data a model was designed that allows companies in the mining industry to properly select and compare data from benchmarking partners in order to improve their performance. The model specifically allows the benchmarking company to analyze gaps between own and partners’ data, thus highlighting possible areas of improvement.

Introduction

The Bauxite mining industry in Suriname started 90 years ago and has always been one of the main generators of export income for the Suriname government. Technological development as well as recent upgrading of the refinery has led to Bauxite from West Suriname (300 km from Paramaribo) being attractive to process.

In the west of Suriname lies an enormous bauxite reserve. The challenges for mining this reserve are: One of the challenges is that to compete in the global arena the production cost must be kept at competitive levels.

As the mine is projected to be active for 30+ years, one must keep in mind other factors as well, such as, future mine planning, planning for labor and equipment, etc.

At this time, corporate management of the mining companies in Suriname sets targets based on the “best in class.” This results in targets for headcounts, overhead costs, equipment, and so on, independent of the environment in which the mines operate. It is argued that setting such individual targets without taking into account the whole picture of all influencing factors is not correct. Targets should be related to “best process,” taking the environment specifically into account.

Using the Brook Hunt “Bauxite and Alumina cost” database, a cost curve (see graph #1) of the mines located in the western world was generated and analyzed. Because of sensitivity the actual dollar values have been omitted. This graph clearly indicates that the Suriname mines (except for Coermotibo) are higher up the cost curve, which is not a good competitive position. They rank respectively 4, 11 and 15 out of 23. Analyzing the graph, it is obvious why the BHP Billiton’s Boddington (#2) operation, in Australia, is perceived by BHPB management as to be the “best in class.”

It is argued that the ultimate performance will be based on a combination of different targets that are set for the different departments. These targets do not necessarily each individually represent a “best in class,” but in the optimal combination lead to a benchmark mining performance with regard to cost per tonne bauxite mined. Support for this statement is presented later. The research presented here was conducted in the period September 2007 to March 2008. The outcome of this research is a model that will enable management to identify performance improvement opportunities and set the appropriate targets for the different processes (departments) in order to achieve an overall benchmark performance that should equal or surpass the production cost per ton of the Boddington mine.
Problem statement, research question, hypothesis and research objectives.

A problem that a multinational faces when operating a subsidiary in a country as Suriname is to determine what performance is achievable. Hence, the following problem definition:

*What are the factors that influence the ability to mine bauxite at a competitive cost per ton?*

Once these factors are known, it is key to know how their values rate against the same values in other, so-called “best in class” operations. This gives a reasonable indication as to what an achievable “KPI-level” is under the current circumstances, and, more importantly, which factors to focus on in order to improve the performance of the mining companies in Suriname. The resultant main research question therefore is:

*Which factors affecting the cost per ton bauxite mined are location specific?*

With an analysis of mining as the core business, performance of all other (none-core) cost contributors should become more visible, because they directly impact the core business. The hypothesis therefore is:

*Proper benchmarking of the mining industry in Suriname should focus on the core business processes, taking into account location specific factors, rather than “best in class” figures for the key cost contributors.*

To make proper business decisions it is imperative for management to make a sound and practical judgments of a mining operation’s capability and/or performance. Therefore the research objective is to:

*Design a model that takes into account location specific factors that influence the operation and allow for comparison to other locations for benchmarking purposes.*

The research methodology

The research methodology used is depicted in the flowchart.
Through literature study and interviews with a benchmarking expert (Tony Eltringham, Vice President Operating Excellence, BHPB Base Metals), “benchmarking” has been defined. Based on this definition a cost model was designed to get the right focus and to arrive at a hypothesis that was subsequently tested using Brook Hunt’s “Bauxite and Alumina Cost” database. After hypothesis proved to be correct, interviews where conducted with operations managers in order to determine the essential components for a location specific benchmark model. Subsequently the model was prepared. The whole process was then evaluated and recommendations were made on basis of the final model.

**Benchmarking**

The literature review and the interviews with a benchmarking expert led to the same basic conclusion: A benchmark in itself is meaningless unless it is put into context. Researchers classify benchmark models based on the processes that are benchmarked. All describe some forms of internal benchmarking and forms of external benchmarking. It is generally agreed that benchmarking is a process that starts with gaining knowledge of the own processes. Based on the evaluation of these processes, it is determined which benchmark partner to choose. Each author sums up various do’s and don’ts (limitations) for this determination, as he or she sees it. Despite different formulations the do’s can be summarized as:

- Prepare and implement a plan to close the gaps, and
- Benchmarking is a continuous process.

The limitations can be summarized as:

- Don’t imitate but try to understand what processes are needed to get the intended performance improvement,
- Focussing on the wrong KPI’s will lead to wrong results,
- Benchmarking can be used for the wrong reasons. Benchmarking is not to set KPI’s and targets,
- The company must be ready for benchmarking, and
- Data is perishable. Do not use outdated data for benchmarking purposes.

There are four benchmarking methods:

1. **Internal** (benchmark within a corporation, for example between business units)
2. **Competitive** (benchmark performance or processes with competitors)
3. **Functional** (benchmark similar processes within an industry)
4. **Generic** (comparing operations between unrelated industries)

This paper defines benchmarking as:

*The process of determining who has the best performance, who sets the standard, and what that standard is. This is done by a systematic*
comparison of organizational processes and performance to create new standards or to improve processes.

Benchmarking is an exercise that will confront the participants with observations or facts that are sometimes unsettling. The basis of benchmarking is the recognition that benchmarking will lead to uncovering of gaps between where we are and where we could be. This will then enable a company to direct its focus to closing those gaps and hence improve its performance.

The above will be used to prepare a model focusing on the mining core business while at the same time taking into account location specific aspects in such a way that it will facilitate the selection of benchmark partners. Upon selection of the benchmark partners, the model will also facilitate the decision making regarding which processes to benchmark.

**Cost model**

Because the ultimate indicator is the cost per ton mined, this research starts with the financial reports. As explained earlier, this will not be enough and therefore operational data will be used to explain, focus on, or draw attention to differences in the performance of the benchmark partners.

Analyzing cost reports reveals that the cost structures of mines differ. Therefore the cost per ton in and of itself cannot be benchmarked. Investigating the cost structure of the bauxite mines in Suriname allows for the following observations:

- One mine transports ore via the river to the Refinery in Paramaribo while the other mines use highway trucks to haul their ore.
- One mine is in a sensitive area and therefore has a separate line for Community services.
- Because of the remoteness one operation maintains a village and a hospital.

The above illustrates the main argument of this study: Comparing the cost per ton mined with the others is only valid if the location specific costs are taken into account. In other words, for example, what would be the cost of partners if they also had to do community service and maintain a village.

Analyzing cost reports of two of the Suriname mines (KG & KB) there is another issue that can be noted and that cannot be judged by the cost report alone (for confidentiality reasons the actual numbers have been omitted and instead the percentage difference was calculated using the real data, see table 1) Merely looking at the data presented, the conclusion may be drawn that KB has a lot of improvement opportunity and that management should focus on improving drainage. However, this study argues that such a conclusion is not valid, as the cost report does not allow sufficient insight into the location specific factors. Looking at location specific factors it may be noted that the KB mine is next to the river while the KG mine is 18 km more inland. The KB mine is below ground water level, while the KG mine is on higher ground. With this knowledge it is logical that KB has to spend more on drainage to keep the mine dry. Therefore, a benchmarking team might very well opt to exclude drainage cost when comparing the two mines. This doesn’t mean that the cost associated with drainage cannot be benchmarked. However, one must look for a suitable benchmark partner in order to do this.

<table>
<thead>
<tr>
<th>Difference between KB and KG cost as a percentage of KB cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bauxite ROM</td>
</tr>
<tr>
<td>Drainage</td>
</tr>
<tr>
<td>Stripping</td>
</tr>
<tr>
<td>Hauling</td>
</tr>
</tbody>
</table>

*(source: BMS cost report Dec 2007)*

A characteristic of benchmarking is that benchmarking does not have to be against one company. Benchmarking is done per area or activity against any other similar area or activity even if in different companies. Therefore the designed model will be more or less modular in order to facilitate this sectional comparison.

As will be discussed in the next section, a further problem is that the units of measurement used are often overlooked and this also can lead to wrong conclusions. Table 1 indicates that the comparison was made based on $/ROM data. One will note that KB is producing 19% less than KG. This may have an impact on the $/ROM for items that have a certain fixed cost associated with them. This will be further discussed in the next section.

Financial data is often very sensitive, difficult to come by, and often already manipulated. However, as has been discussed earlier, benchmarking should focus on processes and performances. Hence it is very useful when benchmarking that references are used that take into account the “operational” side.

**Determinants of BMS mining costs**

The finance department of BHPB Suriname was consulted. Based on a dissection of the cost reports of the various Suriname bauxite mines a cost model was designed, presented in model 2.
This model identifies three areas:

1. **The cost for mining (core business)**: Mine development & Mine preparation, Drill and Blast, Ore Lifting, Drainage & Stripping, Hauling, Crushing & Barge-loading, Mine Rehabilitation, Mine Preparation & Rehab, Remnants Mining & Wash-plant

2. **The cost for sustaining the core business**: Mobile Equipment Repair, Mechanical Maintenance, Electrical Maintenance, and Civil Maintenance

3. **The cost of support**: Mine General Administration, Medical, Human Resources, Security, HSE, Personnel Logistic, CSR & PR, Foundation, Finance & Controlling, Supplies & Logistic, ICS, Secretary, GSAP, and Transportation

---

**Model 1: Refined Cost model for mining in Suriname**

![Diagram of cost model for mining in Suriname]

Subsequently this paper argues that when benchmarking the mining industry the focus must be on the “core business” block. The reasoning is that processes and performances of all the other blocks will be reflected in the core processes of the “core business” block. Hence by investigating benchmarking gaps of the core business, if needed the surrounding blocks will automatically be addressed. This way the benchmarking focus can be kept as simple as possible.

Thus the hypothesis:

“**Proper benchmarking of the mining industry in Suriname should focus on the core business processes taking into account location specific factors instead of stating “best in class” figures for the key cost contributors.**”

**Test the hypothesis**

To test the hypothesis data from the Brook Hunt “Bauxite and Alumina cost” database was used (see graph 2). If Boddington as a whole were to be the benchmark, because of its ranking (cost per ton), then this paper argues that would not be a correct approach, because environment would not be taken into account. The graphs show that for “consumables” Boddington, KG and KB are about level, while for “R&M materials” KG and KB show far better results. If the four mines would be benchmark partners, then of benchmarking interest would be:

- For Diesel: Boddington
- For Labor: Boddington and KG
- For Consumables: Boddington, KG, KB
- For R&M materials: KG, KB
- For Services: CBO

By having benchmark partners the goal is to learn from each other’s strengths. So benchmarking should be a sharing of information.

Determining comparable bottlenecks alone is not enough. Knowledge of how they tie into the rest of the process is of the utmost importance. For example, in the mining industry blasting is an area that is often benchmarked, including the type of explosives used and the technique of the blasting itself. While investigating this process, it became clear that improvements were made while taking into account the next steps in the process, Ore-lifting and Hauling. As long as these steps were unaffected...
or improved, the “improvement” in blasting is considered a success. However if the bigger picture is taken into account and interlinks are being observed, then one will notice that blasting has a direct influence on the crushing. The coarser the blasted material the more expensive crushing gets. This means that the solution to a crusher “underperformance” may lie in changing the blasting technique. This is where the LSB model must assist managers with insight. The LSB model takes into account that performances are interlinked.

Graph 2: Brook Hunt “Bauxite and Alumina cost” database. Cost contributors curve

<table>
<thead>
<tr>
<th>Name</th>
<th>Diesel ($/t)</th>
<th>Labour ($/t)</th>
<th>Consumables ($/t)</th>
<th>R&amp;M Materials ($/t)</th>
<th>Services / Other ($/t)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Boddington</td>
<td>0.6</td>
<td>0.9</td>
<td>0.8</td>
<td>1.4</td>
<td>0.7</td>
</tr>
<tr>
<td>Kaaimangrasie</td>
<td>1.8</td>
<td>1.0</td>
<td>0.8</td>
<td>0.5</td>
<td>0.7</td>
</tr>
<tr>
<td>Klaverbad</td>
<td>2.5</td>
<td>2.0</td>
<td>0.8</td>
<td>0.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Moengo-Coermotibo</td>
<td>2.0</td>
<td>2.4</td>
<td>1.6</td>
<td>2.0</td>
<td>0.5</td>
</tr>
</tbody>
</table>

The inter-links mentioned above are very difficult to spot if one is not very familiar with the local circumstances. Therefore, workforce “buy-in” and appreciation for benchmarking are important, not only from supervisors, but also from operators and other front line staff. They are valuable when determining the proper benchmark parameters. For instance, if one assumes that the benchmark partner works 24hrs per day while in fact they only worked 21hrs per day. The 3 hours (13% of 24hrs) can lead to very wrong conclusions and deductions. The model presented gathers this type of data, which will enable Surinamese mines to properly gather and analyze data from benchmarking partners.

Interviews with operations management and model design

Benchmarking for the sake of benchmarking is a waste. Benchmarking must make a difference and must get the “buy-in” of the workforce. As mentioned earlier benchmarking is a process by which management is able to determine where there is room for performance improvement. The LSB-model designed in this study reveals “many” opportunities, and management will have to decide on prioritization.

Research for the LSB model focussed on the core business (stripping, drilling & blasting, ore lifting and hauling) and the main support and maintenance. Management has also been included in order to capture any management specific aspects. Information for LSB model design was gathered by interviewing the operational managers and supervisors. A major aim was to gather information related to the site-specific aspects of their jobs.

Management

Management plays a big role due to its decision making power, which directly influences the operations.
Interviews were conducted with P. Schultz, BMS operations manager and with M. Veira, BMS KG/KB mine manager.

The Mining strategy (e.g., Mine→Stockpile→Refine v. Mine→Refine) will determine the number of re-handling points. Also, stock-pile design may pose constraints.

It is obvious that if multiple mines are used this will make a difference in the overall performance. As many mines are often integrated with a refinery process, the LSB model should also determine how overhead costs are allocated.

Apparently workers morale is also of influence. Therefore absenteeism should be used as an indicator. Additionally it is also important to know what available facilities such as canteens, food, etc are available. Last but not least the shift system used will determine how many workable hours there are in a day.

Maintenance

Mr. V. Lodewijk, Mechanical Supervisor KG/KB mines, was interviewed regarding maintenance information. A key parameter for performance is the availability of equipment. One needs to clearly stipulate how to calculate this factor, as it may differ from other places. The LSB model uses availability that is calculated as the % of the available work time that the equipment was actually available for the workforce. The location specific factor in this is the shift lengths that are being run. The shift length will determine the workable time.

The LSB model also looks at the amount of planned maintenance and the amount of unplanned (breakdown) maintenance. This may reflect the effectiveness of the maintenance or the “harsh” conditions equipment works under.

Getting parts into Suriname is a challenging task. This will be reflected in the amount of spare parts that need to be purchased and kept on hand. As this influences the overall cost, the LSB model also takes into consideration the dollar value of the spare parts in stock and the average delivery time for non-stock (off-the-shelf) items.

Suriname has very little outsourcing capability and therefore BMS has to do most of the maintenance jobs in-house. The LSB model therefore takes into account the number of man-hours that are being outsourced.

Stripping

Mr. D. Narsing, Superintendent Stripping KG/KB mines, was interviewed to give insight into the stripping activities. The diesel fuel consumed by the equipment per volume stripped is considered, including the haul to the dump area. A shorter distance to the dump area therefore decreases the hauling cost. Performance is also determined by the equipment mix, such as excavator match to truck, which influences how easy it is to load the truck and how much time it takes. Another factor for measuring the performance of stripping is volume delivered to the dump area.

Stripping is extremely vulnerable to the weather. For Suriname rainfall would be a good measure but that does not compare well to places with snow or extreme droughts. Therefore the LSB model looks for workable days. This accounts for days lost due to weather, holidays, etc. This is another example of why understanding the collected data as well as the processes that produced that data need careful consideration. Finally, in stripping loading cost are sometimes charged separately. The LSB model also allows for this.

Drilling and Blasting

Mrs. A. Martodrono, foreman 2nd class drilling and blasting KG/KB mines, and Mr. R. Jackson, team leader drilling and blasting KG/KB mines, provided information regarding the drilling and blasting specifics. It appears that performance of this phase is, among other things, influenced by the shift structure and the weather. Further, for drilling one needs access to the drill area, which is very much location specific. Variables range from preparation of the area to the conditions of the ground, distances to be traveled, etc. It is apparent that other factors influencing this are number of holes to be drilled, the compression strength of the ore, the drill depth, and the water level in the holes. The LSB model looks at the average time needed to drill a hole—where timing starts with the initial order and ends when finalizing the hole—versus time available for drilling.

Blasting follows drilling. A key performance determinant for the blast crews is the amount of manual labor needed to load the holes and subsequently detonate the explosives. In Suriname the holes are loaded manually and to blast a 600m cable must be manually rolled out and checked. This will of course have an impact and the LSB model looks at the number of man-hours per hole needed to do a blast. Focusing on efficiency, the LSB model incorporates: powder factor (kg explosive/volume), Charge (kg explosives), and Stemming (m). Preparation time for explosive is based on type of explosives used and the subsequent preparation needed. While method of firing has a time effect, the number of misfires must also be taken into account. The latter is dependent on the blast explosive. Certain explosives may make detection of misfires very difficult and therefore the number of misfires must be carefully analyzed before being used as a benchmarking parameter.

Ore lifting

Mr. C. Peiter, supervisor KG mine, supplied the operational info related to ore lifting. Workable days are a key indicator of available time to perform. Also important...
is the influence of planning. To measure this, the LSB model looks at the planned volumes versus the actual volumes in the ground. The more accurate the planning, the smoother the operation, and hence the better the performance. This may mean that improving ore lifting comes down to improving planning. Thickness of ore body plays a role when considering that as the lowest part of ore body is reached, the crews move to the next spot. This means time delays relating mainly to construction of haul roads and movement of equipment.

**Hauling**

Last but not least is the hauling phase, where ore is hauled from the stock-pile to the refinery. At some mines ore may be hauled directly from the mine, also sometimes by other means, such as barging, conveyor systems, etc. Mr. H. Margaret, SEMC operations manager (hauling contractor), provided insight into the hauling issues. Most important is the cycle time in combination with hauling distance. A very location specific aspect in Suriname is that due to safety reasons trucks have certain times at which they do not drive (to allow employee busses to cross the haul roads). Speed limits often force trucks to reduce speed at intersections, bridges, etc. This is all included in the average speed.

Hauling cycle time is very important and is greatly determined by the average speed, which is dependent on Haul road design (width, type, max truck size, interaction) in combination with type of equipment. Also important is the Equipment mix on the haul road (interaction with other traffic).

Stockpile layout will determine the ease with which trucks can get loaded and start their haul. The more congested the longer the turnaround of a truck. Another possible location specific factor is percentage carry back. This is the amount of ore that remains in the tray after the truck has dumped into the crusher. The type of environment that trucks drive in may demand extra maintenance to vehicles, represented in the LSB model by hours of maintenance per ton ROM. Where shifts are not implemented 24/7 it is also good to look whether or not the “dead-time” is utilized. This can be done by, for instance, staggering the shifts of the maintenance and operations.

**Conclusion & recommendations**

Cost contributors can be grouped into Maintenance, Preparation, Support, Mine Closure, and Core Businesses. These contributors are being seen as the drivers of the mining cost. Therefore, proper benchmarking of the mining industry in Suriname should focus on the core business processes, taking into account location specific factors, rather than looking at “best in class” figures for the key cost contributors. Thus, location specific factors play an important role when assessing opportunities for performance improvement. Of equal importance is that identified opportunities must be seen in relation to the other parameters of the model, in order to determine the interlinks and influences on each other. The LSB model was reviewed by the BMS operational staff and has been well received. In general they approve this approach to the benchmarking philosophy.

It is recommended that BMS turns first to internal benchmarking. This will help BMS to better understand the benchmark process as well as “force” it to review its own processes before attempting external benchmarking.

The internal benchmarking exercise will be a good practical test and provide opportunity to adjust the model to become truly location specific to Suriname. It is also recommended that this model be used by the Bakhuys project team when designing the Bakhuys mine.

Apart from typical mining benchmark partners it is recommended to also look for partners outside the industry that have expertise in railroad and barging operations. This in view of the future Bakhuys mine operations.

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The Impact of Trade Liberalization on Poverty in the Poultry Sector in Suriname

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Arthur Sybrandy, Maastricht School of Management, The Netherlands

More than half of the Surinamese population lives in poverty. The government has not been effective in reducing the levels of poverty in recent years. Therefore it is necessary to approach poverty alleviation in a different manner. One approach is thru the private sector, by opening the economy to foreign trade and investment. One then has to study the effects of globalization and international trade agreements on various sectors in the economy. Furthermore, there is an ongoing debate about Suriname’s WTO commitments and their effects on the economy. This study looks at the poultry sector as a case study. Many aspects of international trade affect the local producers and consumers of poultry, both directly and indirectly, in both negative and positive ways. This paper discusses the effects of Suriname’s international trade commitments in this specific industry.

Introduction

It is argued that economic growth is a necessary condition for poverty alleviation, while a liberal trade regime is a prerequisite for sustainable economic growth. However, trade liberalization affects consumers and producers differently. While tariff reduction on imports may bring welfare gains to consumers, there would be many producers who are adversely affected by such trade policy reforms. Though the relationship between trade, growth, and poverty is the subject of contentious debate in the literature and in trade negotiations, there is little doubt that trade can be a powerful source for economic growth.

The question then arises how trade liberalization is linked to poverty. Trade can generate significant welfare gains by increasing allocative efficiency, raising capacity, achieving economies of scale in production, export orientation and an increase in the variety of products. Furthermore, there is also the possibility that trade liberalizations, by lowering tariffs and non-tariff barriers, reduces the relative price consumers pay for products, and thus increasing real wages (UNDP, 2003).

But this can theoretically also work the other way around and trade can impose hefty adjustment costs for exporters, consumers, and for the economy as a whole. There is a possibility that it may lead to increased inequality, when small producers are pushed out of the market and big concerns take over. There is evidence that economic growth creates wealth, with an attendant reduction of poverty.

Hence, this paper attempts to look at the impact of trade liberalization on poverty with a special focus on the poultry sector in Suriname. It examines whether the WTO liberalizations are a cause for poverty and aims to give trade policy recommendations to specifically address the trade and poverty issue. A potential model is presented for the relationship between trade and poverty for the Surinamese economy as a whole.

Trade, Growth and Poverty

After World War II, a general consensus arose that countries could bring about economic growth by lowering the barriers to trade. The General Agreement on Tariffs and Trade (GATT) of 1947 was established especially to achieve that goal. The GATT stayed in existence for almost fifty years, before being transformed into the WTO in 1995. A total 151 countries are members of the WTO nowadays.

It is possible that trade liberalization generates growth that is either anti- or pro-poor, based on redistribution effects (Berg and Kreuger, 2003). Most books of economics explain the rationale behind trade liberalization and the growth it will generate, and without doubt many believe it does (Perkins, 2001). There are strong reasons to assume that trade liberalization will benefit the poor at least as much as it benefits the average person. If, nonetheless, trade liberalization worsens the income distribution enough, then it is possible that it is not good for overall poverty reduction, despite its overall growth effects (Berg and Kreuger, 2003).

It might also be possible that trade liberalization forces developing countries to lower their tariff rates, and that the domestic industrial base of the developing country gets undermined. This might lead to joblessness as industries
shrink or even disappear with a total loss of income to its workers (UNDP, 2003).

**Causal Linkages Between Trade and Poverty**

The literature on trade and growth is vast. Economic principles like comparative advantage, development, openness, free trade, and many more support the dominant link between trade and growth (Pugel and Lindert, 2000). Yet, when discussing the negative aspects of trade liberalization, the literature is scarce and sometimes silent, as many people either do not see a link or do not accept a negative outcome of an increase in trade. To give a clear picture of the causality between trade and growth, it is necessary to also give the causality between trade and poverty.

The ambiguity arises partly because of the heterogeneity of poverty: there are many reasons why people are poor; and even within broadly defined groups there are huge differences in the circumstances of individual households. Simple statements about “the poor” will lose information, at best, and simply be wrong most of the time. An important aspect of any analysis of poverty is the definition and measurement of poverty itself. However, the majority of the empirical economic literature on poverty, especially in relation to the trade liberalization issue, adopts an absolute income or consumption metric.

Finally, it is worth emphasizing that our concern is with poverty, not inequality. Since trade liberalization tends to increase the opportunities for economic activity, it can very easily increase income inequality while at the same time reducing poverty. Consequently, statements about its effects on inequality cannot be translated directly into statements about its impact on absolute poverty. Certainly the evidence suggests that, with care, trade liberalization can be an important component of a “pro-poor” development strategy, according to Winters (2004).

There are strong reasons to believe that trade liberalization will benefit the poor. Trade liberalization tends to reduce consumer prices as competition increases. In developing countries it may be expected that opening up the market will increase the relative wage of low-skilled workers. On the other hand, trade liberalization might also worsen the income distribution, for example by adoption of skill-biased technical change in response to increased foreign competition (Berg and Kreuger, 2003). If trade liberalization worsens the income distribution and the fragile industrial base of developing countries, then it is quite possible that it is not a good tool for reducing poverty.

During the last decade there have been several attempts to measure the effects of trade policy on poverty. Some studies conclude that trade is beneficial to the poor since it brings about economic growth without modifying income distribution. Other studies investigate the change that trade policy causes on the income and the consumption patterns of the poor. The existing cross-country studies refer mainly to different trade liberalization experiences of developing countries during the last decades. Dollar and Kraay, two leading economists on this matter, conclude that greater openness results in poverty reduction (2004).

As figure 1 below suggests, nobody really knows the overall indirect effects of trade reform and its effects on poverty.

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**Figure 1: Uncertainty of the effects of trade liberalization**

<table>
<thead>
<tr>
<th>Trade Reform</th>
<th>Wage changes</th>
<th>Employment changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth (?)</td>
<td>Social Transfers</td>
<td>Informality</td>
</tr>
<tr>
<td>Poverty</td>
<td>Poverty</td>
<td>Changes in prices of consumption goods</td>
</tr>
</tbody>
</table>

The debate on trade liberalization and poverty is still an unsettled issue due to the lack of adequate measurements to quantify trade policy stances on poverty (Barraud, and Calfat, 2005). The impact of trade policy on the poor is channeled mainly through variations in relative prices of their consumption bundle and through changes in their sources of income in most studies. The study of the possible impact of policy measures on poverty can be modeled in two steps. First, by determining the effect of the trade liberalizations on the poultry sector in Suriname, and second its possible effect on the consumption pattern of the population.
Poverty is a multidimensional problem of which the causes are multiple, interacting factors at both the household and national levels. In addition to low income and lack of employment, which undermine consumption capabilities, other circumstances can also lead to an impoverished existence (Tammiletho, 2003). Some of these include lack of health care, social, cultural, and religious discrimination, lack of education, low standard of housing, and gender inequality, as women are poorer than men.

The above mentioned multidimensional causes of poverty can be exacerbated by another set of causes, which have their roots in the international playing field. First, some countries have accumulated large debts in the past, which today act as a heavy burden on the economy. Second, the unequal terms of trade between poor and rich countries enhances poverty in the poor countries. Third, due to the dominance of neo-liberal economics, globalization and liberalization of markets tend to distort the vulnerable industrial base of the poor countries. Finally, the dominance of the rich countries and the IFI’s, determine the terms under which aid is granted to poor countries. If a poor country is not in conformance with the structural adjustment programmes it cannot get the necessary aid to address poverty (De Wit, 2004).

A study was done in the Philippines on the vegetable and the poultry sectors. This study examined some aspects of the globalisation and liberalisation processes that affected rural producers. In particular it looked at the effects of trade liberalisation that were undertaken as part of the Philippines’ commitments under the WTO. The authors concluded that the liberalization of the import regime in the Philippines has led to increased imports of agricultural products into the country. The country utterly lacked knowledge of the WTO agreements. They recognized that a cost reduction did take place due to cheap and illegal imports and that the direct impact of liberalizations was job loss and income loss (Tauli-Corpuz, et al., 2006). In Suriname such a study has not yet been conducted.

**Poverty measurement in Suriname**

The Surinamese Government calculates poverty by using a Basic Food Package (BFP), which represents basic food needs and takes into account the nutrient content. The General Bureau of Statistics (ABS) calculates the poverty and poverty lines in Suriname.

The definition applied by the ABS reads as follows:

*A unit, person or household is considered poor if he/she/it does not have available sufficient means to provide for his/her/its basic needs, with a prominent role being played by the need for food. The amounts that (given the size and composition of the unit) indicate the distinction between poor and non-poor units are called poverty lines (ABS, 2001).*

Poor households spend almost 20% more on food than non-poor ones, as a share of total expenditure. The poor spend 60% of their total expenditure on food, as opposed to 42% by the non-poor. This result, which takes into account food items purchased as well as food consumed outside the house, is unsurprising, and is consistent with Engel’s law.

**Impact of Trade Liberalization: A Descriptive Analysis**

Trade liberalization was an essential component of the 1979 economic reform efforts in Suriname. In order to develop its own trade policy the young Republic joined the GATT in 1979 (GATT, 1979). The Surinamese government submitted a Schedule of Commitments, as to what import tariff rates Suriname would apply for different products. The tariff rates varied from 3% to 40%. Agricultural products were scheduled at an import tariff of 10%.

Several important changes in trade policy took place during the last decades. A major step was taken on 15 April 1994, when Suriname filed a new Schedule under the Uruguay Round of the GATT. Suriname now applies a 20% ceiling to all items included in Annex I of the Agreement on Agriculture of the GATT, which is applicable from 1995 onwards. This means that Suriname cannot apply higher tariffs rates for agricultural products than 20%, for WTO agreements are binding once signed. It is also important to mention that the Schedule of commitments of 1994 has an option to increase the import tariff by 30% (GATT, 1994). This means that Suriname can increase its import tariff on agricultural products under special conditions.

In 1995 the Surinamese government became a member of the WTO. Many people thought that this new global institute would lower the tariffs in the developed world on agricultural products and thus create valuable market access for the underdeveloped economies of the world, which predominantly produces agricultural products.

The WTO agreements are binding, which means that countries are committed to implement the agreements. In its Agreement on Agriculture, the WTO stipulates the lowering of the tariffs, rules and special safeguards as to how governments should treat agricultural products (GATT, 1994).

When the WTO Agreements were signed, the Surinamese government still applied 10% tariff on agricultural products as committed under the Schedule of 1979. This is in conformity with the rules of the WTO, which put the ceiling at 20% for agricultural products. By applying a lower rate, Suriname was well under the ceiling of 20%. Before joining the WTO, the import tariff applied by Suriname on broiler meat and meat products was 10%. So, before 1995, American and Brazilian poultry meat entered the economy with a 10% import tariff.
The next important change was the increase of the tariff rates on agricultural products by 10% in 2002, to 20%. This was done to protect domestic agricultural producers from foreign agricultural producers.

**Trade liberalization and the poultry sector**

For the poultry sector the trade policy and liberalization had several implications. First, the poultry sector could not be protected by the government through an increase of the tariff rates on imports beyond 20%. Second, the sector cannot be subsidized, as government subsidies are prohibited under the WTO. Third, according to the poultry sector, the WTO Agreements undermine its capacity to achieve economies of scale and effectively become competitive. The cheap imports from Brazil and the US do not give the sector the necessary time to develop. Finally, the poultry sector thinks the government has no idea what they are trying to achieve with the trade liberalizations and their dislocated trade policy. It also cannot comprehend why the government does so little to protect the industry. Meanwhile, the lobby of the poultry sector has been significantly influential, even to such an extent that the Ministry of Trade and Industry has sent a Notification to the WTO in 2003, which states that Suriname is interested in raising the import tariffs to 30% in order to protect the industry.

**Figure 2: Chicken Consumption**

![Chicken Consumption Chart](chart)

73% increase in 3 years (in MT)

Suriname is one of the major chicken consuming countries in the American hemisphere, where per capita consumption is over 40 kilograms (kg) per annum. It is above the average per capita intake of the Caribbean Community (CARICOM) of 39 kg, above the Free Trade Area of the Americas (FTAA) average of 26 kg and second only to the consumption in the United States, which is at 48 kg (Best, 2003). Poultry represents 90% of all meats consumed in Suriname. Domestic production satisfies 35% of the consumption in Suriname (APSS, 2001). About 3000 people work in the poultry sector, most on 18 large farms of which 70% are located in the district of Wanica.

The consumption of poultry meat is growing rapidly in Suriname. (Figure 2)

Yet, this growth is driven by cheap imports of poultry products from Brazil and the United States (Figure 3). Leg quarters from the US are sold below production cost. The production cost of whole birds in US is between $1.32 – 1.50US$/Kg and these are imported for $0.41 per kg. The Brazilian poultry products are being imported at $0.65/kg. The production costs of the Surinamese poultry sector are $1.55 (Ganpat, 2005).

**Figure 3: US/Brazilian Imports**

As a result the Suriname Poultry sector is in its decline, as can be seen in Figure 4. The domestic market share is decreasing and eventually it could mean that the sector could disappear.

This confirms the outcome of the study conducted in the Philippines, in which the author states that trade liberalization caused job loss and income loss (Tauli-Corpuz, et al., 2006). In the long run it could result, on the production side, in the terrible situation of 3000 people losing their job and livelihood and ending up unemployed and impoverished. The situation seems more distressing when production costs and tariffs applied by various poultry producing countries in the FTAA region are analyzed.

The price competitiveness of the Suriname poultry sector is rather significant compared to the FTAA and CARICOM. As Table 1 shows, Suriname produces poultry at third lowest production costs in the region, but does not have economies of scale. The situation becomes distressing when we look at the tariffs applied by other governments to protect their poultry sector, as shown by the next two tables (2 and 3).
To make the situation worse, the Surinamese government applies up to a 35% import tariff on products necessary for poultry production. The Surinamese poultry farmers pay between 2% and 35% on the import of chicken feed, cages, medicine, etc. According to the poultry sector, it would be received as a welcome trade policy if these tariffs were lowered, significantly decreasing the production costs per kg meat by $0.07 (Ganpat, 2005).

Table 1: Production costs in US$/KG

<table>
<thead>
<tr>
<th>Country</th>
<th>Cost ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barbados</td>
<td>$3.50</td>
</tr>
<tr>
<td>El Salvador</td>
<td>$2.25</td>
</tr>
<tr>
<td>Guatemala</td>
<td>$2.10</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>$2.05</td>
</tr>
<tr>
<td>Jamaica</td>
<td>$2.03</td>
</tr>
<tr>
<td>Belize</td>
<td>$2.00</td>
</tr>
<tr>
<td>Trinidad &amp; Tobago</td>
<td>$1.80</td>
</tr>
<tr>
<td>Mexico</td>
<td>$1.70</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>$1.65</td>
</tr>
<tr>
<td>Panama</td>
<td>$1.63</td>
</tr>
<tr>
<td>Honduras</td>
<td>$1.60</td>
</tr>
<tr>
<td><strong>Suriname</strong></td>
<td><strong>$1.55</strong></td>
</tr>
<tr>
<td>United States</td>
<td>$1.32</td>
</tr>
<tr>
<td>Brazil</td>
<td>$0.65</td>
</tr>
</tbody>
</table>

As shown in the tables, the governments of the region are reluctant to implement trade liberalizations in the poultry sector. They defend their sensitive industry by applying high tariffs. These countries also give their poultry sector tax holidays as incentives. The sectors are furthermore protected by the issuing of low interest loans for investments, and the provision of free land to expand the sectors to achieve economies of scale (Ganpat, 2005). In sum, there exist low tariffs on poultry meats and there are high tariffs on inputs. The sector is now in a phase that the production capacity is under-utilized. Besides, the government does not give any incentives to the sector.

Table 2: Defending A Sensitive Industry: On Leg Quarters - Normal Tariffs applied

<table>
<thead>
<tr>
<th>Country</th>
<th>Tariff Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Panama</td>
<td>239%</td>
</tr>
<tr>
<td>Jamaica</td>
<td>260%</td>
</tr>
<tr>
<td>Trinidad &amp; Tobago</td>
<td>131%</td>
</tr>
<tr>
<td>Belize</td>
<td>110%</td>
</tr>
<tr>
<td>Honduras</td>
<td>70%</td>
</tr>
<tr>
<td>USA</td>
<td>25%</td>
</tr>
<tr>
<td>Cuba</td>
<td>25%</td>
</tr>
<tr>
<td>Brazil</td>
<td>35%</td>
</tr>
<tr>
<td>Mercosur</td>
<td>25%</td>
</tr>
<tr>
<td><strong>Suriname</strong></td>
<td><strong>20%</strong></td>
</tr>
</tbody>
</table>

Table 3: Defending A Sensitive Industry: Tariff Rate Quota Systems: Bone in Cuts

<table>
<thead>
<tr>
<th>Country</th>
<th>Tariff Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>271%</td>
</tr>
<tr>
<td>Barbados</td>
<td>204%</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>154%</td>
</tr>
<tr>
<td>El Salvador</td>
<td>176%</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>170%</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>99%</td>
</tr>
<tr>
<td>Guatemala</td>
<td>45%</td>
</tr>
<tr>
<td><strong>Suriname</strong></td>
<td><strong>20%</strong></td>
</tr>
</tbody>
</table>

Trade liberalization and Effects on Poverty

There is general consensus within the agricultural sector that rural employment could increase if Suriname moves toward increasing the tariff rates from 20% to 50%. The Schedule of Commitments of Suriname has an option to increase the tariff by 30%. This increase is only possible if Suriname renegotiates its tariffs at the WTO. This does not seem far-fetched. Grenada, a member of the CARICOM, renegotiated its tariffs in 2003 and the WTO concluded that the country may apply a 100% tariff on agricultural products to protect its small agricultural sector. Suriname could also renegotiate the tariffs and emphasize food security, livelihoods of people, and the protein intake the poultry sector provides. If the WTO members would approve these findings, the 30% increase could have the following effects on the production side.

According to the poultry sector, employment would increase with 6000 people. For the poultry sector this would mean an increase of labour between 200 and 400 people...
Foreign exchange savings would increase if the agricultural sector would increase its output and exports would increase. The poultry sector believes that the competition would increase and that fairer consumer prices would be achieved (Note that this is the industry’s argument, which is not necessarily supported by theory and research). Larger volumes will allow for economies of scale, lower prices, and more local output. Trade in CARICOM, especially with Guyana, Trinidad, and Tobago, would create new competition to keep prices in check. The higher tariffs would greatly improve government revenue, which can be used for combating poverty.

The Surinamese poultry sector acknowledges that a sudden increase of the import tariffs could also have negative effects on their industries. Although they would favor an increase, they also recognize that if production does not increase, the imports would continue. The Association Poultry Farmers therefore suggests that the government increases the import tariff over a period of 8 years to accommodate their production capacity (APSS, 2001). Increased tariffs will, of course, also have negative impact on consumers.

The Model

The model assumes that the household is the unit of analysis. The total income of the household is taken as the sum of own production and wage employment. The income from own production and wage employment can be identified as the product of a set of prices and a set of quantities. This model assumes that in the short run, households cannot change their activities in response to changes in prices. A first approximation to the change in their income resulting from a price change of poultry products can be formulated. Therefore, a change in the costs associated with a price change will have a poverty analyzing effect (Jayanetti and Tilakaratna, 2005).

According to the model, the impact of a price change of a particular good on welfare of the household will depend on the relative importance of the good concerned as a source of nutrition to the household and its importance in the household consumption basket. For example, if the price of a good (e.g., poultry products) increases, then the producers of poultry products will benefit while consumers (population of Suriname) will lose.

To analyze this, first, we have to look at the contribution to household income from different income sources and the household expenditure shares for different consumption items. As stated earlier, poultry products are an important source of nutrition and protein intake for the Surinamese population. Based on the fact that consumption of poultry is increasing and that the price per kilogram is low, due to cheap imports, one can conclude that trade liberalization decreases poverty as a share of the consumption basket per household (as the price for poultry products is low).

Based on the assumption that import tariffs were to increase by 30% due to protectionism, one can assume that this would lead to an increase in price. More than 65% of the imports on poultry would then be taxed by the higher tariffs. The increase in price would result in a higher share of the income being absorbed by the consumption of poultry. This would lead to an increase of poverty. If one assumes that the Surinamese government decides to renegotiate its import tariff for the Agreements in Agriculture at the WTO for an increase of 30%, the increase would affect all agricultural products and not only poultry products. The entire basic food basket would increase, because the 30% increase of tariffs would in the long run affect all agricultural products being imported, from grain to milk, etc. This would further increase poverty.

One can calculate the poverty effects of trade liberalization and protectionism by calculating the price changes it has on the products in the basic food basket. If one could know which products are part of the basic food basket. Unfortunately, the ABS does not give the content of the BFP. This is considered a real constraint for this study, for the trade liberalization effects on poverty cannot be accurately calculated, for now!

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<table>
<thead>
<tr>
<th>Trade liberalization</th>
<th>Growth</th>
<th>Competition</th>
<th>Prices of consumption goods</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Poverty</td>
<td>Poverty</td>
<td>Poverty</td>
</tr>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
<td></td>
</tr>
</tbody>
</table>
In this figure numerals are placed and read as follows:
1. Trade liberalization leads to economic growth. Suriname has shown steady economic growth since 2001. This is mainly due to high commodity prices. Yet poverty is increasing, as the figures from the ABS show. Thus, there is a significant unequal distribution of wealth.
2. Trade liberalization by reducing tariffs on industry outputs ensures fierce competition, which causes the poultry sector and the people working in that sector job loss, income loss and degradation of their livelihood. This increases poverty. Reducing tariffs on inputs is likely to reduce poverty.
3. Trade liberalization reduces the prices of consumption goods. This implies that poultry products become cheaper and people spend less of their income on poultry meat, thus increasing real income of the population at large. This has a poverty reducing effect.

Policy Recommendations

Policy recommendations must be given to prevent two disasters. First, the poultry sector must be stimulated to compete, because of its strategic value to the food security, livelihoods, nutrition and protein intake of the population, and second to prevent the incidence of protectionism. In addition, there are a number of complementary policies that the Ministry and government could follow to increase the productivity of the poultry sector, reduce inefficiencies, and improve market conditions, infrastructure facilities and institutions. These policies would help the poultry producers to reduce their costs and improve the quality of their products, which in turn would help them cope with international competition. These are also, in fact, the main goals of the Ministry of Trade and Industry: to facilitate the business community and to enhance the international competitiveness of the country.

First, the poultry sector identified that they can reduce production costs if the government reduces the import tariff of 35% applied on the products necessary for production for the sector. So, in fact to facilitate the poultry sector, policy can be made to remove this obstacle to production. This would decrease production costs by $0.07 per kg.

Second, some policies that could help improve productivity and reduce inefficiencies in the poultry sector include: promoting research and development, with cooperation of the University of Suriname, issuing land to the sector for the production of feed, improving market facilities, modernizing the different branches within the sector, improving storage facilities, and improving transportation facilities.

Third, the policy needs to facilitate the sector in getting loans necessary for investments. The banking sector, the Ministry of Finance, and the government in general can also create credit schemes, as applied in other countries, that would help the producers to better cope with any uncertainties caused by trade policy reform and to improve efficiency within the sector. Furthermore these loans might be provided against low interest rates.

Fourth, policy can be developed to reduce transactions costs by combining and concentrating the different poultry producers. As 70% of the poultry farmers are located in the district of Wanica, economies of scale can be a possibility. If the government is willing to facilitate the sector it is quite possible that economies of scale could be achieved, also because the sector is producing at a capacity of 40%.

Fifth, renegotiation of the bound rates at the WTO is a process that can be time consuming. In other words, it is a long-term process, while the incentives and policy recommendations mentioned above can be implemented immediately, government willing of course. Again, renegotiation is not a wise policy option.

Finally, mention need to be made of the fact that protectionism is not appreciated by the rest of the world. It invokes reciprocity, as others will counter your policy. It further constrains and distorts trade. Furthermore, in the very long run these protective measures have to go, as globalization/WTO demands from us all.

Conclusion

In this paper, an attempt was made to analyze the impact of trade liberalization on poverty, with special reference to the poultry sector in Suriname. The results of the analytical model showed the effect of trade liberalization on the poultry sector and showed that the industry is not yet able to compete with foreign cheap poultry imports. The devastating result of liberalizations might be a complete disappearance of the sector from the Surinamese economy in the long run, thus eventually leading to job-loss, lost livelihoods, and lost incomes, which will have a poverty increasing effect. Reasoned this way, one can say that trade liberalization undermines the domestic poultry sector in Suriname and thus causes poverty levels to rise.

However, this paper also attempted to show that trade liberalization can generate positive welfare effects and reduce poverty. The extent of welfare gain from tariff reduction on agricultural products and especially poultry products finds its form in price reductions and resultant rises in real incomes of consumers. As Suriname consumes 90% of all meats in the form of poultry the effects might be significant. Further, the poorer households will spend a relatively larger share of their expenditure on poultry, as the consumption is rising. Hence, a price reduction on poultry as a result of trade liberalization would bring a relatively larger benefit to poor groups.
It is crucial for the economy and for poverty alleviation that the government takes necessary action to mitigate the adverse effects of trade liberalization on certain segments of the economy. In the long term it is quite possible that the poultry sector disappears. This would mean that the jobs in that sector would disappear, as would the contribution of the sector to GDP. This of course has a poverty increasing effect in the short term, as 3000 people would lose their job and would need alternate employment, thus leading to a situation in which rural poverty increases for the district of Wanica, were 70% of the poultry farmers are located.

The poultry sector clearly identified that they would favor a trade policy of increasing the import tariff to save their decaying industry. Such an increase would clearly come at the expense of the consumers. Given the current situation, there seems to be general consensus in the Ministry of Trade and Industry that Suriname should renegotiate its bound rates for poultry products at the WTO. In fact, a notification was already dispatched to the WTO in 2003.

This paper tried to give a picture about what the effects of higher import tariffs would be on the poultry sector, consumers, and the entire economy. This was done by developing a model that unfortunately could not be fully quantified due to the current lack of data.

This paper stressed the vivid possibility that protectionism can have a price increasing effect, as shown by the model. One can imagine that one does not renegotiate the bound rates of a single product. If that would be the case, than surely the US and Brazil would object to the increase of tariffs in a market of which they both hold 60%. If one renegotiates the bound rates, than one would do that for an entire agreement, like the Agreement on Agriculture of the WTO. This form of protectionism would increase price levels on all agricultural products. The assumption was made and underpinned by the model in chapter 4, that protectionism increases the prices of products. Thus, there would be an increase in the prices of different agricultural products, to the effect that more imported goods and especially foodstuffs would be taxed. The increase of price levels for more products than solely poultry in the BFP of Suriname will have a poverty increasing for 500.000 people. If such a situation would occur, it is necessary to further develop the model.

References

ABS (2001), Poverty lines and Poverty in Suriname. Paramaribo
This study presents a profile of earnings warning able to distinguish between a strong bank and a weak bank. In the natural yearning of liquidity market players to identify bank financial characteristics that differentiate a healthy bank from the sick, bank reported earnings deliver surprising set of discriminating profile that prove useful. They are intermediation spread, rate of return and overhead burden and they successfully shape the outlook of earnings that could have classified Nigerian bank health in the distress era (1990 – 1995). Transmitting through financial statements, they suggest signals of problem banking in Nigeria around risk efficiency (also reflecting market power), profitability and burden.

Introduction

Problem banking poses serious and recurring challenges to global financial system. The Asian crises and the Argentinean crises of the recent past readily come to mind. Both the developed and the emerging markets have had their share of banking crises in one form or another. Recent cases are the Northern Rock run of Britain and the sub-prime mortgage lending binge of the United States of America. These episodes are grim reminders of the spate of distress in the Nigerian banking arena in the 1990s. Beck, Cull and Afeikhena (2005) note the year 1995 as a high point of the banking crisis in Nigeria with banking problem up to 1995 still receiving attention by 2005. It shows that the risk of banks becoming distressed not discerned early enough would worsen and protract. A challenge is that some factors known through theory to be critical causative factors for bank distress hide at country and macro-economic levels and therefore, allow uncertainty to fester upon them to promote instability. Their effects compel the need to examine whether lagged bank fundamentals gleaned from financial statements offer factors useful in predicting bank probability of failure ex-ante. Can shocks that shake depositors’ and market confidence transmit through bank financial statements and send adverse concerns to market watchers to trigger denial of liquidity support? If so, liquidity problem turns into solvency shock (Diamond & Divbig, 1983; Lai, 2002). What then are the critical concerns transmitted from bank financial statements, which prove useful in classifying bank financial condition?

In the natural yearning of the liquidity market to identify bank financial characteristics that differentiate a healthy bank from a sick bank, information asymmetry beclouds the set of financial variables to watch. Literature suggests some factors that account for bank failures across the globe, but the predominant factors vary from study to study, depending on the country being studied. Curiously, not much has been written about bank failures in Africa. In particular, there is dearth of literature about the specific case of Nigeria. In our experience, this black box is mainly attributable to absence of research data due to policy of secrecy of the regulatory authorities. Although data on bank failure may not be readily available in Nigeria at the public domain, at least bank financial statements are not scarce. In this study, we examine bank financial statements to see whether they prove useful in suggesting factors that influenced the bank failure case of Nigeria in the 1990s.

Seriousness of the Distress Phenomena in Nigerian Banking

In the 1990s, bank distress was deep enough in Nigeria to reduce the number of solvent banks from 120 in 1993 to about 50 by the close of 1995 (50% decline) (See Table 1). However, the exact health conditions of banks were not apparent to depositors until the banks became overtly distressed. Critically, published accounts of banks were at the public domain. What appeared lacking was ability to glean useful factors from the published financial reports to predict bank health condition at the time. As a result, the debacle dragged up to the close of 2005 when minimum capital requirement of N25billion ($195 million) was imposed on banks to force closure through consolidations in mergers and acquisitions (Jato, 2001), effectively reducing the number of banks from 120 banks in 1993 to 25 mega banks by 2006. Critically, the factors compelling closure of banks require clear understanding and plugging to prevent the emergent big banks from turning into big bags with holes.
Table 1. Magnitude of Problem Banking

<table>
<thead>
<tr>
<th></th>
<th>1995</th>
<th>1994</th>
<th>1993</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of licensed banks as at 31 December 1993</td>
<td>120</td>
<td>120</td>
<td>120</td>
</tr>
<tr>
<td>Less: No. of (distressed) banks in liquidation</td>
<td>5</td>
<td>4</td>
<td>Nil</td>
</tr>
<tr>
<td>Current number of licensed banks</td>
<td>115</td>
<td>116</td>
<td>120</td>
</tr>
<tr>
<td>Less: No. of distressed banks acquired by the CBN</td>
<td>12</td>
<td>6</td>
<td>Nil</td>
</tr>
<tr>
<td>Less: Other financially distressed (or potentially distressed banks)</td>
<td>43</td>
<td>45</td>
<td>28</td>
</tr>
<tr>
<td>Total number of distressed banks</td>
<td>60</td>
<td>55</td>
<td>28</td>
</tr>
<tr>
<td>No. of solvent banks</td>
<td>60</td>
<td>65</td>
<td>93</td>
</tr>
<tr>
<td>Less number of banks unable to produce accounts</td>
<td>10</td>
<td>13</td>
<td>37</td>
</tr>
<tr>
<td>No. of banks included in survey</td>
<td>50</td>
<td>52</td>
<td>56</td>
</tr>
</tbody>
</table>

(Source: Agusto & Co. 1996 - Analysis of Industry Coverage)

The Problem

Since financial statements serve a major source of information for bank credit rating, it is useful to evaluate what signals they send. Specifically, can shocks that shake depositors’ and market confidence transmit through bank financial statements and send adverse concerns to market watchers to trigger denial of liquidity support? If so, liquidity problem turns into solvency shock (Diamond and Dybvig, 1983). This is the root of individual bank liquidity shock. Due to intrinsic fragility, banks experience illiquidity and are, therefore, subject to failure (Olorunshola, 2004). Banks, weak or strong, face liquidity risk - failing to meet its short-term obligations as they fall due (Wimboh, 2004), and at a reasonable cost (Gilbert, Meyer & Vaughan, 2002), due to bank fragility (Vij, 2005), which may lead to loss of depositor’s confidence and hence, run (Lai, 2002). However, liquidity market exists to bail out a bank in need of cash, but may fail in a bid to do so due to credit risk concerns. In particular, the inter-bank market and the deposit market that banks rely on might fail to provide the liquidity that the bank needs thereby turning a liquidity problem into a solvency problem (Lai, 2002).

Conceptual framework

Fragility is in the nature of banking (Diamond & Rajan, 2001), (Santomero, 1996), (Bektas, 2006). Acceptance of deposits for short period and supplying loans to customers for longer periods is the source of bank fragility (Bektas, 2006), characterized as loan-deposit maturity mismatch (Diamond & Dybvig, 1983). This is the root of individual bank liquidity shock. Due to intrinsic fragility, banks experience illiquidity and are, therefore, subject to failure (Olorunshola, 2004). Banks, weak or strong, face liquidity risk - failing to meet its short-term obligations as they fall due (Wimboh, 2004), and at a reasonable cost (Gilbert, Meyer & Vaughan, 2002), due to bank fragility (Vij, 2005), which may lead to loss of depositor’s confidence and hence, run (Lai, 2002). However, liquidity market exists to bail out a bank in need of cash, but may fail in a bid to do so due to credit risk concerns. In particular, the inter-bank market and the deposit market that banks rely on might fail to provide the liquidity that the bank needs thereby turning a liquidity problem into a solvency problem (Lai, 2002).

Nature and Dimensions of Bank liquidity Market Failure

Theory blames crisis initiation on market failure in providing liquidity. In particular, the inter-bank market and the deposit market may fail to provide liquidity to a bank in need where there is liquidity crunch and low assets cover (Lai, 2002). Bank liquidity is, therefore, vulnerable since fragility is inherent in banking (Santomero, 1996) as exemplified in credit to deposits ratio (Bektas, 2006). Fluctuating government dependent deposits compound the Nigerian case (Siddiqi, 2005). The risk here is that government deposit is not stable and fluctuates with oil prices. The mix between loan and deposit thus returns positive relationship between bank fragility and bank failure.

Asset Side Liquidity Problem. The drying of liquidity in the market place raise inter-bank credit standard (Allen and Gale, 2000). Hence, a desperate bank might end up selling assets at below fair value and create gap in the liquidity market structure. In particular, insolvent banks weaker in inter-bank sharing (Alger 1999) are compelled to lend to keep alive, but are not necessarily able to attract liquidity due to credit risk. It means that the weaker the bank fundamentals the higher the distress due to loss of confidence.
Liability Side Liquidity Problem. In the case of self-fulfilling bank run (Diamond and Dybvig, 1983) information asymmetry induce fragility from bank use of demand deposits to create liquidity in an otherwise illiquid state. Run results from this fragility in a self-fulfilling manner since delay to run may lead to loss. This claim contrasts with the assets side view that a run occurs because of shrinkage in bank’s assets (Lai, 2002).

Both theories go a long way in explaining bank vulnerability to fragility. However, they leave one in doubt about the exact factors that propel the decision to run. What do depositors observe in a bank directly or indirectly to initiate a run? Are these signals observable in bank fundamentals? Several issues are implied. First, if the risk is rife that deposit may be threatened, how do depositors and market players come to that conclusion? Second, with what certainty do they observe problem banking? Might they be wrong in suspecting a problem bank to be healthy or a healthy bank to be problematic? How might the classification of banks in their health categories reduce errors of misclassification? Whether bank failure is an asset side problem or liability driven, its extent might be widespread and should be observable in publicly available bank level data, ex-ante. It is, therefore, critical to conceptualise the concerns that liquidity market would observe about a bank in need to deny liquidity support.

CAMELS theory offers some clue of bank risks reflecting in six bank fundamentals of capital protection (C), asset quality (A), management competence (M), earnings strength (E), liquidity risk exposure (L), and market risk sensitivity (S), denoted by the acronym (CAMELS) (Peek & Rosengren, 1996). A close look at CAMELS would underscore the nature of bank risk in four possible outcomes - safe (low risk) and sound (high return); unsafe (high risk) and sound (high return); safe (low risk) but unsound (low return); unsafe (high risk) and unsound (low return) (Gilbert et al, 2002). These risk-returns transmissions provoke concerns to constrain liquidity market support and may compel supervisory interventions. The insight interprets CAMELS framework to represent examiners’ perception of the interaction between bank safety and soundness in the sense of bank risk and performance outcome consistent with risk.

Critically, the CAMELS framework faces problematic measurements due to its complexities. For example, how do you measure the management factor? In addition, measurements within Basel II bank regulatory capital, which attempts to capture behavioral implications of operational risks, present worries (Wahlström, 2006). Furthermore, such framework is artificial to the true decision dynamics in the liquidity marketplace. Players in the liquidity market either as depositors or in the inter-bank market relate with bank financial statements in their daily dealings, rather than employing CAMELS models. Whereas the CAMELS models usefully suggest important factors in bank health ex-post, decisions of analysts and players respond mainly on the basis of perceptions within financial statements themselves ex-ante. It is, therefore, conceivable to evolve simple models that reflect the reality of how bank health perceptions happen. Since CAMEL interprets as risk and its consistency with earnings, a possible clue to bank health identification would be a set of earnings variables that can achieve high classification rate in discriminating among bank health categories. However, which particular earnings variables to watch may prove murky due to multicollinearity. What then, is a viable set of earnings discriminating variables?

The use of earning variable to signal bank health may, however, generate concerns among market participants about the degree of confidence that can be reposed on published financial statements due to fraud (Rezaee, 2005), especially profit manipulation practices (Lambert & Sponem, 2005), exemplified by information asymmetry and opportunistic behaviour of agents as in Enron (Arnold & Lange, 2004). Cullinan (2004) cites Andersen's deficiency in the Enron case around audit process breakdown. These cast doubt on the significance of accounting reports in detecting delusional complexes of agents and the risks associated with their win-at-all-costs tendencies (Craig & Amernic, 2004). In particular, strictly numerical earnings measures may not necessarily be reliable guide to rationality of corporate governance (Marnet, 2007), since creative accounting may mask poor performance (Hooper & Kearins, 2007). Baker and Hayes, (2004) cite the exploitation of legal form to obscure economic substance underlying transactions to demonstrate how Enron used (1) off-balance-sheet financing; (2) revenue recognition; and (3) financial statement disclosures to conceal a more realistic view of the company’s financial position and performance.

Though confidence concerns about financial statements are real, our comfort, in the specific case of earnings, is that optimistic reporting of bank profit in financial statements offers hope for robust bank failure models based on them. If reported earnings appear rosier than real, it should prove more difficult in detecting weak banks. As such, a set of earnings variables that breaks the ice to successfully differentiate a weak bank from a strong bank, in spite of the rosier picture painted by financial statements, raises hope. The challenge, therefore, reduces to gleaning from publicly available bank financial reports a set of performance variables useful in classifying bank financial condition. The emphasis on publicly available data is because bank supervisory agencies consider bank health data confidential and out of the reach of liquidity market players. Critically,
these unavailable data constitute the basis of the CAMELS framework, meaning frustration in practical use. We, therefore, propose an ‘earnings warning’ conceptual framework (See Fig 1). It suggests that earnings warnings transmit through intermediation risk efficiency, burden and profitability to classify bank health successfully.

**Fig. 1 Bank Financial Risk within CAMELS framework**

(Source: Researchers’ design)

**Hypothesis**

Transmissions of risk efficiency, burden and profitability classify bank health better than chance.

**Methodology**

The study strategy is quantitative. The major data comes from the financial statements of banks covering the period 1990-1995. This period witnessed major reformation of the landscape of Nigerian banking. It saw the birth of new generation banks and the death of many banks. It was a period of deregulation of banking in Nigeria. Most banks that became distressed were born during this period. The choice of the period 1990-1995 was for two major reasons. First, it offers a unique opportunity to trace most sampled banks from birth to death. It thus presents great diagnostic value. Secondly, the period promises availability of adequate financial reports for sampled banks. Most sampled banks would not have been born before the period. In addition, the banks that died or became distressed would not have filed financial returns up to date. Our interest is in subjecting all banks in the sample to same playing field. We believe that there is no significant difference between distress of banks in the 1990s and the period leading up to merger in 2006, being the last episode of distress in Nigerian banking (Beck, Cull & Afeikhena 2005). Later years were merely resolving problem banking originating from this period. The list of closed banks published by the Nigerian Deposit Insurance Corporation (NDIC) in 2006 feature more or less the same problem banks of the 1990-1995 eras. This means that for purposes of comparison, current financials of surviving banks may not have matched the old accounts of the banks in distress prior to failure if we were to situate the study in a more recent period. One primary goal of this study is to explain the failure of banks in spite of the success of others. This compels comparison of banks in the same era as the episode.

Company level data is one of the most general methods of assessing factors that have implication for health. Banking regulations require banks in Nigeria to file audited accounts with the Central Bank of Nigeria (CBN) and the Nigerian Deposit Insurance Corporation (NDIC). These government agencies maintain copies of the filed accounts. These accounts serve as sources of financial ratios that are gainfully analysed alongside data from the industry survey of bank analysts such as Agusto & Co. for the relevant years. Gratefully, the bank industry surveys by Agusto & Co (1991-1996) provide a rich collection of bank ratios, derived from the same financial statements. They also report the rating history of all the commercial and merchant banks for the relevant periods (Agusto, 1996). We corroborate this rating with reported list of distressed banks published by the Nigerian Deposit Insurance Corporation (NDIC) and opinions of other analysts. We resolve discrepancies in favour of known cases as reported by NDIC and otherwise, the average opinion of analysts. On this basis, we group bank health for each year into weak, normal and strong and match bank health for each year with corresponding bank level data for the previous year. Banks rated by analysts as unsound (mainly the risk rating of 5 and 6 under the Agusto scale) correspond to the official list of distressed banks as published by the Nigerian Deposit Insurance Corporation and were grouped as weak. Those rated by analysts as sound (mainly the risk rating of 1 and 2 under the Agusto scale) were grouped as strong. The rest were the normal banks. The resulting matched bank-health-year constitutes our unit of analysis and represents individual cases of bank health for any given year.

**Data and Analysis**

The population for this study is health-year cases of all rated commercial and merchant banks operating in Nigeria during 1990-1995 based on the opinions of analysts and industry watchers. From a population of 684 health years observable for the period 1990-1995, the study selects bank financial statement data that predict bank health one year later. Banks that become distressed subsequently drop out of sample since they cease to file accounts up to date (Agusto & Co, 1996). Moreover, banks that were born within the period would lack full financials for the entire period. As a result, health-years for which matching data is available provide practical means of attaching bank health to the fundamentals that drive them and therefore, constitute the sample size of 409 bank health year cases (See Table 2).
Table 2. Bank Health Years

<table>
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<tr>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Weak banks</td>
<td>120</td>
<td>1</td>
<td>20</td>
<td>39</td>
<td>13</td>
<td>18</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Normal banks</td>
<td>230</td>
<td>5</td>
<td>76</td>
<td>23</td>
<td>30</td>
<td>23</td>
<td>26</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Strong banks</td>
<td>59</td>
<td>6</td>
<td>2</td>
<td>18</td>
<td>13</td>
<td>11</td>
<td>9</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>409</td>
<td>7</td>
<td>98</td>
<td>80</td>
<td>56</td>
<td>52</td>
<td>50</td>
<td></td>
</tr>
</tbody>
</table>

(Source: Researchers’ Primary Data)

Our sample size of 409 adequately meets the criteria of discriminant analysis, including the recommended ratio of 20 observations per predictor variable, with the smallest group of at least 20 observations also exceeding the number of independent variables (Hair et al., 2006). With the 1990 health-year as base year (and therefore, not to be included in analysis), the 1990 financials predict 1991 health-year one year hence, and so on. The criteria for inclusion of a bank-year in our sample are known health condition associated with the bank data for the respective years.

Discriminant Analysis

This is the choice technique because the data involves a categorical dependent variable and scale independent variables (Hair et al, 2006). The Discriminant function (D) is a latent variable representing a linear combination of the discriminating (independent) variables. It takes the following form:

\[ L = b_1x_1 + b_2x_2 + \ldots + b_nx_n + c, \]

Where,

- \( L \) is the discriminant score
- \( b_1 - b_n \) are the discriminant coefficients,
- \( x_1 - x_n \) are the discriminating variables, and
- \( c \) is the constant.

Variable Definitions

Dependent variable (Categorical)

- \( X_1 \) - Bank health-year categorised as strong, normal or weak.

Independent variables (Metric)

- \( X_2 \) - intermediation risk efficiency (Net-interest margin)
- \( X_3 \) - burden (level of operating expenses)
- \( X_4 \) - profitability (ROA).

We split the sample 50:50 into analysis sample and holdout sample. Both samples provide ratio in excess of 15:1 between the cases and the independent variables. The minimum group sizes are 29 for the analysis sample and 28 for the holdout sample. They meet the recommended level of 20 cases per group (Hair, 2006). The unequal group sizes reflect the characteristic of the population and recommend the use of prior probabilities in classifications and interpretation. The model estimates two discriminant functions, representing two functional dimensions for the tri-chotomy of weak, normal and strong banks.

The canonical discriminant function (See Table 3) specifies the models as follows:

\[
\begin{align*}
\text{Bank health} &= -1.365 + .042 \times \text{Efficiency} + .336 \times \text{Profitability} - .015 \times \text{Burden} \\
\text{Bank health} &= -333 - .048 \times \text{Efficiency} + .354 \times \text{Profitability} + .018 \times \text{Burden}
\end{align*}
\]

Table 3 Canonical Discriminant Function Coefficients

<table>
<thead>
<tr>
<th>Canonical Discriminant Function Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td>( b_1 )</td>
</tr>
<tr>
<td>1.042</td>
</tr>
<tr>
<td>-.048</td>
</tr>
<tr>
<td>Net interest margin. Net revenue from fund-based activities as a percentage of interest income (net of loan loss).</td>
</tr>
<tr>
<td>.336</td>
</tr>
<tr>
<td>.354</td>
</tr>
<tr>
<td>Profit after tax as a percentage of average assets.</td>
</tr>
<tr>
<td>-.015</td>
</tr>
<tr>
<td>.018</td>
</tr>
<tr>
<td>Operating expenses as a percentage of net earnings.</td>
</tr>
<tr>
<td>-1.365</td>
</tr>
<tr>
<td>-.333</td>
</tr>
<tr>
<td>Unstandardized coefficients</td>
</tr>
</tbody>
</table>

(Researchers’ Analysis)

The Eigen values. (See Table 4) and Wilks’ Lambda (See Table 5) suggest statistically significant model fit for both functions.

Table 4 Eigenvalues

<table>
<thead>
<tr>
<th>Eigenvalues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Function</td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>2</td>
</tr>
</tbody>
</table>

\(^a\)First 2 canonical discriminant functions were used analysis.

(Source: Researchers’ Analysis)
Predictive accuracy

The model achieves classification rate of 76.2 percent (See Table 6). The hit ratio for the analysis sample (76.2 percent) compares favourably with 71.9 hit ratio for the holdout sample. It thus, achieves high external validity. The model also achieves high internal validity with hit ratio of 75.7 percent of cross-validated group cases. The cross-validation is by the leave-one-out criteria.

The hit ratios of more than 70 percent perform better than chance when compared with proportional chance classification of 49.15 percent, i.e. 1.25* {(98/206) 2 + (29/206) 2} and maximum chance classification of 59.47%, i.e. 1.25 * (98/206). In addition, the individual bank groups indicate classification rate in excess of 60 percent, which also surpasses the threshold values. In all the counts, classification rates indicate performance better than chance. We can, therefore conclude that the model is valid with sufficient statistical and practical significance in differentiating the banking groups.

Table 6 Classification results

<table>
<thead>
<tr>
<th>Bank rating 1y</th>
<th>Predicted Group Membership</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Weak</td>
</tr>
<tr>
<td>Cases Select</td>
<td>Count</td>
</tr>
<tr>
<td>Original</td>
<td></td>
</tr>
<tr>
<td>Strong</td>
<td>18.4</td>
</tr>
<tr>
<td>Normal</td>
<td>19</td>
</tr>
<tr>
<td>% Weak</td>
<td>82.7</td>
</tr>
<tr>
<td>Normal</td>
<td>24.1</td>
</tr>
<tr>
<td>Strong</td>
<td>0</td>
</tr>
<tr>
<td>Cross-validated</td>
<td>Count</td>
</tr>
<tr>
<td>Original</td>
<td></td>
</tr>
<tr>
<td>Strong</td>
<td>80</td>
</tr>
<tr>
<td>Normal</td>
<td>19</td>
</tr>
<tr>
<td>% Weak</td>
<td>81.6</td>
</tr>
<tr>
<td>Normal</td>
<td>24.1</td>
</tr>
<tr>
<td>Strong</td>
<td>0</td>
</tr>
<tr>
<td>Cases Not Select</td>
<td>Count</td>
</tr>
<tr>
<td>Original</td>
<td></td>
</tr>
<tr>
<td>Strong</td>
<td>70</td>
</tr>
<tr>
<td>Normal</td>
<td>14</td>
</tr>
<tr>
<td>% Weak</td>
<td>79.5</td>
</tr>
<tr>
<td>Normal</td>
<td>16.1</td>
</tr>
<tr>
<td>Strong</td>
<td>3.6</td>
</tr>
</tbody>
</table>

The model variables may be interpreted as intermediation efficiency (Net Interest Margin); profitability (Return on assets); and burden (Operating expenses) (See Table 7). The set constitutes the ‘earning warning’ construct proposed in this study.

Table 7 Structure matrix

<table>
<thead>
<tr>
<th>Function</th>
<th>1</th>
<th>2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit after tax as a percentage of average assets.</td>
<td>.756*</td>
<td>.655</td>
</tr>
<tr>
<td>Net interest margin. Net revenue from fund-based activities as a percentage of interest income (net of loan loss).</td>
<td>.627*</td>
<td>-.619</td>
</tr>
<tr>
<td>Operating expenses as a percentage of net earnings.</td>
<td>-.217*</td>
<td>.159</td>
</tr>
</tbody>
</table>

Pooled within-groups correlations between discriminating variables and standardized canonical discriminant functions

Variables ordered by absolute size of correlation within function.

* Largest absolute correlation between each variable and any discriminant function

The result may be interpreted as bank financial statements sending signals of earning warning in the form of risk efficiency, profitability and burden to generate confidence concerns that enter liquidity market decision to deny or give support to a bank in need of cash. Hence, liquidity crisis turn into insolvency problem. To contrast the proposed earning warnings framework with the traditional CAMELS framework, we introduce proxy CAMEL variables into the analysis. Critically, combining a set of earning warning with other significant CAMEL factors did not improve classification accuracy materially due to multi-collinearity (See Table 8).

Table 8 Classification results (inclusive of CAMELS related variables)

<table>
<thead>
<tr>
<th>Predicted Group Membership</th>
<th>Bank rating 1y</th>
<th>Predicted Group Membership</th>
<th>Bank rating 1y</th>
<th>Predicted Group Membership</th>
<th>Bank rating 1y</th>
<th>Predicted Group Membership</th>
<th>Bank rating 1y</th>
<th>Predicted Group Membership</th>
<th>Bank rating 1y</th>
<th>Predicted Group Membership</th>
<th>Bank rating 1y</th>
<th>Predicted Group Membership</th>
<th>Bank rating 1y</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weak</td>
<td>88</td>
<td>14</td>
<td>18</td>
<td>55</td>
<td>16</td>
<td>4</td>
<td>11</td>
<td>5</td>
<td>13</td>
<td>5</td>
<td>17</td>
<td>7</td>
<td>10</td>
</tr>
<tr>
<td>Normal</td>
<td>18</td>
<td>58</td>
<td>3</td>
<td>79</td>
<td>0</td>
<td>9</td>
<td>0</td>
<td>9</td>
<td>0</td>
<td>9</td>
<td>0</td>
<td>9</td>
<td>0</td>
</tr>
<tr>
<td>% Weak</td>
<td>85.7</td>
<td>13.3</td>
<td>0</td>
<td>100.0</td>
<td>0</td>
<td>9</td>
<td>0</td>
<td>9</td>
<td>0</td>
<td>9</td>
<td>0</td>
<td>9</td>
<td>0</td>
</tr>
<tr>
<td>Normal</td>
<td>22.8</td>
<td>73.4</td>
<td>3.8</td>
<td>100.0</td>
<td>0</td>
<td>31.0</td>
<td>69.0</td>
<td>100.0</td>
<td>0</td>
<td>31.0</td>
<td>69.0</td>
<td>100.0</td>
<td>0</td>
</tr>
<tr>
<td>% Strong</td>
<td>84.7</td>
<td>15.3</td>
<td>0</td>
<td>100.0</td>
<td>0</td>
<td>9</td>
<td>0</td>
<td>9</td>
<td>0</td>
<td>9</td>
<td>0</td>
<td>9</td>
<td>0</td>
</tr>
<tr>
<td>Cross-validated</td>
<td>Count</td>
<td>Weak</td>
<td>88</td>
<td>14</td>
<td>18</td>
<td>55</td>
<td>16</td>
<td>4</td>
<td>11</td>
<td>5</td>
<td>13</td>
<td>5</td>
<td>17</td>
</tr>
<tr>
<td>Original</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strong</td>
<td>68</td>
<td>19</td>
<td>1</td>
<td>68</td>
<td>16</td>
<td>55</td>
<td>16</td>
<td>87</td>
<td>2</td>
<td>4</td>
<td>28</td>
<td>2</td>
<td>28</td>
</tr>
<tr>
<td>% Weak</td>
<td>71.3</td>
<td>21.8</td>
<td>1.1</td>
<td>100.0</td>
<td>18.4</td>
<td>63.2</td>
<td>18.4</td>
<td>100.0</td>
<td>7.1</td>
<td>14.3</td>
<td>78.6</td>
<td>100.0</td>
<td>7.1</td>
</tr>
</tbody>
</table>

a Cross validation is done only for those cases in the analysis. In cross validation derived from all cases other than that case.

b 76.2% of selected original grouped cases correctly classified.
c 71.9% of unselected original grouped cases correctly classified.
d 75.7% of selected cross-validated grouped cases correctly classified.

* Cross validation is done only for those cases in the analysis. In cross validation, each case is classified derived from all cases other than that case.

76.1% of selected original grouped cases correctly classified.

71.4% of unselected original grouped cases correctly classified.

77.7% of selected cross-validated grouped cases correctly classified.
See the structure matrix at Table 9 for details of CAMELS related variables included. Whereas the earning warnings model yielded classification result of 76 percent using the three variables alone, by adding CAMEL related variables to the same data set classification improved only slightly by 3 percent, i.e. 79 percent (See Table 9). It shows that earning warning in itself mirrors risk issues reflected in capital adequacy, assets quality, management ineptitude and liquidity to transmit signals that predict bank failure.

Table 9 Structure matrix (inclusive of CAMELS related variables)

<table>
<thead>
<tr>
<th>Structure Matrix</th>
<th>Function</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Profit after tax as a percentage of average assets.</td>
<td>.718*</td>
</tr>
<tr>
<td>Net interest margin. Net revenue from fund-based activities as a percentage of interest income (net of loan loss).</td>
<td>.616*</td>
</tr>
<tr>
<td>Profit attributable to ordinary shareholders as a percentage of average equity.</td>
<td>.454*</td>
</tr>
<tr>
<td>Loan loss expense as a percentage of interest income.</td>
<td>-.389*</td>
</tr>
<tr>
<td>Adjusted capital to total loans.</td>
<td>.356*</td>
</tr>
<tr>
<td>Non-performing loans to total loans (Gross).</td>
<td>-.300*</td>
</tr>
<tr>
<td>Cumulative loan loss provision as a percentage of gross loan and advances.</td>
<td>-.279*</td>
</tr>
<tr>
<td>Loan loss provision/Non-performing loans.</td>
<td>.238*</td>
</tr>
<tr>
<td>Operating expenses as a percentage of net earnings.</td>
<td>-.196*</td>
</tr>
<tr>
<td>Adjusted capital to risk weighted assets.</td>
<td>.323</td>
</tr>
<tr>
<td>Net revenue from funds expressed as percentage of net earnings.</td>
<td>.324</td>
</tr>
</tbody>
</table>

Pooled within-groups correlations between discriminating variables and standardized canonical discriminant functions

Variables ordered by absolute size of correlation within function.

1. Largest absolute correlation between each variable and any discriminant function.

2. This variable not used in the analysis.

(Source: Researchers’ Analysis)

Conclusion

We, therefore, conclude that policy target at improving risk efficiency; enhancing profitability and reducing bank burden simultaneously should improve bank health. Since bank interest margin also reflects market power, policy makers should also aim at increasing it. The model is novel in suggesting that using simple publicly available data within bank financial statements the health transmissions of banks are discernible. In particular, the simplicity lends the model usable to player in the liquidity market place. It, therefore, mitigates the frustration of information asymmetry that presently exists in the market place. Investors wishing to know the financial condition of Nigerian banks no longer have to suffer frustration of not getting the information from regulatory authorities due to policy of secrecy. Those who cannot interpret bank financial statements can now find answer in a simple model. The regulatory authorities themselves can now find an added resource useful in their diagnosis of bank health.

References


Designing Quality Service through the SERVQUAL: The Case of Mobile Communications Service

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Young-Yei Kim, Seoul Digital University, Republic of Korea
Simon W. Tai, Bang College of Business, KIMEP, Republic of Kazakhstan

This study investigates relationships between service quality and customer satisfaction, considers how such relationships act to derive customer loyalty, and identifies which dimensions of service quality differentiate among service providers. The SERVQUAL scale for service quality framework was applied to mobile communications service. Empirical data are collected through online survey from customers in South Korea. Factor analysis, structural equation modeling method, and analysis of variance have applied to the empirical data. The result shows that modified SERVQUAL dimensions are still useable to assess service quality and can be used for designing quality services.

Service quality is a major component of relative service advantage, and many empirical studies affirm that service quality is highly related to product/service success (e.g. Chang & Wildt, 1994; Dawar & Parker, 1994; Zeithaml, 2000). Because quality is positively associated with the degree of product/service success, managers must be able to successful implement those marketing strategies and activities so as to raise customers’ perceived quality to another higher level. More often than not, many customers use extrinsic characteristics to judge quality. Dawar and Parker (1994) suggested that customers use brand name, price, company reputation, and physical appearance of products as signals of product quality. Lefkoff-Hagius and Mason (1993) distinguish between characteristic, beneficial, and image attributes that influence customer behavior in preference and similarity judgment.

The preference is defined in terms of the customer’s judged distance between an existing product and an ideal product, while similarity is defined in terms of the customer’s judged distance or proximity between products. The same researchers further proposed that what is important to the customers at the time when they judge the similarity of products does not necessarily match what is important to them when they evaluate products for purchase. However, past marketing studies have generally suggested that when customers provide higher service quality evaluations, their behavioral intentions towards the company and brand tend to be more favorable, and they are more likely to remain as customers. Similarly, higher perceived service quality and higher satisfaction tend to result in higher levels of purchase intentions and repeat actual purchases (see Zeithaml, 2000).

Customers may rely on surrogate cues to evaluate service quality in those situations where they are unable to compare competing services side-by-side as they do with competing products. Moreover, since the actual quality of services can vary from customer to customer and from region to region, marketers should try to standardize their services in order to provide consistency of service quality. In addition to the vast amount of support in the service quality literature concerning a link between customer interests and future purchases (e.g. Boulding, Kalra, & Staelin, 1999; Zeithaml, Berry, & Parasuraman, 1996), the idea that customers prefer greater service quality is intuitive, particularly if price and other cost elements are held constant. It is very likely that mobile communications service quality is of special importance to customers who want to value service quality over price.

Service quality is mainly concerned with how to “meeting customers’ expectation.” Parasuraman, Zeithaml and Berry (1985, 1988) have defined and conceptualized service quality as a form of attitude derived from a comparison of customers’ expectations with perceptions of performance. They have developed and continued to revise the SERVEQUAL (Parasuraman et al., 1988, 1994) variable for the purpose of measuring service quality. The SERVEQUAL scale is based on a gap model, that is, it measures the gap in the service quality between the expectations of customers and their perceptions of actual performance. It includes five constructs of tangibles, reliability, responsiveness, assurance, and empathy. “Tangibles” assess the extent of the appearance of a company’s physical facilities, equipment and personnel. “Reliability” measures the ability to perform the promised service dependably and accurately. “Responsiveness” represents the willingness to help customers and to provide a prompt service. “Assurance” evaluates the knowledge and courtesy of employees and their ability to inspire confidence. Finally, “Empathy” determines the caring and individualized attention the firm provides to its customers.

It is well known that service personnel play an important role in customers’ evaluation of the service quality of a business. In service business such as mobile communications service industry, delivering high quality
service that meets customers’ needs is an important tactic to achieve competitiveness. Over the past two decades, service quality, customer satisfaction and customer loyalty have occupied a dominant position in research on the marketing of service industries. This study is to investigate relationships between service quality and customer satisfaction and to consider how such relationships act to derive behavioral intention. Therefore, the following hypothesis is proposed:

Hypothesis 1: The perception of service quality measured by SERVQUAL scale has an association with the levels of customer satisfaction.

Hypothesis 2: There are significantly different perceptions of the SERVQUAL among service providers.

Combining the above hypotheses, this study puts forth an integrated research framework, as shown in Figure 1.

Figure 1: The research framework of this study

Methodology

Survey and sample characteristics

This study developed a questionnaire for collecting empirical measures of service quality and customer satisfaction variables, and administered a web-based survey to online access panel members through the Internet during December 2007 in South Korea. In total, 500 respondents completed the questionnaire, and after careful evaluation, all 500 were considered as useable.

Of these respondents, 63 percent (314 respondents) were male and the mean age of the sample was 36.4 years old (standard deviation (S.D.)=11.1). About 72 percent of these respondents have college or university education. About 53 percent (264 respondents) of them have been employed full time for longer than 1 year in various industries. The remaining respondents are self-employed (10.6 %), professionals (9.2 %), civil servants (5.2 %), students (8 %), and housewives (7 %). The average income per capita for these respondents is about USD2,200 per month, which is higher than the average income per capita of USD1,700 per month for Korean employees in 2007, see Table 1 for details.

The respondents were spending an average of 51 US dollars (Mean=$51.3, S.D. =24.4) for the monthly expenses of mobile communications service and had an average of 3 years (Mean=3.2, S.D.=1.7) experience in subscribing certain mobile communications service providers. The respondents were satisfied with current service providers at the average of 4.8 (S.D.=1.2) out of 7 point scale and had intention to recommend current service providers at the average of 4.6 (S.D.=1.3) out of 7 point scale.

Table 1: Sample characteristics

<table>
<thead>
<tr>
<th>Sample characteristics</th>
<th>N</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sex</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| Male                   | 314 | 63%
| Female                 | 186 | 37%|
| Age                    |     |    |
| Below 19 years old     | 20  | 4% |
| 20-29                  | 129 | 26%|
| 30-39                  | 181 | 36%|
| 40-49                  | 113 | 23%|
| Above 50 years old     | 57  | 11%|
| Monthly income         |     |    |
| Less than USD1000      | 75  | 15%|
| USD1001-2000           | 144 | 29%|
| USD2001-3000           | 133 | 27%|
| USD3001-4000           | 67  | 13%|
| USD4001-5000           | 53  | 11%|
| More than USD5001      | 28  | 6% |
| Education              |     |    |
| Secondary (high school)| 141 | 28%|
| Junior college         | 80  | 16%|
| University             | 249 | 50%|
| Graduate               | 30  | 6% |

Measurements

In its simplest form, a customer satisfaction research involves dividing the customers’ overall experiences into sub-levels of standards or criteria, and then a rating scale is applied to measure how satisfied these customers were with the services on the basis of these criteria. More sophisticated techniques for customer satisfaction research tend to focus on the relative importance that the customers attach to each of these criteria. The most widely accepted framework for research on service quality comes from the premise that a customer’s evaluation of service quality is a function of the magnitude of the gap between the customer’s expectations of service and his/her perception of the service actually delivered (Zeithaml, Parasuraman, & Berry, 1990). These expectations generally stem from word-of-mouth that the customer has heard about the
service, one’s past experience, and the promises made about the service in its marketing promotions (Zeithaml et al., 1993).

Parasuraman, Berry, and Zeithaml (1991a) designed the “SERVQUAL” scale that consists of the five dimensions of reliability, responsiveness, assurance, empathy, and tangibility. Among these five dimensions, the process of responsiveness, assurance, and empathy is a significant opportunity to exceed customer expectations (Parasuraman et al., 1991b). Since its development, the SERVQUAL scale has been used in numerous studies, although not all of the empirical findings correspond precisely to the five dimensions of the original design.

To measure service quality attribute variables in this study, a questionnaire of 22 items of the SERVQUAL scale developed by Parasuraman et al. (1991a) was applied. In so doing, this study employs questions with all of their responses measured at an interval scaled, which is a modified Likert scale. In the application, respondents are asked to indicate their degree of agreement on a symmetric scale for each of a series of statements relating to the importance of attributes (e.g., not agreed=1, strongly agreed=7).

To measure customer satisfaction, this study uses a single item to measure customers’ overall satisfaction with the level of service rendered. Their responses range from ‘not satisfied=1’ to ‘very satisfied=7.’ To measure customer loyalty, the authors asked questionnaire respondents to show a degree of agreement on the statement “to remain loyal to a current service provider and continue engaging in transactions with the service provider.” Their responses range from ‘least likely=1’ to ‘most likely=7.’

All respondents were further asked to indicate their preferences about different brands of mobile communications service providers, labelled as firms A, B and C, in Korea. Each respondent can then be grouped into one of the three A, B, or C categories based on his or her service provider preference answer. Since each respondent also conducted an assessment of each of the service provider’s service quality, the mean values of the service providers’ service quality can be calculated by each of the three service provider categories. These variables were then used in the analysis of variance for the empirical testing of hypothesis 2. To insure the minimization of idiomatic wording, all of the instruments were first translated into Korean, and then results were checked and translated back to English by the authors.

Reliability and validity of measurements

This study applied theories to specify a path model, and then utilized the survey data to empirically test the model. To specify the path diagram, the authors reviewed and studied a large number of potential predictors, which were measured by the survey responses. Then, the simple correlation coefficients among these empirically measured variables were calculated in order to determine which sets of independent variable combinations can best explain or predict dependent variables.

To solve the problem of over calculations, the authors applied the principal components analysis procedure to transform the 22 items of the SERVQUAL scale into fewer sets of linear combinations (Kaiser-Meyer-Olkin measure of sampling adequacy was 0.967 and Chi-square=8574.444, degree of freedom=231, and significance=0.000 by the Bartlett’s Test of Sphericity). Applying this variable reduction scheme to the SERVQUAL dimensions, the authors were able to derive a modified four-component model, in which each component is represented by a linear combination of the survey items having the highest loadings (>0.500) with these components. These four components were named as “reliability,” “empathy,” “assurance,” and “tangible,” respectively.

Results from the above analyses indicate that the sums of squared loadings from the modified four components have the cumulative value of 67.343% in explaining the total variance of the dependent variable. From a reliability analysis of the measurement scale, the component of “reliability” obtained the higher reliability coefficient and validity (Cronbach’s Alpha=0.922 with 5 items); the component of “empathy” achieved a reliability coefficient of Alpha equal to 0.871 with 4 items; the component of “assurance” attained the Alpha value of 0.868 with 4 items; and the component of “tangibles” obtained the Alpha value of 0.806 with 3 items, respectively, see Table 2 for details.

Goodness-of-fit of measurements and a structural model

After determining that the variance and covariance had satisfied the methodological assumptions and were of a form appropriate for validating causal relationships, the authors utilized 500 full data samples as an input to construct a variance-covariance matrix. The Analysis of Moment Structures (AMOS: Arbuckle, 1994) was then conducted for an empirical test of the model, and the Maximum Likelihood Estimation (MLE) was applied to estimate numerical values for the components in the model. In the application of MLE, the multivariate normality was assumed in order to derive the efficient and unbiased estimates.

To diagnose the presence of distribution problems in the data and to gauge their effects on the parameter estimates, bootstrapping method is used. Bootstrapping (Efron, 1979, 1982, 1987; Stine, 1989) is a versatile method for evaluating the empirical sampling distribution of parameter estimates. In particular, bootstrapping is used to obtain empirical standard error estimates of the model parameters, in addition to the regular standard error estimates that are parts of the usual AMOS output when maximum likelihood estimate is employed. The present study demonstrated bootstrapping with the structural equation model and 300 bootstrap replications were
obtained and used for computing the bootstrapped standard errors.

Table 2: Results of factor analysis and reliability test for the components of service quality

<table>
<thead>
<tr>
<th>Items</th>
<th>Factor loadings</th>
<th>Eigenvalue</th>
<th>Extracted variance</th>
<th>Component name</th>
<th>Corrected item-total correlation</th>
<th>Alpha</th>
</tr>
</thead>
<tbody>
<tr>
<td>Perform service correctly</td>
<td>0.793</td>
<td>4.916</td>
<td>22.234%</td>
<td>Reliability</td>
<td>0.835</td>
<td>0.922</td>
</tr>
<tr>
<td>Provide service at the time</td>
<td>0.737</td>
<td></td>
<td></td>
<td></td>
<td>0.825</td>
<td></td>
</tr>
<tr>
<td>Show a sincere interest</td>
<td>0.730</td>
<td></td>
<td></td>
<td></td>
<td>0.818</td>
<td></td>
</tr>
<tr>
<td>Promise something to do</td>
<td>0.678</td>
<td></td>
<td></td>
<td></td>
<td>0.769</td>
<td></td>
</tr>
<tr>
<td>Provide accurate service</td>
<td>0.611</td>
<td></td>
<td></td>
<td></td>
<td>0.743</td>
<td></td>
</tr>
<tr>
<td>Have a customer's interest</td>
<td>0.841</td>
<td>4.063</td>
<td>18.470%</td>
<td>Empathy</td>
<td>0.753</td>
<td>0.871</td>
</tr>
<tr>
<td>Convenient working hours</td>
<td>0.771</td>
<td></td>
<td></td>
<td></td>
<td>0.734</td>
<td></td>
</tr>
<tr>
<td>Give personal attention</td>
<td>0.599</td>
<td></td>
<td></td>
<td></td>
<td>0.716</td>
<td></td>
</tr>
<tr>
<td>Understand specific needs</td>
<td>0.571</td>
<td></td>
<td></td>
<td></td>
<td>0.705</td>
<td></td>
</tr>
<tr>
<td>Instill confidence</td>
<td>0.523</td>
<td>3.492</td>
<td>15.874%</td>
<td>Assurance</td>
<td>0.759</td>
<td>0.868</td>
</tr>
<tr>
<td>Have knowledge and skills</td>
<td>0.736</td>
<td></td>
<td></td>
<td></td>
<td>0.721</td>
<td></td>
</tr>
<tr>
<td>Courteous with customers</td>
<td>0.688</td>
<td></td>
<td></td>
<td></td>
<td>0.706</td>
<td></td>
</tr>
<tr>
<td>Feel satisfaction</td>
<td>0.624</td>
<td></td>
<td></td>
<td></td>
<td>0.693</td>
<td></td>
</tr>
<tr>
<td>Visually appealing materials</td>
<td>0.819</td>
<td>2.344</td>
<td>10.654%</td>
<td>Tangibles</td>
<td>0.667</td>
<td>0.806</td>
</tr>
<tr>
<td>Neat in personnel appearance</td>
<td>0.681</td>
<td></td>
<td></td>
<td></td>
<td>0.653</td>
<td></td>
</tr>
<tr>
<td>Visually appealing facilities</td>
<td>0.647</td>
<td></td>
<td></td>
<td></td>
<td>0.641</td>
<td></td>
</tr>
<tr>
<td>Total variance</td>
<td></td>
<td></td>
<td>67.343%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Extraction method: Principal Component Analysis.
Rotation method: Varimax with Kaiser Normalization.

Results of the Data Analysis and Hypothesis Tests

Statistical testing of “hypothesis 1”

The hypothesis 1 was empirically tested by the survey data, and results of data analysis show that associations between the SERVQUAL dimensions and customer satisfaction are statistically significant at the 5% confident level, see Table 3 for details. Consequently, the results of the empirical test support that the tangibles, reliability, and empathy of the SERVQUAL dimensions can be utilized to design quality service of mobile communications service and communicate to a selection of service provider. The results of testing hypothesis-1 also show that the tangibles, reliability, and empathy dimension of the SERVQUAL have positive relationships with the customer satisfaction of mobile communications service.

The results of the data analysis generally achieved an appropriate parsimony model (degrees of freedom=647, PRATIO=0.883). But to some extent, the model has relatively poor goodness-of-fit measures, in particular, the indices of GFI (0.713), AGFI (0.639), NFI (0.737), and RMSEA (0.152). The GFI of 0.713 describes that the goodness of fit of the model indicates about 71% fit. The NFI of 0.737 describes that the fit of the proposed model is about 73% closer to the fit of the saturated model (the perfectly fitting model). Note that values of the GFI and AGFI can vary from 0 to 1, with values above 0.90
considered as good and values from 0.80 to 0.90 considered as moderate (Bentler & Bonett, 1980). For NFI, the closer its values to 1, the better are the fitness of the hypothesized model over the null model. Note that a value of about 0.08 or less for the RMSEA would indicate reasonable error of approximation (Browne & Cudeck, 1993).

Table 3: Outputs of structural equation model (SEM) estimates

<table>
<thead>
<tr>
<th>Regression weights</th>
<th>Proposed model</th>
<th>Bootstrapping(300)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Estimate (t-value)</td>
<td>Estimate Mean</td>
</tr>
<tr>
<td>Tangibles ---&gt; Customer satisfaction</td>
<td>0.391 (6.797)***</td>
<td>0.395**</td>
</tr>
<tr>
<td>Reliability ---&gt; Customer satisfaction</td>
<td>0.315 (5.946)***</td>
<td>0.323</td>
</tr>
<tr>
<td>Empathy ---&gt; Customer satisfaction</td>
<td>0.168 (3.453)***</td>
<td>0.164</td>
</tr>
<tr>
<td>Assurance ---&gt; Customer satisfaction</td>
<td>0.053 (0.971)</td>
<td>0.045</td>
</tr>
<tr>
<td>Customer satisfaction ---&gt; Customer loyalty</td>
<td>0.916 (22.791)***</td>
<td>0.915</td>
</tr>
<tr>
<td>Customer satisfaction ---&gt; Word-of-mouth</td>
<td>0.848 (27.642)***</td>
<td>0.845</td>
</tr>
</tbody>
</table>

Standardized indirect effects

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Tangibles ---&gt; Customer loyalty</td>
<td>0.208</td>
<td>0.208</td>
</tr>
<tr>
<td>Reliability ---&gt; Customer loyalty</td>
<td>0.172</td>
<td>0.172</td>
</tr>
<tr>
<td>Empathy ---&gt; Customer loyalty</td>
<td>0.100</td>
<td>0.100</td>
</tr>
<tr>
<td>Assurance ---&gt; Customer loyalty</td>
<td>0.031</td>
<td>0.031</td>
</tr>
<tr>
<td>Tangibles ---&gt; Word-of-mouth</td>
<td>0.241</td>
<td>0.241</td>
</tr>
<tr>
<td>Reliability ---&gt; Word-of-mouth</td>
<td>0.199</td>
<td>0.199</td>
</tr>
<tr>
<td>Empathy ---&gt; Word-of-mouth</td>
<td>0.115</td>
<td>0.115</td>
</tr>
<tr>
<td>Assurance ---&gt; Word-of-mouth</td>
<td>0.036</td>
<td>0.036</td>
</tr>
</tbody>
</table>

Standardized total effects

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Tangibles ---&gt; Customer satisfaction</td>
<td>0.306</td>
<td>0.306</td>
</tr>
<tr>
<td>Reliability ---&gt; Customer satisfaction</td>
<td>0.253</td>
<td>0.253</td>
</tr>
<tr>
<td>Empathy ---&gt; Customer satisfaction</td>
<td>0.147</td>
<td>0.147</td>
</tr>
<tr>
<td>Assurance ---&gt; Customer satisfaction</td>
<td>0.046</td>
<td>0.046</td>
</tr>
<tr>
<td>Tangibles ---&gt; Customer loyalty</td>
<td>0.208</td>
<td>0.208</td>
</tr>
<tr>
<td>Reliability ---&gt; Customer loyalty</td>
<td>0.172</td>
<td>0.172</td>
</tr>
<tr>
<td>Empathy ---&gt; Customer loyalty</td>
<td>0.100</td>
<td>0.100</td>
</tr>
<tr>
<td>Assurance ---&gt; Customer loyalty</td>
<td>0.031</td>
<td>0.031</td>
</tr>
<tr>
<td>Tangibles ---&gt; Word-of-mouth</td>
<td>0.241</td>
<td>0.241</td>
</tr>
<tr>
<td>Reliability ---&gt; Word-of-mouth</td>
<td>0.199</td>
<td>0.199</td>
</tr>
<tr>
<td>Empathy ---&gt; Word-of-mouth</td>
<td>0.115</td>
<td>0.115</td>
</tr>
<tr>
<td>Assurance ---&gt; Word-of-mouth</td>
<td>0.036</td>
<td>0.036</td>
</tr>
<tr>
<td>Customer satisfaction ---&gt; Customer loyalty</td>
<td>0.680</td>
<td>0.680</td>
</tr>
<tr>
<td>Customer satisfaction ---&gt; Word-of-mouth</td>
<td>0.785</td>
<td>0.785</td>
</tr>
</tbody>
</table>

Chi-square: 1893.662 (300 usable bootstrap resamples were obtained and analysed.

For bootstrapping estimates, bias (the difference between the bootstrap mean and original estimate)-corrected confidence intervals are represented at significant level 0.05 with 95% confidence interval.

Fitness measures:

<table>
<thead>
<tr>
<th>Discrepancy / df =12.478, RMR=0.624, RMSEA=0.152, PRATIO=0.883, GFI=0.713, Adjusted GFI=0.639, NFI=0.737</th>
</tr>
</thead>
</table>

Many fit measures represent an attempt to balance between parsimonious and well fitting model, that is, two
conflicting objectives—simplicity and goodness of fit. Steiger (1990) stated that “In the final analysis, it may be impossible to define one best way to combine measures of complexity and measures of badness-of-fit in a single numerical index, because the precise nature of the best numerical tradeoff between complexity and fit is a matter of personal taste. The choice of a model is a classic problem in the two-dimensional analysis of preference” (p. 179). The authors seek the grounds for preferring a simple, parsimonious model instead of complex ones. At the same time, a well-fitting model is preferable to poorly fitting ones.

Statistical testing of “hypothesis 2”

To test the hypothesis 2, an analysis of variance (ANOVA) of the SERVQUAL dimensions was applied to the Korean mobile communications service providers (there are three mobile communications service providers in South Korea: SK telecom, LG Telecom, and Korea Telecom). The results of ANOVA suggest that there are significant differences in the mean values of “tangibles” dimension of the SERVQUAL (F-value=3.665, significance=0.026) among service providers, see Table 4 for details. For the other dimensions of the SERVQUAL, that is, “reliability,” “empathy,” and “assurance,” the empirical data do not support that there are significant differences in their mean values among mobile communications service providers, see Table 4 for details.

When respondents are grouped according to the dimensions of the SERVQUAL, they show a preference for certain service providers. For example, a larger group of the respondents, who appreciate positively service provider-A, had a mean value of 4.881 out of 7 point scale with the standard deviation of 1.134 in their perceptions of the “tangibles” attribute of service quality (factor loadings score=0.055). Another group of the respondents, who less appreciate service provider-B, yielded a least mean value of 4.572 with the stand deviation of 1.116 in their perceptions of tangible attribute (factor loadings score = (-0.254)).

Levene statistics method is applied to test homogeneity of variances of groups. Equal variances are assumed, see Table 4 for details. For Post Hoc multiple comparisons to see mean differences between specific groups, Duncan’s multiple-range test is applied with subset for alpha 0.05 level, see Table 5 for details.

<table>
<thead>
<tr>
<th>SERVQUAL</th>
<th>Levene Statistic</th>
<th>Sig.</th>
<th>Firm-A</th>
<th>Firm-B</th>
<th>Firm-C</th>
<th>Total</th>
<th>F-statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tangible</td>
<td>0.611</td>
<td>0.543</td>
<td>4.881(1.134)</td>
<td>4.572(1.116)</td>
<td>4.838(1.160)</td>
<td>4.764(1.136)</td>
<td>3.665**</td>
</tr>
<tr>
<td>Reliability</td>
<td>1.396</td>
<td>0.248</td>
<td>4.732(1.192)</td>
<td>4.474(1.118)</td>
<td>4.557(1.338)</td>
<td>4.587(1.216)</td>
<td>1.065</td>
</tr>
<tr>
<td>Empathy</td>
<td>0.307</td>
<td>0.735</td>
<td>4.395(1.336)</td>
<td>4.236(1.206)</td>
<td>4.263(1.402)</td>
<td>4.298(1.315)</td>
<td>0.203</td>
</tr>
<tr>
<td>Assurance</td>
<td>2.689</td>
<td>0.668</td>
<td>4.746(1.245)</td>
<td>4.571(1.049)</td>
<td>4.566(1.297)</td>
<td>4.627(1.197)</td>
<td>0.809</td>
</tr>
</tbody>
</table>

**p<0.05 statistically significant at α=0.05 with 95% confidence interval

Table 5. Outputs of Duncan’s multiple-range test of Mean differences between groups

<table>
<thead>
<tr>
<th>SERVQUAL</th>
<th>Subset</th>
<th>Firm-A</th>
<th>Firm-B</th>
<th>Firm-C</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>272</td>
<td>92</td>
<td>136</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tangible</td>
<td>1</td>
<td>-0.254</td>
<td></td>
<td></td>
<td>0.998</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>0.055</td>
<td>0.063</td>
<td>0.947</td>
<td></td>
</tr>
<tr>
<td>Reliability</td>
<td>1</td>
<td>0.056</td>
<td>-0.028</td>
<td>-0.094</td>
<td>0.244</td>
</tr>
<tr>
<td>Empathy</td>
<td>1</td>
<td>0.010</td>
<td>0.035</td>
<td>-0.044</td>
<td>0.541</td>
</tr>
<tr>
<td>Assurance</td>
<td>1</td>
<td>0.052</td>
<td>-0.049</td>
<td>-0.071</td>
<td>0.344</td>
</tr>
</tbody>
</table>

The group sizes are unequal. The harmonic mean of the group sizes (=136.993) is used. Means for groups in homogeneous subsets are displayed. Subtest for alpha = 0.05

As shown in Table 5, there are statistically significant mean differences at alpha 0.05 level between Firm-A and Firm-B, and between Firm-C and Firm-B, respectively. Contrary to the “tangibles” attribute, the other attributes of the SERVQUAL have no significant differences on the mean values between service providers. Possible reasons for explaining the above results are that the customers’ perceptions towards Korean mobile communications
service providers may be neutralized by the companies’ marketing communications efforts and/or moderated by the mixture of different brands of the companies.

Managerial Implications and Discussion

The results of the hypothesis-1 testing empirically show that there exist certain associations between the SERVQUAL dimensions and customer satisfaction. Empirical findings affirm the view that service quality is one of the primary determinants of customer satisfaction (Athanassopoulos, 2000; Cronin, Brady, & Hult, 2000; Parasuraman, Zeithaml, & Berry, 1994). Thus, the results of the current cross-sectional study reinforce the same causal relationship that perceived service quality is an antecedent to customer satisfaction in mobile communications service industry.

The results of the hypothesis-2 empirical testing show that the average of “tangibles” measures of the SERVQUAL differ significantly among three service providers. However, the results of the hypothesis-2 test also show that there are no significant differences in the mean values of the other SERVQUAL dimensions, for example, reliability, empathy and assurance attributes.

While the fundamentally intangible nature of service itself has long been a central issue in research on the service industry (Bebko, 2000; Parasuraman, Zeithaml, & Berry, 1994), the significance of tangibility as a dimension of service quality was recognized in the important findings of Parasuraman, Zeithaml, and Berry’s (1991) work. Indeed, most service industries offer both intangible services and tangible products to customers in varying proportions. It is worth noticing that the impact of the quality of tangibles on customer satisfaction is crucial and significant, in particular, in mobile communications service.

Customer loyalty, which may be defined as the continuously positive purchasing behavior of a customer towards a certain company or brand, or the positive attitude of a customer that shows distinct preference or liking for a brand or product, will be affected by customer satisfaction. This conclusion has been many times supported by empirical research (Chiu, Droge, & Hanvanich, 2002; Cronin, Brady, & Hult, 2000; McDougall & Levesque, 2000). And the results of the hypothesis-1 testing empirically affirm that customer satisfaction is an antecedent to customer loyalty in mobile communications service industry. Recently, Cronin, Brady, and Hult (2000) pointed out that service quality indirectly affects customer loyalty through customer satisfaction (Jamal & Naser, 2003) and, at the same time, service quality also has a direct impact on customer loyalty (Varki & Colgate, 2001). The results of the current study show that perceived service quality has a direct and positive effect on customer satisfaction and is also strongly and indirectly related to customer loyalty.

In mobile communications service industry, which represents a higher level of tangibility, require a higher quality of tangible service to enhance customer satisfaction and boost customer loyalty. Indeed, perceived service quality is related to customer satisfaction and still indirectly related to customer loyalty. The results of the study suggest that managers in those service industries that offer high levels of tangible services must pay attention to the quality of tangible attributes of a service, then work to enhance other dimensions of service quality. Overall, this study suggests that managers in service industries should evaluate the proportion of intangible and tangible attributes of a service. Then, managers in service industries with high levels of tangible service must place emphasis on the management of service quality, in particular, its quality of tangible attributes, and should examine the level of its service quality on a regular basis.

Tangibles in service quality represent ability to maintain the appearance of physical facilities, personnel and communication materials, that is, physical representations of the service. For example, mobile communications service industry must emphasizes on visually appealing materials, neat in personnel appearance, highly trained and skilled personnel, and visually appealing facilities. Effective delivery of quality services involves identifying customers’ needs and meeting or exceeding their expectations. It proposes that employees are the key to delivering excellent quality of tangible services. Thus, developing the right employees and creating a talented workforce are likely to be the major steps to design a quality service in mobile communications service in order to gain a strategic competitive advantage.

For academicians, the relation between different levels of tangible services and the importance of service quality would be an interesting topic for future research. It would be practical and useful, if similar studies are to be conducted in other cultural contexts in effort to find out whether these findings should be identified as culturally limited or as universal conclusions.

References


An Empirical Assessment of Country Brand Equity-Insights from Hong Kong

Erdener Kaynak, The Pennsylvania State University at Harrisburg, USA
Simon Kwai-ming Mak, City University of Hong Kong, Hong Kong

As an industry of growing importance amidst an globalizing economy, increasing academic pursuit would soon enrich practical perspectives that will lead to offering of more appealing tours by industrial practitioners, as travelling becomes more popularized upon increasing affluence. Previous tourism marketing studies failed to address the holistic components of destination image because of structured methods being used. Unstructured methods are disadvantaged by respondents' variable details voiding comparative analysis. The current study assesses the application of a country brand equity model for China, Hong Kong and Macau to identify attractive country destination characteristics.

Tourism is increasingly an important industry around the globe, generating significant national income, mostly earned in the form of foreign exchange, and it also creates increased employment opportunities. The present study assesses the application of a proposed country brand equity model for China, Hong Kong and Macau, to identify attractive country destination characteristics. On the basis of this assessment, the government of each country could work to improve the added value – the 'country brand equity' of a place to appeal to more potential and/or repeat visitors, in accordance with the priorities suggested by tourists' ranked satisfaction. Tourism market planners can then assess various investment alternatives that a country can offer to further develop livability, visitability and investibility of a country. The model developed and the findings of an empirical study should help provide indicators of prioritization of areas of development, and the respective paces, as based on the value and immediacy of tourists' need(s) to satisfy. Survey results indicate attributes of attractiveness of one territory to surpass that of another, providing further reference points for prioritizing local investment for more cost effective tourism development.

Introduction

Few industries have as much impact on the economy of a nation, region, or city as tourism. In recent years, there has been a phenomenal growth in tourism industry around the globe. As such, it has become an increasingly important industry for most countries – especially for developing emerging markets. With a market of 3 billion annual arrivals worldwide, the industry can generate a significant national income, mostly earned in the form of foreign exchange, and can create increased employment opportunities for the locals. Hence, it is worth studying the most proper way to develop tourism and hospitality industry of a country or region.

Tourism, in the early usage of the term, prescribes a lifestyle of the leisured class – travelling. Travelling for leisure was, before the 1980s, not a regular event. Travelling would be regular only when job requirement commanded it. Since the latter part of the twentieth century, tourism has become a mass phenomenon, and has been referred to as a “social fact” in the Durkeimian sense, and as an “international fact” (Lanfant, 1980) that merits scholarly attention. Studies on tourism, so far, has concentrated on two streams of research: the first one is the psychological approach that examines motivational and experiential factors; and the second stream is the sociological approach that examines cultural values, social mechanisms, and structural conditions of tourism. The latter group of studies have a wider context since they focus on both cultural and structural conditions for the “socio-genesis of tourism.” From this perspective, tourism development has proved to be one of the most effective instruments for a national economy to decide on priorities for future development, for blending economic benefits with social effects and for developing and preserving the national, natural and cultural heritage. In this study, the authors utilize a hybrid approach where the impact of both sociological (macro) as well as psychological (micro) variables are examined for the development of effective country tourism development plans, programs, and strategies.

1 Acknowledgement for the data input in ANOVA to Mr. Don Wu, Management Science Department of City University of Hong Kong
From Globalization to International Tourism

The international attribute of tourism is receiving a push in the globalized economy. It presents a “transmission belt” between “the post-industrial sending societies, and the developing countries” and vice versa (Lanfant et al, 1995, p. 28), at different stages of development. Tourists from the sending societies are motivated to travel to a place of their choice of holiday. People from developing nations may engage in long-term or permanent migration, while people from developed nations migrate to the “pleasure periphery” of the less developed nations (Turner and Ash, 1975). Apparently tourism involves a temporary change in status quo, in actuality it reinforces the status quo. In a way, it is a temporary stay in a certain area by people in pursuit of their recreational, cultural, or other holiday-related needs.

Tourism is an indicator of the affluence brought about by modernity and its associated lifestyles. International tourism has emerged as one of the most important growth industries due to technological advancement and improvements in communications. During the period between 1990 and 2005, international tourist arrivals rose from an annualized average rate of 5.6 per cent from 439 million in 1990 to 806 million in 2005. International tourist receipts increased from US$270 billion in 1990 to US$680 billion in 2005, an annualized average growth rate 10.1% (United Nation World Tourism Organization, 2006, p. 3-4). The Tourism Economic Report has confirmed that tourism is one of the top five export categories earning foreign exchange for 83% of the countries, and the main source of foreign currency for 38% of them.

Tourism has become a major economic activity in a number of countries. “The ability of the national economy to benefit from tourism depends on the availability of investment to develop the necessary infrastructure and on its stability to supply the needs of tourists”, as Williams and Shaw (1988, p. 5) neatly denote the key issue of international tourism.

A Natural Product of Most Countries

Tourism was usually linked to the studies of hotel and hospitality service industry. Subsequently scholars have developed various perspectives to study tourism marketing to aim at beneficial breakthrough. In recent years, tourism has been studied from the perspective of country destination image, considering that destination images do influence tourist behavior (Hunt, 1975; Pearce, 1982). These studies suggest that those destinations with strong, positive images are more likely to be considered and chosen in the travel destination decision process (Goodrich, 1978; Woodside & Lysonski, 1989). As such, destination image has an important role to play in the travel decision making process (Schmoll, 1977; Moutinho, 1984; Woodside & Lysonski, 1989). When a tourist visits a country destination, satisfaction largely depends upon a comparison of tourist expectations based on previously held images of the country destination and the actual reality encountered while visiting the country destination (Chon, 1990).

Country Destination Image and its Measurement

Reynolds (1965) describes the formation of image as the development of a mental construct based upon a few impressions chosen from a flood of information. Regarding country destination image, this ‘flood of information’ has many sources – a tourist’s daily life activities including whatever promotional literature (travel brochures, posters) he/she receives, daily interpersonal exchanges bewaring the opinions of others (family/friends, travel agents) and coming across the general media (newspapers, magazines, television, books, movies) about the country destination.

Echtner and Ritchie (1991) scrutinized many studies and facilitated the efforts with a summary survey of the definitions provided in the major destination image measurement studies: From Hunt (1975) aiming at measuring the images of four states: Utah, Montana, Colorado, and Wyoming, using the definition that image being “perceptions held by potential visitors about an area”, to, Reilly (1990) aiming at measuring the image of Montana, using the definition that image being “not individual traits … but the total impression an entity makes” (Dichter, 1985). Echtner and Ritchie (1991) also conceptualized a framework for the measurement of destination image. They propose a framework of three continuums to calibrate the measures: (i) attribute-holistic; (ii) functional-psychological; and (iii) common-unique. A diagram of the framework shown below well illustrates the basis of calibration.
Hurdles in Measuring Destination Images

Measuring the images of destinations in various places or countries has become the core subject in numerous studies. However, no consensus has been reached regarding the effectiveness of various attempts to define and measure the concept of destination image. Previous tourism marketing studies failed to address the holistic components of destination image because of the methods used in those studies (Echtner and Ritchie, 1991). For studies that examine the attribute component of destination image, use of structured methods has been preferred. Structured method such as semantic differential scale or Likert scale requires an individual to rate a set of predetermined attributes subjectively, or to characterize stimuli by using standardized rating scales. Factor analysis, average ratings or multidimensional scaling is also used to reduce responses to a smaller number of independent underlying perceptual dimensions. Because this type of procedure involves a prior list of attributes to which an individual is supposed to respond, it might be relatively unreliable on its own (Timmermans et al., 1982, p. 191). Great care must be taken or some important attributes may be missing, or some might be unimportant to the individual.

Structured method has the following advantages: (i) easy to administer; (ii) simple to code; (iii) results are easy to analyze by using sophisticated statistical techniques; and (iv) facilitates comparisons among destinations. Its disadvantages include: (i) no holistic aspects of image; (ii) attribute focused; and (iii) the completeness of structured methods - can miss dimensions. Unstructured method, can allow the respondent to freely voice impressions of the destination. Data are gathered from a number of respondents. Sorting and categorization techniques are then used to determine the ‘image dimensions’. Its advantages include: (i) conducive to measuring the holistic components of destination image; (ii) reduces interviewer bias; and (iii) reduces likelihood of missing important image dimensions or components. Its disadvantages include: (i) level of detail provided by respondent is highly variable; (ii) statistical analyses of the results are limited; and (iii) comparative analyses are not facilitated.

Calibrating an Alternate Measure of Tourist Destination

More tourists to a country means more spending of foreign exchange in the host country, which in turn means that each tourism product, that is, each destination, carrying an image in the eyes of the potential tourists in the world, adds up to an ‘brand equity or value’ of the country. A destination and its image that can attract more tourists’ visit realistically can bring greater brand equity (value) to the place (destination). Insightful conceptual analysis should be more readily forthcoming for studying a country’s tourism development potential, by examining the tourism product (the destination) and its image, using the conceptual frameworks and theoretical constructs of the consumer product and the country brand equity.

Thus the earlier discussion showed how destination image adding the perspective to the studies on tourism relies more on the tourist’s subjective assessment of certain common functional characteristic such as price level, natural environment, and transportation infrastructure. The destination can also be assessed on commonly considered psychological characteristics: level of friendliness, safety, low crime rate, quality of service expected. On the other end of the continuum, images of destination can be associated with unique features and events (functional characteristics) or special auras (psycho-social characteristics) (Echtner and Ritchie 1991).

Study Procedures

The data for the study were collected through personal interviews. A personal interview technique was utilized at shopping complexes such as Ocean Terminal, Ocean Center, and commercial centers such as Nathan Road, Des Voeux Road Central and Queen’s Road Central in two regions of Hong Kong, namely Hong Kong Island and Kowloon. A group of students from a local university in Hong Kong was hired as interviewers. Each interviewer was briefed to approach roughly equal proportion of men and women (including housewives, both aged below and above 30, and those below the age of 20 was kept to a maximum of 5% in total). They delivered the questionnaires in a random fashion at busy centers of the two regions in the morning and the completed questionnaires were collected in the afternoon at the same location. Interviewer briefing also included a beginning question to assure the right target respondents who could briefly comment on the touristic attractiveness of each of the three destinations selected for the study. More importantly, the interviewers were provided with brief procedures and checklist of key issues in approaching respondents. To increase participation rate in the survey, an incentive award coupons worth of HK$100  (US$13) per completed questionnaire was offered. To obtain a broad cross-section of travelers from Hong Kong, interviews were held on weekdays as well as Sundays and holidays. Initially, the researchers aimed at 50% male and 50% female respondents. In terms of age, half aged below 30 and another half above the age of 30 were targeted. More than 400 questionnaires were completed by the respondents. Certain difficulties were encountered during survey administration: some respondents were in a hurry, and found the survey questionnaire lengthy. As well,
tourist destination countries, best liked and least liked attributes of China, Macau, and Hong Kong were investigated. Differences among different groups of respondents along destination-related dimensions were analyzed by use of the application of Tukey’s Post Hoc Multiple Comparisons of One-Way ANOVA.

Tourists’ Behavior, Destinations Brand Equity, and Other Brand Equity Constructs

The current study attempts to bring in tourism assessment counting on the economic value imparted to a country due to its tourists’ behavior, thus proposing a measure of a country brand equity for tourism development, that can also highlight areas to facilitate tourism development. This should serve as an indicator that may guide government investment priorities to boost tourism potential of the country. Because the added equity mainly arise from tourists’ behavior in the host country, at particular destinations, and a destination is usually regarded as a tourism product, the measure can also be understood to be composed of country brand equity, tourism brand equity, destination brand equity, and event brand equity, making reference to tourists’ spending potential at various attractive destinations on different occasions (Kaynak and Mak 2007). It is noteworthy that the measures would not be confined to the destination per se of the associated characteristics or features, but also acknowledge the potential value arising from the tourist’s economic activities pursuant to the physical country attributes and/or his/her attaining personal satisfaction (both physically and psychologically).

Bearing in mind that tourists mostly add value to a country via consumer behavior, the measure of the model will in part exhibit the characteristics of the customer-based brand equity.

Customer-based Brand Equity and its Salient Dimensions

In the development of tourism marketing plans and strategies, a country brand may be categorized at different levels of abstraction. For instance, a country brand equity (value) as a macro construct has been studied extensively in different contexts (Papadopoulos and Heslop, 2002). At the second level, a country brand may be categorized in terms of destinations, regions (areas), and events (attractions) (Kotler and Gartner, 2002). These are micro constructs. To be successful in effective country brand building and development, a country must be very specific about what types of country-specific products/amenities/attractions/ facilities it wants to market, how it will market, and to which market segments it will market. As part of their country branding strategy, countries engage in creating travel destination brands, positioned as powerful market niches and distinct from the competing country destinations. Such categorization is related to event branding. In this instance, brand equity of particular tourism events offered in a country destination is measured. Based on this measurement, appropriate tourism marketing plans and strategies are developed.

Measuring customer-based Brand Equity for Tourism Destination

It was stated by Yoo and Donthu (2001) that there is still yet no agreement on how brand equity phenomenon should be measured. As such, brand equity can be created, maintained, and expanded by strengthening the dimensions of brand equity. Brand equity consists of four dimensions: brand awareness, brand loyalty, perceived quality of brand and brand associations (constituting brand image) (Aaker 1991 & 1996).

Tourism brand is treated within the general parameters of a country brand. Prior research discovered that loyal customers show more unconditional preference for the destination brand than non-loyal or brand-switching customers (Grover and Srinivasan 1992). Such strong attachment and loyal bondage can not be either developed or destroyed in the short run but can be created through carefully designed long-term marketing strategy development. It is posited that the tourist destination accessible in a country have a similar bondage effect, which is moderated by the desire to travel to a different attraction.

On the basis of the conceptualization developed and the existing literature, and following Konecnik (2006), country brand equity variables of awareness, image, perceived quality, and loyalty were operationalized in
estimating their standardized loading for the evaluation of customer-based tourism brand equity in regards to tourism destination selection.

**Applying the Tourism Brand Equity Model to Predict Future Tourism Market Potential of Countries**

A country can first assess its own current and future tourism market potential by making comparison to those positive attributes that impress tourists to see how many of those positive traits/attractions the country itself is already in possession and which others should be developed as either in the short term or in the long run.

Factor analysis results for perceived quality in China (see Table 1, 2, 3 of Fig. 1) show 2 factors with eigenvalue larger than 1. With a loading of significance of 0.5 or above on the principal factor (which explains 43.8% of the variance). Underlying variables comprise: Quality perception of the country, quality of living in the country, safety record of the country, employee service quality, law and order in the country, and buildings, monuments, and sculptures. Variables with loadings of 0.5 or above on the other factor (which explains 10.2% of the variance) comprise: quality of in-country transportation system, recreation and entertainment facilities, and availability of sports and recreation arenas.

In this regard, tourists’ quality perception of China, quality of living in the country, safety record (police and fire protection) of the country, employee service quality, law and order and quality of in-country transportation system each scores a mean below the average rating of 3, implying room for further improvement and development.

As China becomes more of a service-oriented economy, an increased focus of attention will be exerted on these service development factors in order to satisfy ever discerning tourists’ needs and expectations.

<table>
<thead>
<tr>
<th>Table 1 Rotated Component Matrix: China</th>
<th>Component</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>qual.perc.cou_cn</td>
<td>.678</td>
</tr>
<tr>
<td>exis.mark_cn</td>
<td>.385</td>
</tr>
<tr>
<td>qual.livi.cou_cn</td>
<td>.631</td>
</tr>
<tr>
<td>safe.reco.cou_cn</td>
<td>.711</td>
</tr>
<tr>
<td>emp.l erv.qua_cn</td>
<td>.816</td>
</tr>
<tr>
<td>law.orde.cou_cn</td>
<td>.830</td>
</tr>
<tr>
<td>buil.monu.scu_cn</td>
<td>.523</td>
</tr>
<tr>
<td>qual.inco.tran_cn</td>
<td>.444</td>
</tr>
<tr>
<td>recr.ente.fac_cn</td>
<td>.274</td>
</tr>
<tr>
<td>spor.recr.are_cn</td>
<td>.034</td>
</tr>
<tr>
<td>avai.wild.lif_cn</td>
<td>.217</td>
</tr>
</tbody>
</table>

Similarly, in regards to Hong Kong, 2 factors with eigenvalue greater than 1 were derived from the following variables. With loadings of 0.5 or above on the principal factors (which explained 45% of the total variance). Underlying variables comprised of quality perception of the country, existing marketplaces, quality of living in the country, safety record of the country, employee service quality, law and order in the country, quality of in-country transportation system, and recreation and entertainment facilities. On the other hand, the following variables with loadings of 0.5 or above on the other factor (which explains 10.1% of the variance) comprised the variables of buildings, monuments and sculptures, sports and recreation arenas, and availability of wild life/ecotourism destinations.

In this regard, ‘employee service quality’ for Hong Kong scores a mean of 2.73 and ‘Hong Kong’s availability of wild life/ecotourism destinations’ a mean of 2.7, below the average rating of 3, signal a need for concerted upgrading.

<table>
<thead>
<tr>
<th>Table 2 Rotated Component Matrix: Hong Kong</th>
<th>Component</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
</tr>
<tr>
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<td>.686</td>
</tr>
<tr>
<td>exis.mark_hk</td>
<td>.608</td>
</tr>
<tr>
<td>qual.livi.cou_hk</td>
<td>.684</td>
</tr>
<tr>
<td>safe.reco.cou_hk</td>
<td>.794</td>
</tr>
<tr>
<td>emp.l erv.qua_hk</td>
<td>.722</td>
</tr>
<tr>
<td>law.orde.cou_hk</td>
<td>.524</td>
</tr>
<tr>
<td>buil.monu.scu_hk</td>
<td>.448</td>
</tr>
<tr>
<td>qual.inco.tran_hk</td>
<td>.745</td>
</tr>
<tr>
<td>recr.ente.fac_hk</td>
<td>.593</td>
</tr>
<tr>
<td>spor.recr.are_hk</td>
<td>.373</td>
</tr>
<tr>
<td>avai.wild.lif_hk</td>
<td>.042</td>
</tr>
</tbody>
</table>

However, for Macau, only one factor exhibits eigenvalue larger than one, with acceptable loadings (>0.5) on each of the 11 variables employed in the factor analysis.

This implies that those tourists who visit Macau for a general reason (we can assume that this general reason is gambling) do not consider specifically any of the given attributes of perceived quality. We can also state that most tourists visiting Macau may have also some other special interest not mentioned in the survey. Motivational research techniques are needed to uncover these hidden factors motivating people to visit Macau.

In this regard, ‘existing marketplaces’ for Macau scores a mean of 2.99, and ‘quality of in-country transportation system’ a mean of 2.88, both being contributing factors but below the average rating. Again this implies the need to invest to upgrade by the government.
Table 3 Component Matrix: Macau

<table>
<thead>
<tr>
<th>Component</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>qual.perc.cou_ma</td>
<td>.719</td>
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<tr>
<td>exis.mark.ma</td>
<td>.694</td>
</tr>
<tr>
<td>qual.livi.cou_ma</td>
<td>.725</td>
</tr>
<tr>
<td>safe.reco.cou_ma</td>
<td>.683</td>
</tr>
<tr>
<td>empl.serv.qua_ma</td>
<td>.651</td>
</tr>
<tr>
<td>law.orde.cou_ma</td>
<td>.643</td>
</tr>
<tr>
<td>buil.monu.scu_ma</td>
<td>.740</td>
</tr>
<tr>
<td>qual.inco.tran_ma</td>
<td>.686</td>
</tr>
<tr>
<td>recr.ente.fac_ma</td>
<td>.666</td>
</tr>
<tr>
<td>spor.recr.are_ma</td>
<td>.668</td>
</tr>
<tr>
<td>avai.wild.lif_ma</td>
<td>.507</td>
</tr>
</tbody>
</table>

One component extracted, no rotation.

**Trip-related Information of Travelers**

It was discovered that 45% of the respondents stated that they go on holiday 160 kms (100 miles) away from home once a year, 34.4% twice a year, 16.1% three times a year, and 4.4% four times a year. Of the total respondents, 71.7% permanently reside in Hong Kong, and 28% of them are permanent residents of the following countries: Australia (1.7%), Canada (1.1%), Macau (1.7%), Singapore (0.6%), United States (1.1%), Taiwan (0.6%), France (0.6%), India (0.6%), Iraq (0.6%), Japan (3.3%), UK (0.6%) and China (13.9%). Study results further illustrates that 21.1% of the respondents involved 4 overnight stays, 20.6% 5 overnight stays, 15.6% 3 overnight stays, 10.6% 7 overnight stays, 10% 6 overnight stays, 7.8% 2 overnight stays, 3.3% 1 overnight stays, 2.2% 8 overnight stays, 2.2% 10 overnight stays, 1.7% did not stay overnight, 1.1% 14 overnight stays, and 0.6% involved 19, 30, or 80 overnight stays. Most people (39.2%) go on holiday with their friends, while some others (32.1%) with their spouses, 16% with their children, and 11.3% go on holiday alone.

**Socio-economic and Demographic Characteristics of Travelers**

Of the 180 respondents, most people (37.8%) would spend US$100-150 a day (inclusive of hotel rental and meals), some (18.3%) would spend less than US$100 a day, 17.8% US$151-200, 9.4% US$201-250 a day, 5.6% US$251-300, 5% US$301-350, and 3.3% US$351-400, and 2.8% more than US$400.

Most respondents (30.5%) first learned of the destination country before the visit from the travel agent, 28.6% from friends and relatives, 19.7% from brochures and print media, 15.2% from TV/Radio advertising, and 6% from other sources of information such as internet. Respondents being male have 47.8%, and 51.7% female. Most (42.2%) are of the age of 20-29, 31.1% age of 30-39, 16.7% age of 40-49, 5.6% 50-59, 3.9% less than 20, and 0.6% age of 60-69. Most (63.9%) of the respondents have highest level of education up to university or college education, 25.6% up to secondary school education, 6.7% up to vocational training, and 1.7% other level of education including one up to doctoral level of education.

A majority of the respondents (31.7%) describe their present occupation as professionals, 16.7% as administrative personnel, 13.9% as technical personnel, 13.3% as tradesman or salesman, 13.3% as student, 6.1% as housewife, 5% others including 1 aviation and 1 designer. Most (51.9%) have a monthly income in the range of US$2,000-3,999, some (19.2%) below US$2,000, 17.3% US$4,000-5,999, 7.7% US$6,000-7,999, and 3.8% US$8,000-9,999.

**Relative Importance of Country Destination Choice Criteria**

In regard to perceived quality of China, Macau and Hong Kong, One-way ANOVA test was conducted. Analysis results reveal that the mean scores of each of the 11 attributes (such as quality perception of the country, law and order, etc.) in each of the three places differ significantly, implying the need for further scrutiny to find out which of the three single out more conspicuously, except for the variable of buildings, monuments, and sculptures (see Table 4).

<table>
<thead>
<tr>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>buil.monu.scu</td>
<td>Between Groups</td>
<td>.544</td>
<td>2</td>
<td>.272</td>
</tr>
<tr>
<td></td>
<td>Within Groups</td>
<td>188.367</td>
<td>177</td>
<td>1.064</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>188.911</td>
<td>179</td>
<td></td>
</tr>
<tr>
<td>All other variables individually</td>
<td>Between Groups</td>
<td>10.8-109.2</td>
<td>2</td>
<td>5.4-54.6</td>
</tr>
<tr>
<td></td>
<td>Within Groups</td>
<td>116.5-199.3</td>
<td>176 or 177</td>
<td>0.658-1.126</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>N. A.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
To fulfil the assumption of independence of variables (of rating for each of the three places), the 180 responses for each of the 11 variables were converted into 3 groups of 60 different sample elements for each place as input data for the ANOVA procedure.

Besides, the responses in the questionnaires reflect that traveling to China poses a variety of expectations in regards to appreciation of landscapes, beauty of nature, and provincial traditions, cultures, arts, and institutions. At some places such as in the industrialized cities, infrastructure is well developed, whereas at some places such as in the rural areas or counties, modern facilities are not fully adequate at the current state of tourism infrastructure development.

Hong Kong’s popular value for tourists includes a variety of consumer products and many other products that usually present a good quality standards yet only at a reasonable price or even low price. Besides, wide varieties of food menu of many nationalities, they also offer good value for money. Good variety of scenery can be accessible in short traveling time because of availability of excellent transportation infrastructure.

Macau is a neat place with relatively small population. The urban areas provide adequate number of good facilities, especially the activities of the entertainment industry. Serving several cultural heritages, outskirts of the urban areas provide tourists a refreshingly novel rural experience.

Selected Dimensions of Travel to Country Destination

Previous discussion has shown how the quality perception segment of the Tourism Brand Equity Model correctly reflects the specific area(s) of shortcomings amidst the existing conditions in China, Macau and Hong Kong to be further developed by concerted efforts to enhance the potential of the tourism industry in each place. Next the relative importance will be shown of generally selected dimensions of travel to country destinations as derived from ‘country specific characteristics’, the first segment of the same Equity Model.

Selected dimensions of travel to a country destination often originate from an awareness of respective attributes of a country. However, the decision to plan to actually going on a tour will materialize only if there is not a negative image going against the tentative awareness of attaining specific benefits or satisfaction. Borrowing from Keller (1993), destination brand image is defined as perceptions about a brand as reflected by the destination associations held in consumer memory. Thus based on the survey, factor analysis identifies the factors loaded with the following variables to be polished to facilitate people’s awareness and other variables to formulate a positive image, in the cases of China, Macau and Hong Kong.

**Awareness** For China, two factors have eigenvalues larger than 1, and with loadings of 0.5 or above on the principal factor, explaining 40% of the variance. Loaded variables (after rotation by varimax) comprise accessibility of the destination, rich cultural heritage, landscape and natural beauty, climate, political openness, level of development of the country and safety of the country. Because people are aware of these specifics of China, they more likely decide to travel to China (see Table 5 of Fig 2).

<table>
<thead>
<tr>
<th>Variable</th>
<th>Component 1</th>
<th>Component 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>pol.open_cn</td>
<td>.013</td>
<td>.751</td>
</tr>
<tr>
<td>access_cn</td>
<td>.628</td>
<td>.248</td>
</tr>
<tr>
<td>rich.cult_cn</td>
<td>.808</td>
<td>.023</td>
</tr>
<tr>
<td>lev.deve_cn</td>
<td>.086</td>
<td>.775</td>
</tr>
<tr>
<td>safe.coun_cn</td>
<td>.383</td>
<td>.597</td>
</tr>
<tr>
<td>land.natu_cn</td>
<td>.806</td>
<td>.097</td>
</tr>
<tr>
<td>coun.infr_cn</td>
<td>.403</td>
<td>.604</td>
</tr>
<tr>
<td>climate_cnn</td>
<td>.543</td>
<td>.370</td>
</tr>
</tbody>
</table>

Because people are aware of these specifics of China, they more likely decide to travel to China. Similarly, for Hong Kong, two factors show up. With loadings of 0.5 or above on the principal factor explaining 37.7% of the variance, variables comprise political openness, accessibility, level of development, safety, country infrastructure fulfilling visitors’ needs, rich cultural heritage, landscape and natural beauty, and climate. Macau, on the other hand, has only one factor (that explains 42.7% of variance), comprising all eight variables loaded of 0.5 or above.

**Image** for China, two factors have eigenvalues larger than 1. With loadings of 0.5 or above on the principal factor explaining 38.3% of the variance, variables comprise range of sports and recreation facilities, friendliness of the people, available shopping facilities, receptiveness of country residents towards visitors, liquor laws and regulations, opportunities for sportive activities, cultural and other attractions, rich history and famous personages and availability of places for adventure (see Table 6 of Fig. 3).

Similarly, for Hong Kong, two factors show up. Contributing to the principal factor explaining 43.6% of the variance, loaded variables comprise cultural and other attractions, rich history and famous personages, range of sports and recreation facilities, availability of places for adventure, friendliness of the people, opportunities for sportive activities, available shopping facilities, receptiveness of residents towards visitors and liquor law and regulations and liquor laws and regulations.
Conclusions and Recommendations

Sports and recreation facilities.

Visitors, liquor laws and regulations, cultural and other facilities, receptiveness of country residents towards money, entertainment facilities, available shopping opportunities.

36.9% of the variance, variables comprise value for the tourists and thus for the country itself – the added value for the tourists.

Development to boost tourism.

Macau and Hong Kong. The government of each country has documented an assessment of the application of a proposed country brand equity model to identify core areas wanting further development.

Insightful conceptual analysis should be more readily forthcoming for studying a country’s tourism development potential, by examining the tourism product (the destination) and its image, using the conceptual frameworks and theoretical constructs of the consumer product and the country brand equity. Based on the model developed in this research, areas wanting further development are highlighted, which coincide with realistic situations: In regards to Hong Kong, for example, availability of wild life/ecotourism destinations was rated 2.67, below the average, while our model highlighted that the attribute is associated with one of two core factors affecting quality perception of the place. This indicated the area of weakness calling for priority in upgrading for the sake of tourism. In regards to China, the model developed highlighted 9 variables loading significantly on two core factors critical for boosting tourism. However, six of the variables were rated below average, calling for systematic development to boost tourism.

References


Grover, R and V. Srinivasan (1992), Evaluating the multiple effects of retail promotions on brand-loyalty and brand-switching segments, Journal of Marketing Research, 29 (February), 76-89.


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Changes in Business Structures: Challenges for Management of Libyan Industry

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Erik J. de Bruijn, University of Twente, The Netherlands.
Harm-Jan Steenhuis, Eastern Washington University, USA.

Libya has become a transition economy due to global industrial and political changes in the past decades. Being for long time under government control has created a number of challenges for the management of the SOEs. The most challenging aspect is firm performance improvement. Based on a pilot study, this paper develops a conceptual model that determines the firm performance after transition. The results show that despite the change of managerial incentive, behaviour and relationship; the performance of investigated firms did not improve. This can be explained by firm’s restructuring, privatisation method, trade openness, and the weak enforcement of law.

Introduction

Privatisation is one of the basic steps in the transition of the economy from a centrally planned to a market-based economy (Louzek, 2005). Most of the governments have embarked privatisation with an optimistic set of objectives e.g. improve the performance of the state-owned enterprise SOEs (Ruiz-Mier, Garron, Machicado, & Capra, 2002). A large number of empirical studies have compared various performance ratios before and after privatisation to examine whether privatisation leads to improve the firm performance. Most of these studies have documented superior performance improvement after privatisation; although a few studies resulted in opposite conclusions (Megginson and Natalie 2006). Such mixed results seem to indicate that there are other factors that are more important, in determining the performance changes, than privatisation (Parker & Martin, 1995). Previous studies in determining these factors concluded that privatisation is combined with change in internal and external organisational factors (Ramamurti, 2000). The effect of these factors cannot be isolated from the effect of privatization (Sheshinski & Lopez-Calva, 1999). However, these studies did not explore the dynamic interrelationships among privatisation and external organisational changes (Megginson and Natalie, 2006). The aim of this paper is to bridge this gap by developing a conceptual model that explains the process of privatisation with regards to stages, activities and factors at each stage that seem to have an influence on such process and its outcome. To achieve this aim, two research questions were examined: (a) What are the stages in the process of privatization and which factors influence these stages? (b) What are the results of privatization in terms of a firm’s performance?

Literature Review

To obtain the foundation of the conceptual model, this section divided into two parts. The first part presents stage of privatisation and influential factors at each step. The second part discusses empirical studies that compare the firms before and after privatisation.

Privatisation is broadly defined as a process providing the private sector with the biggest role in business decision-making (Berg & Berg, 1997). In the narrow sense of the term, which is applied in this paper, privatisation is defined as a process of selling the government assets in the SOEs to private investors (Jackson & Price, 1994). The first stage in this process is a feasibility study to determine which SOEs are most likely to be privatised (Moor, 1986). The strategic nature and the economic importance of the SOEs have an influence on this stage (Zahra, Ireland, Gutierrez, & Hitt, 2000). The second stage is restructuring actions to get the SOEs into a position where they can survive in private sector and also to encourage private investors to become involved in the process of privatisation (Moor, 1986). Six internal areas within the SOEs have been identified for restructuring including labour, management, efficiency program, investment, de-investment, and debt (Lopez-de-Silanes, 1997). Besides internal restructuring, some degree of economy restructuring is required to create effective environment for privatisation, to assure investors that they will be fairly treated and to protect the consumers against the abuses of monopoly power which exists to make profits (Kikeri & Nellis, 2004). Economy restructuring is consistent with deregulations and liberalisation (Ramamurti, 2000). These restructurings depend on the development of the economy because developed and developing economies are not equalled endowed with market-supporting institutions (Boubkri Cosset, & Guedhami, 2005). The final stage is the decision of privatising the SOEs (Moor, 1986). Several privatisation methods are available for this decision (Mahoobi, 2003).
The choice of an appropriate method depends on the governments’ objectives, the characteristic of the market, and the SOEs (Megginson & Natalie, 2004). Megginson, Nash, and Randenborch (1994) documented strong performance improvement after privatisation for 61 firms, from 6 developing and 12 industrialized countries, that were privatised during 1961-1990. Boubkri, Cosset, and Guedhami, (1998) found significant performance improvements after privatisation for 79 firms, from 21 developing countries, that were privatised during 1980-1992. D’Souza and Megginson (1999) documented significant performance improvements after privatisation for 85 firms, from 13 developing and 15 industrialised countries, that were privatised during 1990-1996. Megginson and Natalie (2006) presented a survey of 64 studies that examined the impact of privatisation in developing countries. The authors found that in most of their studies, privatisation yields performance improvements, only six studies document performance decline after privatisation. Overall the result of Aussenegg & Jelic (2002) the privatised firms in Poland, Hungary and Czech Republic did significantly reduced efficiency in post-privatisation period. Crompton and Jupe (2003) concluded that privatisation produced an inefficient system for Britain’s railways with higher costs, reduced quality of services, and increased public subsidy.

Such mixed privatisation results led researchers to assume that there might be other factors that are fundamental in determining the firm performance (Parker & Martian 1995). This was investigated by researchers who sought further to determine the sources of performance change after privatisation. Galal, Jones, Tandon, and Vogelsang (1994) attributed positive welfare gains that occurred in 11 out of 12 firms from the UK, Chile, Malaysia, and Mexico to the way in which the firms were privatised; trade liberalization; deregulations; and changes in management, incentives, and training programs. Andrews and Dowling (1998) found a strong association between superior post-privatisation performance of 41 privatised firms, change in leadership, and financial restructuring. Laurant and Bozec (2001) found that changes in firm’s goals and restructuring that took place after privatisation played a determining role in enhancing the productivity of Canadian National and its privatised rival Canadian Pacific. Loh, Kam, and Jackson (2003) suspected that changes in management practices and work organization after privatisation are the key factors that improve the operating efficiency of the plantation sector in Sri Lanka. Li, Zhen-Qiang and Wu (2004) found that countries that implemented more aggressive reform programs experienced significantly more performance gains than countries that implemented less aggressive reform programs. Debrah and Toroitch (2005) attributed the success of the Kenya airline after privatisation to the way in which the firm was sold, the change of the management, the cut of political intervention, and restructuring prior to privatisation. In 2005, the Libyan Ministry of Planning stated that most of the SOEs that were privatised during 1992-1999 showed a performance declined because of restructuring prior to privatisation, the government involvement in economic activities, and the method of privatisation. The result of Boubkri, Cosset, and Guedhami (2005) showed significant performance improvements for 230 firms from 32 developing countries that were privatised during 1990-1998. However, the changes in performance varied with macro-economic reforms and the effectiveness of corporate governance. In particular economic growth, control relinquishment by the government, legal protection of investors, developed stock market, trade and financial liberalisation. D’Souza, Megginson and Nash (2005) indicated that the ownership, degree of economic freedom, level of capital market development are significantly affect post-privatisation performance of 129 privatised firms, from 23 developed countries, that were privatised during 1961-1999. Aussenegg and Jelic (2007) found that the most important determinants of no performance improvement after privatisation, for 166 privatised firms from Hungary, Poland and Czech Republic during 1990-1998, were country effects, timing of the privatisation, industry classification, and the state ownership.

Conclusion the literature review shows that privatisation is combined with change of external and internal organisational factors. The influence of these factors is different across developed and developing countries. Most of the privatisation studies that have focused on developed countries have stated that changes of internal organisational factors are the most important determinants of post-privatisation performance (D’Souza, Megginson & Nash, 2005). Privatisation studies that have focused on developing countries have stated that the most important determinants of post-privatisation performance are changes of external organisational factors. This was referred to that these countries are not equalled endowed with market-supporting institutions (Boubkri Cosset, & Guedhami, 2005). Accordingly, the following section develops a conceptual model explains privatisation process and its dynamic interrelationship with relevant factors. The section also proposes a number of propositions that help to explain the process of privatisation. The development of such model is in line with the suggestions for further research as discussed by Cuervo and Villalonga (2000), Ramamurti (2000), Zahra, Ireland, Gutierrez, and Hitt (2000), Aussenegg and Jelic (2007).

The Privatisation Model

This model (figure 3.1) was developed based on the literature review in previous section. The performance of the SOEs, in this model, is considered as the initiation of the privatisation at micro-level because privatisation is largely considered as response to the poor performance of
the SOEs (Ramamurti, 2000). The performance of former SOEs is considered as the final outcome of privatisation (D’Souza & Megginson 1999) because the primary objective of any privatisation, at micro-level, is to improve the performance of former SOEs. To gain better understanding of how this performance is improved, the model is divided into four stages. The first stage is the feasibility study; restructuring prior to privatisation is the second stage; the third stage is the decision of sale (Moor, 1986). The fourth stage of the model considers newly privatised firms, which have different characteristics compare with the SOEs, as intermediate outcome of privatisation (Martin & Parker, 1997).

Figure 3.1 a conceptual model explaining the process of privatization and its outcomes

![Conceptual Model](image)

**Operationalisation of the model**

The feasibility study was undertaken by skilled management as a first stage of the privatisation process. The aim of this stage is to describe the situation of the SOEs and therefore determine which SOEs are most likely to be privatised. The conclusion of this study includes possibility, options and prerequisites of any sale, and recommendations, which are utilised to assist to obtain Parliamentary authority to precede the choice of option (Moor, 1986). Parliamentary authority includes also the creation of a new agency to continue with the process of privatisation (Kayizzi-Mugerwa, 2002). However, the determination of the SOEs for privatisation is influenced by the strategic of the SOEs for national sovereignty and their importance for fulfilling market demand, creating jobs, meeting the needs of the other sectors (Zahra, Ireland, Gutierrez, & Hitt, 2000). Accordingly, the following proposition is proposed:

**P.1: Strategic and important SOEs are less likely to be privatised, while poorly performing SOEs frequently among the first to be privatised.**

Restructurings actions prior to privatisation are a second stage of privatisation process (Moor, 1986). These restructurings were divided into SOEs and economy restructurings. The SOEs must be restructured because their senior managers have been hired to cooperate with politicians not to run the SOEs efficiently (Barberis, Boycko, Shleifer, & Tsukanova, 1996). Thus, it is possible that senior managers of the SOEs could be replaced to command a greater price for the SOEs. If this happens, the possibility of replacing the senior managers again after privatisation would be low (Cuervo and Villalonga, 2000). Since, the SOEs are often overstaffed for social and political reasons (Boycko, Shleifer, & Vishny, 1996) labour reduction is expected as part of the SOEs restructuring (Parker, 1991). To adjust labour surplus governments have several mechanisms including early-retirement programs to labour who take the chance to retire, self-employment programs to labour who wish to start their own business (Omran, 2004), job search assistance, and severance payments to labour who are displaced by restructuring actions. Furthermore, the SOEs restructuring also include absorption of outsiders’ debt, efficiency program, investment measures, and finally de-investment (Lopez-de-Silanes, 1997).

To protect the consumers from the abuses of monopoly power which exists to make profits and to assure investor that they will be fairly treated (Kikeri & Nellis, 2004), economy restructurings are required. In particular, for transition economies, where the SOEs dominated all markets and where restrictions on private participation and entry were powerful (Kikeri & Nellis 2004). Economy restructuring is consistent with deregulations (Ramamurti,
2000) and liberalisation (Dornbusch, 1992). These restructurings allow new business entry to the market which was previously monopolised by the SOEs (Ramamurti, 2000). The introduction of other firms raises the competition level and threat of bankruptcy (Hu, Song, & Zhang, 2004). When investors finance their business, they need to have their rights protected from the government itself and from other parties (Boubakri, Cosset, & Guedhami, 2005). Accordingly following proposition is proposed:

**P.2: Privatisation without restructuring the economy and the SOEs is likely yield no performance improvement**

The decision of privatisation is a third stage of the privatisation process. When the SOEs are ready, they must be sold at fixt price that fairly reflects the Exchequer’s interest (Moor, 1986). The SOEs can be privatised through several different methods (Mahoobi, 2003). The choice of an appropriate privatisation method depends on the governments’ objectives, the characteristic of the market, and the SOEs (Kamal, 2002). Partial privatisation has been used as first step for further privatisation in the SOEs where full privatisation is not feasible or desirable (Berg & Berg 2001). Public share offerings are often used to privatise large SOEs with good performance (Mahoobi, 2003). Management buyouts have been used to reduce the adverse impact of privatisation on the management and gain their support for privatisation (Mahoobi, 2003). Politically, mass privatisation is popular because it avoids the sell-out of national assets to foreigners (Gray, 2002). Thus, the following proposition is developed:

**P.3: Privatisation decision might be influenced by government objectives and the characteristics of the SOEs and the industry.**

Newly privatised firms are created as an intermediate outcome of the privatisation process. In contrast with the SOEs, newly privatised firms are owned by private investors and controlled by marketing-skill managers who own little or none of the equity (Denis and McConnell, 2003). They also are no longer being financed and protected by the government (Bortolotti, Fantini, & Siniscaloc, 2004), but it is subjected to market forces where the threat of bankruptcy is very high (Zahra, Ireland, Gutierrez, & Hitt, 2000). The new owners are expected to have strong incentives to monitor the management lowered performance improvement (Denis and McConnell, 2003) because they capture most of the performance improvements (Meggison, Nash, & Randenborch, 1994). In regards to the performance improvement, the firm might be structured again because the restructuring prior to privatisation might not fit new owners’ goals, or the government might did insufficient restructurings (Lopez-de-Silanes, 1997). It is possible that management can be replaced again to hire new management who capable to identify the necessary restructuring and bring the performance improvements (Ramawamy & Glinow, 2000). To encourage management to apply the optimal amount of effort on their job (Shleifer & Vishny, 1997) incentive contracts expected to be designed among owners and management. The contracts can take a variety of forms, ownership and control agreement, the management control the firm and the owners removed from day-to-day operations because they cannot directly observe the optimal needed efforts (Nickell, 1996). Another form of incentive is salary agreement, which links the salary to the firm performance (Cuervo & Villalonga, 2000). Similar to owner and management, a salary contract is expected to be designed among management and workers. Managers are expected to reduce the centralization plan, as part of internal structural adjustment program, to ensure faster decision making. Labour also is expected to be reduced again (Parker, 1991). Thus, the following proposition is developed:

**P.4: Privatisation is expected to lead to internal structural adjustment program which is mainly influenced by the new owners, pre-restructuring, and market environment.**

The performance of the privatised firm is measured by comparing the profitability and the operating efficiency over period of two years before and two years after privatisation. The profitability was measured by using: return on sales (net income to sales), return on assets (net income to total assets) return on equity (net income to equity) (Megginson, Nash, & Randenborch, 1994). The operating efficiency was measured by using: inflation adjusted sale per employee and net income per employee (D’Souza & Megginson 1999). Thus, following proposition is developed:

**P.5: Privatisation is associated with performance improvement measured by profitability and efficiency.**

**Methodology**

Application of the model. Multiple case study design is applied partly because the development of such model requires case-by-case basis with in-depth research by looking inside of the privatised firms and explain exactly how the factors are interact. Partly due to that, the research focuses on contemporary events that no control over (Yin, 2003), and a case study offers the possibility to obtain in-depth knowledge (Verschuren & Doorewaard, 1999) which is required for developing the research model. To increase construct validity, data was obtained from multiple interviews with the same manager, observation, documentation and archival records (firm hierarchy, budget, and previous collected data). Furthermore, key informants were asked to review a draft case study report. Pattern matching logic was used to compare an empirically based pattern with the predicted one and therefore, ensure internal validity (Yin, 2003). To increase external validity, a multiple-case study approach was used that resulted in multiple observations for each predicted relationship (Eisenhardt, 1989). To improve the reliability of the research, a case study protocol was developed to ensure that the same basic approach would be used in each case and to
Research Execution

Libya is particularly interesting for a number of reasons. First of all, Libya is a developing country where the performance of privatised firms is expected to be influenced by external factors rather than internal factors. Secondly, Libya is rich endowed with natural resources which means Libya not like other developing countries that have embarked on privatisation in response to pressures from international organisations and have been required to introduce substantial economic liberalisation (Zahra, Ireland, Gutierrez, & Hitt, 2000). This might influence the process of privatisation through restructuring prior to privatisation and/or the choice of privatisation methods.

Thirdly, Libya was internationally isolated for a decade 1992-2003 (Otman, 2007). During this period, most of business activities, especially the SOEs which were recently privatised, suffered from a lack of new technology and delay of maintenance programs (the Ministry of Planning 2005). If the government decides to maintain and renew all machinery of SOEs before privatisation, it would cost the government rather than generating revenues from sales; otherwise there would be a big challenge for new owners to start their business with old machinery. Finally, Libya has been neglected in the privatisation literature. The research, more specifically, focuses on the privatisation of the industrial sector because it was the first sector exposed to the privatisation and significant emphasis was placed on it. Fifteen privatised industrial firms were selected based on two criteria. Firstly, all selected firms must have been privatised during 2004 in order to have at last two years of post-privatisation data available. Secondly, it is argued that the change in the performance of large-scale firms might not fully occur until many years after privatisation (D'Souza, Megginson and Nash (2005). For this reason, all large-scale firms, employing more than 250 employees, were excluded.

Confectionery and perfume firms were excluded because they went bankrupt. In 13 privatised factories, total of 40 face-to-face interviews were held with 23 managers. During each interview, managers were asked open-ended questions about restructuring that took place before and after privatisation, employees’ incentives, relationships, and behaviours. Each manager was asked to review a draft report. Besides visiting privatised firms, Privatisation Agency, Industrial Research Centre, and Industrial Information Centre were visited. Six government officials were interviewed each was asked open-ended questions about privatisation and its progress. Besides the interview, sale contracts, financial income, economic reports, firm’ brochure, list of privatised firms and resolutions, official reports, and privatisation Journals were studied.

Findings and Discussion

The Libyan state industrial firms were hiring too much unqualified, low productive, and unpaid labour. This, on one hand, refers to the nationalisation policy that took place during 19970s and 1980s when private business were almost inhibited and government expanded its role to be responsible for all aspects of life. Thus, most people who were working within the private sector moved to work in the state sector. On other hand, most people believe that if they worked with the government, they would benefit from a social security system in the future. The government involved in business activities created another problem for the Libyan industrial firms, e.g. law 15/1985, concerns the salary system and limited the ability of senior managers to encourage their workers. The SOEs suffer from weak management that mainly refers to the availability of multiple supervision committees for the same task, e.g. a board of directors, inspection committees, financial controllers, and revolutionary group. They limit the authority of senior managers and dominate most of the working time. Many Libyan state industrial firms suffered from huge external debt and the inability to compete with foreign productions. Several unfair adjudications cost the SOEs huge financial-loses as the judicatory considers industrial firms as government assets. Most of the industrial firms suffered from high energy and internal delivery costs because they were established based on unscientific principles. As results, return on investments have declined to 9.7 % and operating capacities range between 16-36 % (the Ministry of Industry 2000; the Ministry of Planning 2002).

Based on the finding of this paper, all firms visited were organized into functional departments and a highly structured. Senior managers were required to a follow chain of command about their decisions. It was observed that senior managers had more power than they should because either the government was absent or the government provided the power. However, managers had no incentives to work efficiently because their salaries were frozen with minimal increases and they were paid irregularly.

P.1: a feasibility study was undertaken by a number of evaluation committees to evaluate 29 large state-industrial firms from 1999-2001. Based on the strategic nature, and the financial and technical status of each firm, the committees have classified the SOEs into three groups. The first group contains 18 strategic industrial firms that have good financial positions and solvency. This group was recommended to continue within the public sector as their productions are required for economic development. Furniture public firm (Musrata branch), one of this group, is included in this research. The second group contains five faltering industrial firms suffering from cash flow problems and over-laden with huge obligations. This group was recommended to be privatised. Textile National-firm, as one
of this group, was visited but later on it was removed from the sample because of unavailability of data. The third group contains seven bankrupt industrial firms, they not only failed to realise their targets, but they persistently made losses, with a very large debts, and suffer from marketing, technology, and cash flow problems. This group was recommended to be liquidated by proceeding with bankruptcy and privatising their affiliate firms. Al Mamoura foodstuffs and national development firms, as part of this group, are included in this research. These recommendations were authorised by the government. At the same time, a privatisation agency was established to complete the process of privatisation and supervising the SOEs before and after privatisation.

P.2: To prepare the SOEs for privatisation the validity of all business contracts were examined to determine any prior obligations or legal actions brought against or in the favour of the SOEs. The hierarchical structure and the legal status of manpower were examined to illustrate if there was any excess or shortage manpower. As results, 14,415 employees from 69 firms were laid off. To adjust the excess manpower, the government restored a variety of adjustment options, including transfer of 8,722 displaced employees to other sectors, early retirement benefits for 26 displaced employees, voluntary departure for 67 displaced employees, and self-employment program for 766 displaced employees through assisting them to obtain investment loans. All items of assets, ongoing investments, bank credit, cash flow, and debit account were investigated. All prior obligations include taxes, customs duties, unpaid salaries, bank loans and facilities were evaluated to be settled. It included the studying of costs, prices, marketing, ability to create jobs, the profitability for the last three years and the expected profits were examined. All machines and utilities were examined to determine their conditions, validity rate, current and actual capacity. During this stage, to encourage private investors, the government issued many resolutions e.g. free of tax and customs duties for period of five years, e.g. free of tax and customs duties for period of five years, and high possibility of obtaining business loan.

P.3: To obtain a fair value of the SOEs and decide their price for privatisation, book value, revised book value, exchange value and the current value of the net cash flows were evaluated. The Libyan government is officially in favour of management buy-outs to ensure the participation of the management in transactions as buyers of the SOEs. The second preferred method is public share offerings in a complementary not substitution manner.

P.4: investigated privatised firms were purchased by their employees, except for the furniture firm which was purchased by employees and citizens. No senior manager was replaced, instead they were re-elected again based on their experience, except for those who were not interested in buying shares. This is, perhaps, because the firms were purchased by their managers who were not willing to lose their positions. Most of senior managers felt powerless and unimportant because their subordinates owned a large fraction of the equity and had sufficient power to negotiate. In this respect, it is very interesting to note that most of the senior managers preferred to work under state ownership because they have more power and status. However, both managers and workers have strong incentives to maximise profits because they became owners and have rights to participate in the decision making, their salaries also were linked to performance changes. Reducing the size of hierarchy has been the most relevant internal structural adjustment following privatisation to reduce the administrative costs and ensure faster decision-making. The hierarchy was flattened through combining a number of departments and units. As expected, from all firms, labour was reduced from total of 1,146 to 592 employees. Management argue that their firms were not restructured effectively before privatisation because the firms are still equipped with old and obsolete machinery. The firms were also given a high price which does not reflect the real value of the firms. The owners are unable to upgrade the machinery due to their financial inability. Some managers of Al sendian and the food firms argue that trade openness increases the opportunities to obtain financial support through participation of foreign investors and therefore positively affect the firms. Other managers of confectionery and metal cans firms argue that trade openness led to easy access of less-price and quality productions which in turn create imperfect competition and negatively affect their firms’ performance. A third group of managers of sardine and aluminium firms argue that the weak enforcement of law, not trade openness which led to easy access of less price and quality productions to the country.

P.5: There was very limited performance data available from all firms. This refers to that data of sardine and confectionery firms are combined with other firms that are not included in this paper. Data from aluminium and agriculture equipments firms is missing. Data from baby food and cans’ firms are not yet completed. Therefore, this paper is unable to measure the performance changes. To address the unavailability of financial data, the paper focuses on perceptions of the key informants about the performance change. This is because the paper was concerned with developing a conceptual model rather than testing theory. Based on perceptions of the key informants, there was no improvement in the performance of firm, even confectionery and perfume firms went bankrupt. Aluminium and metals firms have shifted their business field. This attributed to restructurings prior to privatisation whereas the firms are still equipped with old and obsolete machinery. Another factor that has contributed to no performance improvement is the financial inability of new owners to invest and upgrade the machinery. Perhaps trade openness and the weak enforcement of law have contributed to no performance improvement of these firms. The method of privatisation also is partly responsible for the no performance improvement because the manager was motivated to keep their positions.

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Conclusion

Based on the findings of a pilot study of 13 Libyan industrial firms that were privatised during 2004. This paper developed a conceptual privatisation model to be applied again for real in-depth case study. The initiation of privatisation, in the developed model, considers the performance of the SOEs obtained from official survey that was carried out by the Libyan government. The first stage is the feasibility study which was undertaken to determine which SOEs are likely to be privatised. The selection of SOEs for privatisation is influenced by three factors: the importance for the economic development, financial, and technical positions of SOE. The second stage is study and examination of the legal, administrative, financial, economic, technical status, and any other regulations. The third stage focus on the book value, revised book value, exchange value, and the current value of the net cash flows of the SOEs which has been used as methods to obtain fair price for the SOEs. The fourth stage is the decision of sale. The privatisation objectives that were set by the Libyan government are considered as factor that influences the decision of privatisation. The fifth stage of the model is newly privatised firms as an intermediate outcome of the privatisation. Initially the managerial incentives, behaviour, and relationships have been changed after privatisation. The most influential factors on newly privatised firms are the financial inability of the new owners and restructuring prior to privatisation. The performance of the privatised firms is considered as the final outcome of privatisation. The firm performance is measured by focusing on qualitative data because of unavailability of quantitative data. Based on qualitative data provided by key informants, there seem to be no performance improvement after privatisation in any of the firms. This attributed to the way in which the firms were privatised whereas they still equipped by old machinery and suffering from external debt on one hand. On the other hand, the new owners are less-empowered to invest in new machines due to their financial inability. Imperfect competition which resulted from easy access of low-price machines due to their financial inability. Imperfect competition which resulted from easy access of low-price and quality of production is responsible for no performance improvement. This means that the failure to implement all required steps of the privatisation process, as found in the literature and stated in the model, leads to a waste of effort and lack of progress in economic development.

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Privatisation and entrepreneurial transformation: emerging
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A survey was undertaken among 70 Turkish companies. It focused on the following areas of inquiry: a) the effects of CU on Turkish trade, b) the effects of CU on individual firms, and c) the effects of CU on foreign direct investment. The survey results indicated that Customs Union contributed to the growth of Turkish firms in the way of creating increased competition, product quality improvements, better market access, and technology transfer. Research evaluations were discussed and some conclusions were drawn.

Introduction

Turkish Customs Union with Europe has widely been discussed in the current literature. Opponents of the CU maintained that the Turkish economy would not adopt itself very well to new and highly competitive environment of Europe. Proponents of the CU, on the other hand, maintained that the entrance to Customs Union will be very beneficial for the Turkish economy as it will create growth and prosperity for the fast developing Turkish economy.

Turkey has had a long history to become a member of the European Union. In order to become a full member of the EU, there are many criteria to meet. One of them is forging a Customs Union with Europe which is the economic mainstay of EU integration. Turkey signed Customs Union agreement in 1963 named Ankara agreement. The aim of this agreement was to prepare Turkey for a full Customs Union membership. The ultimate aim after Customs Union is to attain full membership to EU. Turkey’s ultimate full membership goal has three steps.

Preparation Stage (1964-1969): during this period of time, EU members decreased custom duties for some products like cotton and fig which increased Turkish exports substantially.

Transitory Stage (1973-1996): Transitory stage which lasted 22 years, during which essential measures were put into force toward trade liberalization and great reliance on market forces, and both parties decided that conditions were fulfilled for the establishment of the customs union. In this process, EU decreased custom duties of industrial products to zero except olive oil, sugar, sauce and some other goods. After 1971, Turkish industrial goods entered into EU countries without any custom duties.

Final Stage: By the Association Council Decision of March 1995, the Customs Union came into force on January 1st, 1996. This final stage was the most important step for the modernization of Turkish Economy and its integration into the world trade system. The main idea of Custom Union is that industrial goods move freely between the EU and Turkey without being subjected to customs duties or quantity restrictions. With the entry into the Custom Union, Turkey eliminated all custom duties and charges having equivalent effect as well as quantity restrictions applied on imports of industrial products from the community. For products imported into Turkey from the third countries, Turkey started to apply the rates of protection specified in the communities established custom tariffs, except for those products classified sensitive. On January 1st, 2001, custom duties on sensitive products were eliminated.
Literature Review

Customs union (CU) is the subject of economists for 50 years. Economic integration did not become a separate subject in economic theory until Viner (1950) published his pioneering work. After that until 1965 economic integration (EI) had 2 different periods (Krauss 1972). In the first period, impact of CU was investigated on production and consumption and trade flows (Meade 1955, Lipsey 1957). According to Lipsey (1960), there are five possible sources of welfare gains or losses from forming CU: 1) Specialization according to comparative advantage, 2) Economies of scale, 3) Change in terms of trade 4) Change in efficiency due to foreign competition, 5) Change in economic growth. In the second period after the 1960’s, economists started to ask themselves what are the real objectives of those trying to enter into an integration scheme. Economists had reached to a conclusion that a priori any agreement for the regional liberalization of trade must not be necessarily positive from a normative viewpoint, even for the partners themselves. Lipsey (1957) and others asserted that some trade-diverting customs union would be beneficial for its members. Work by Johnson (1965), Cooper and Massell (1965) and later Berglas (1979) were the most significant in this respect.

In the 1980s the scale economies argument had been progressively linked to new models of international trade under imperfect competition, drawing abundantly from industrial economists (Krugman 1979, Ethier and Horn 1984, Helpman and Krugman 1985, Smith and Venables 1988, Krugman 1991). The interesting question was to know if customs union creation is a substitute or a complement to competition policy. It used to be thought that trade liberalization could replace competition policy insofar as local monopolies would be kept in check by international competition. The argument is back in fashion in connection with the expected benefits of completing the EC's internal market (Smith and Venables 1988).

In recent years, the impacts of Customs Union on the foreign trade of Turkey are analyzed and the existence of these impacts are searched by using econometric methods. When looking over the foreign trade statistics between Turkey and the European Union, It is clear that, both Turkey exports to European Union and imports from European Union are in increase after the Customs Union was established. But the growth of imports is bigger than the growth of exports. This condition creates a negative balance of payments. Customs Union does not create a trade deviation from Turkey to European Union (Seki, 2005). As well, Utkulu and Seymen (2004) confirm that distortions are at reasonably minimal levels. Due to the implementation of the CU with the EU, there exists no tariffs and quotas on industrial commodities between Turkey and the EU. The former one however increases its comparative advantage in the world market while decreases in the EU market which presumably caused by the CU.

Since 1971, the EU had already abolished its tariffs for imports from Turkey, the Customs Union did not bring about a significant liberalization for Turkey’s exports to the EU. On the contrary, Turkey's gradual elimination of tariffs against EU caused slight increases on EU imports to Turkey. But as it can be seen from the secondary data, changes in import figures were not as drastic as expected. The customs union constitutes a very important step towards Turkey's full integration with the EU (Sertoglu and Ozturk, 2003).

According to (Ulgen and Zahariadis, 2004) owing to the EU-Turkish Customs Union, there is already a considerable degree of convergence between Turkey and the EU in the area of trade. In fact, Turkey is the only candidate country that has a customs union with the EU. At least with respect to the trade in goods, Turkey is almost part of the Single Market. The challenge of enhancing the present state of trade integration could be approached in two ways. First, the customs union could be deepened by refining the arrangements and addressing its shortcomings.
Secondly, the degree of trade integration could be enhanced by incorporating areas such as services and agriculture — thus widening the customs union. (Neyapti, Taskin, and Ungor, 2005) observed that the income elasticity of both exports and imports are lower for the EU countries, and especially in the CU period. The effect of the RER on Turkey’s exports is stronger for the CU period, though not earlier. For imports, just the reverse is observed: real appreciation of Turkish Lira has had a positive impact on imports especially from the EU countries, though not in the CU period. The amplified effect on imports of the RER for the EU country group probably captures the increased imports during the periods of largely overvalued Turkish Lira, especially in 1993 and 2000 periods. In addition, they observe that countries with higher political instability and better governance have had more trade with Turkey than others. According to them customs union agreement has contributed to the increased volume of trade between Turkey and the EU. In addition, income effect on trade has decreased over the CU period. However, Turkish exports to the EU have become more responsive to the real exchange rate misalignments during the CU period, though not imports. This implies that periods of overvalued Turkish Lira have come to carry a greater destabilizing risk for Turkish trade with the EU for it leads to a larger fall in exports than before. Ercakir (2005) stated that becoming a member of CU effected Turkish producer to improve quality of their products because of high competition in Europe. (Mercenier and Yeldan 1997) found that Turkish economy was likely to suffer welfare losses from CU. In contrast Harrison et al (1997) explained positive welfare gains from CU. (Astrid-Marina Lohmann) examined Turkey’s intra-industry trade with the EU in the 1990s. Toksoz (1996) found that customs union will give a major boost to EU exports to Turkey as tariffs are reduced on thousands of industrial products. Togan(2000) explained liberalization of trade in industrial commodities and agricultural commodities after the customs union with the EU.

**Study Methodology**

The study was conducted among 70 Turkish firms from Istanbul, Denizli, Ankara, and Samsun, during March and April of 2005. Respondents were selected by use of convenience sampling. 150 questionnaires were distributed and 70 of them were returned and this created a response rate of 47%. The response rate was reasonable. A "drop-off, pick-up" method of survey administration was found very suitable for the purpose of this study and it was adopted. Before the survey administration, a pre-test of the questionnaire was conducted with a small group of respondents, and the results were satisfactory. The questionnaires were administered to company owners or representatives of the firms who have maintained trade relations with EU countries.

Data were collected by means of self-administered questionnaires, each lasting for approximately 15 minutes. The questionnaire was first developed in English and then translated into Turkish. A business professor and a Turkish language professor who are fluent in both English and Turkish checked the Turkish translation. Finally, Turkish translations of the questionnaire were re-translated back into English by four students in order to ascertain that it was conveying the exact meaning as originally designed. Surveys were based on a questionnaire consisting of two parts: the first part consisted of a series of questions focusing on the effects of CU on Turkish trade; and the second part comprised questions about the effects of CU on the performance of Turkish businesses. A special effort was made to keep the questionnaire as simple as possible in terms of structure, wording, and scaling. A five-point Likert scale was used to measure attitudes of Turkish company managers toward custom union.

**Discussions**

Respondents answers to the survey questions, in most cases, depended on how they are affected by Turkish – EU customs union agreement. If the respondents perceived more benefits than losses,
they indicated that CU has a positive impact on Turkish trade. On the other hand, if the respondents anticipate more loss than gain, they indicated that CU with the European Union will have a negative effect on Turkish trade.

Survey results indicated that Turkish managers perceive a substantial number of obstacles with the EU – Turkey customs union. Some of them are: a) small scale Turkish enterprises will be effected because of their low technology level and lack of managerial knowledge and skills, b) Turkish imports from third countries will decrease, c) Turkish firms will be effected by high level competition from European companies, d) Turkish firms’ profitability will decrease, e) EU governments’ support for their producers will influence Turkish producers in a negative way, and f) with the customs union, labor costs in Turkey will increase- hence one of the strategic advantage of Turkish producers will disappear.

Table 1: Turkish Company Managers’ Attitude toward Customs Union

<table>
<thead>
<tr>
<th>Factors</th>
<th>Mean Scores</th>
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<tbody>
<tr>
<td>Labor cost in Turkey increased, and one of the advantages of Turkish producers disappeared after CU</td>
<td>2.94</td>
</tr>
<tr>
<td>Turkey became a center for those EU firms which would like to move products to central Asia, Black Sea Region and Middle East.</td>
<td>2.93</td>
</tr>
<tr>
<td>The benefits of firms increased after CU</td>
<td>2.91</td>
</tr>
<tr>
<td>CU weakens Turkish firm’s competitiveness</td>
<td>2.84</td>
</tr>
<tr>
<td>Access to the EU market will bring huge trade opportunities to Turkish producers</td>
<td>2.71</td>
</tr>
<tr>
<td>Foreign direct investment increased after CU</td>
<td>2.69</td>
</tr>
<tr>
<td>Small enterprises are affected because of low technology and lack of knowledge</td>
<td>2.67</td>
</tr>
<tr>
<td>Custom Union agreement created more trade opportunities between European Union and Turkey</td>
<td>2.64</td>
</tr>
<tr>
<td>Turkey’s infrastructure developed by financial cooperation and also increased cooperation between EU and Turkish firms through joint programs.</td>
<td>2.64</td>
</tr>
<tr>
<td>Custom Union is a big lie</td>
<td>2.63</td>
</tr>
<tr>
<td>EU’s support for its producers influences Turkish producers in negative ways</td>
<td>2.53</td>
</tr>
<tr>
<td>After Custom Union agreement the competitiveness and quality of Turkish products increased</td>
<td>2.36</td>
</tr>
<tr>
<td>Becoming member of CU before Full membership was a big mistake</td>
<td>2.31</td>
</tr>
<tr>
<td>CU will provide more positive effects after full membership of Turkey</td>
<td>2.21</td>
</tr>
<tr>
<td><strong>Overall Average</strong></td>
<td><strong>2.07</strong></td>
</tr>
</tbody>
</table>

Mean scores are based on a five-point scale ranging from 1= Strongly agree to 5= Strongly disagree.

Table 1 displays the results of mean scores for each environmental impact statements used in the study. The statements in Table 1 have been arranged in order of the magnitude of the mean score. The highest mean score (2.94) was for the statement that labor cost in Turkey increased, as this statement shows us that firms were suffered from increased labor cost. This supports the argument that CU will effect small and medium enterprises (SME) in a negative way. Another statement indicates that certain competitive advantages of Turkish producers have disappeared after CU. Turkish firms’ competitiveness was weakened after entry into CU with the European Union (2.84). Many SME’s collapsed after the signing of this agreement. The
representatives of the firms think that Turkey became a hub for those EU firms which would like to move their products to central Asia, Black Sea Region and the Middle East (2.93).

It is found that the benefits obtained by Turkish firms increased after CU (2.91) and access to the EU market will bring huge trade opportunities to Turkish producers (2.71). Many European firms entered into Turkish market after CU. In most cases, Turkish firms signed trade agreements with them and increased the quantity of the product exports. European foreign direct investment in Turkey increased after CU (2.69). Foreign firms came to Turkey to invest more after the CU agreement signed. For instance in 1995, EU’s share of Turkish foreign direct investment (FDI) was 63%; in 1996, it increased to 85.3%; and in 1997, to 61%. There was a sharp decrease in 2002 which was the result of 2001 economic crises in Turkey.

As well, some respondents disagreed that CU will have more positive effects after full membership of Turkey (2.21). This statement is one of the most interesting results. There is a belief that CU is a big step in the right direction for Turkey to become a full member of EU. Respondents mainly from small and medium sized enterprises stated that becoming a member of the CU before full membership was a big mistake (2.31). Owners of firms argued that Turkey must accept the rules accepted by the EU member countries which will be applied to Turkey to which Turkey did not make any contribution while those decision criteria were established by member states during the formative years.

On the positive side, Turkish company managers conceded to the fact that access to the EU market will bring huge trade opportunities to Turkish producers (2.71). As Turkish firms increased the quality of the products they manufacture, created increased demand for their products in many European countries. In order to meet EU’s standards, many Turkish firms renewed themselves. Certain sectors have become more popular and started to produce high quality products and the bulk of their production is destined for Europe. Among all, automotive sector showed a sharp production increase. The production of color television increased from 1.8 million to 8.8 millions of items between 1996-2000. Textile and ready made clothes sector in 1998 had a 19% share and it increased to 39% in total exports of Turkey. As a direct result of CU, input costs decreased in electronics industry. As a result, production in this industry had increased by 14%, and exports by 38% (from $500 million to $1.2-1.3 billion) between the years of 1996-2000. Between 1995-2000, the production of refrigerator had increased from 1.7 millions to 2 millions units, washing machine from 866,000 to 1.3 millions, vacuum cleaner from 879,000 to 1.2 millions, automobiles from 222,000 to 306,000, and buses from 12,000 to 47,000.

Factor analysis produces hypothetical constructs, called factors, which represent sets of variables (Harman, 1967). The principal component method of factor analysis was used with a varimax rotation. The resultant Varimax rotation factors are given in Table 2. The first factor in Table 2 consists of: “EU’s support for its producers influences Turkish producers in negative ways (.749)”, “CU weakens Turkish firm’s competitiveness (.713)”, “small enterprises are influenced because of low technology and lack of knowledge (.604)”. The second factor consists of “Customs Union agreement created more trade opportunities between European Union and Turkey (.829)” and “After Customs Union agreement the competitiveness and quality of products increased (.806)”, “The benefits of firms increased after CU (.542), and “CU will have more positive affects after full membership of Turkey (501). The third factor delineates a cluster of “Access to the EU market will bring huge trade opportunities to Turkish producers (.784), “Foreign direct investment increased after CU (.705), “Turkey became a center for those EU firms which would like to move products to central Asia, Black Sea Region and Middle East (.623)”.

299
Table 2 Factor Analysis of Turkish Company Managers

<table>
<thead>
<tr>
<th>Factors</th>
<th>Factor Loadings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
</tr>
<tr>
<td><strong>Factor 1: Pessimistic approach to Custom Union</strong></td>
<td></td>
</tr>
<tr>
<td>EU’s support for its producers influences Turkish producers in a negative way</td>
<td>.749</td>
</tr>
<tr>
<td>CU weakens Turkish firm’s competitiveness</td>
<td>.713</td>
</tr>
<tr>
<td>Small enterprises are effected because of low technology and lack of knowledge</td>
<td>.604</td>
</tr>
<tr>
<td>Custom Union is a big lie</td>
<td>.602</td>
</tr>
<tr>
<td>Becoming a member of CU before Full membership was a big mistake</td>
<td>.576</td>
</tr>
<tr>
<td><strong>Factor 2: Optimistic approach to Customs Union</strong></td>
<td></td>
</tr>
<tr>
<td>Custom Union agreement created more trade opportunities between European Union and Turkey</td>
<td>.083</td>
</tr>
<tr>
<td>After Custom Union agreement the competitiveness and quality of products increased</td>
<td>-.140</td>
</tr>
<tr>
<td>The benefits of firms increased after CU</td>
<td>.342</td>
</tr>
<tr>
<td>CU will have more positive effects after full membership of Turkey</td>
<td>.141</td>
</tr>
<tr>
<td><strong>Factor 3: Opportunistic approach to Custom Union</strong></td>
<td></td>
</tr>
<tr>
<td>Access to the EU market will bring huge trade opportunities to Turkish producers,</td>
<td>-.008</td>
</tr>
<tr>
<td>Foreign direct investment increased after CU</td>
<td>-.198</td>
</tr>
<tr>
<td>Turkey became a center for EU firms which would like to move products to central Asia, Black Sea Region and Middle East.</td>
<td>.193</td>
</tr>
<tr>
<td><strong>Factor 4: Cooperation seekers</strong></td>
<td></td>
</tr>
<tr>
<td>Turkey’s infrastructure developed by financial cooperation and also increased cooperation between EU and Turkish firms through joint programs.</td>
<td>-.043</td>
</tr>
<tr>
<td>Labor cost in Turkey increased, and one of the advantage of Turkish producers disappeared after CU</td>
<td>.030</td>
</tr>
</tbody>
</table>

**Note:** Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.

The fourth factor delineates a cluster of “Turkey’s infrastructure developed by financial cooperation and also increased cooperation between EU and Turkish firms through joint programs. (.765)”, “Labor cost in Turkey increased, and one of the advantage of Turkish producers disappeared after CU (.521).
Table 3. Factor Analysis Results: Attitudes toward Customs Union

<table>
<thead>
<tr>
<th>Factors</th>
<th>Eigenvalues</th>
<th>% of Variance</th>
<th>Cumulative variance%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Factor 1: Pessimistic approach to Custom Union</td>
<td>2.372</td>
<td>16.944</td>
<td>16.944</td>
</tr>
<tr>
<td>Factor 2: Optimistic approach to Customs Union</td>
<td>2.086</td>
<td>14.901</td>
<td>31.845</td>
</tr>
<tr>
<td>Factor 3: Opportunistic approach to Custom Union</td>
<td>1.998</td>
<td>14.271</td>
<td>46.116</td>
</tr>
<tr>
<td>Factor 4: Cooperation seekers</td>
<td>1.503</td>
<td>10.735</td>
<td>56.851</td>
</tr>
</tbody>
</table>

Notes: *Rotation Sums of Squared Loadings of Total Variance Explained

Reliability Analysis

Cronbach's coefficient alpha was used in this study to assess the reliability of the measures. Nunnally (1976) suggests a reliability coefficient of 0.60 or larger as a basis for acceptance of the measure. A Cronbach alpha coefficient of 1 would indicate perfect uni-dimensionality within a scale. When Cronbach alpha was computed for all the 14 scale items, it was found to be 0.653. This indicated the possibility that the entire scale was uni-dimensional. It can be considered a reasonably high reliability coefficient. Based on this, it can be assumed that all 14 items used are measuring the same construct (Attitudes toward Customs Union) and, therefore, a summative measure can be used to represent the attitudes toward customs union score of the respondents (see Table 4).

Table 4. Reliability Analysis

<table>
<thead>
<tr>
<th></th>
<th>Cronbach's Alpha</th>
<th>N of Items</th>
</tr>
</thead>
<tbody>
<tr>
<td>All</td>
<td>.653</td>
<td>14</td>
</tr>
<tr>
<td>Factor 1</td>
<td>.721</td>
<td>5</td>
</tr>
<tr>
<td>Factor 2</td>
<td>.637</td>
<td>4</td>
</tr>
<tr>
<td>Factor 3</td>
<td>.620</td>
<td>3</td>
</tr>
<tr>
<td>Factor 4</td>
<td>.348</td>
<td>2</td>
</tr>
</tbody>
</table>

Factor 1 consists of five items with internal consistency reliability of 0.721; factor 2 had four items and reliability of 0.637; factor 3 consists of three items with reliability of 0.620, and factor 4 consists of two items with reliability of 0.348. Even though reliability of factor 4 is relatively low, the factor coefficients of the items are highly polarized.

As the survey conducted among 70 company respondents, 53 % (37 firms) owner or representative answered that their trade volume increased after CU, but 47% (33 firms) disagreed. This result implies that more firms increased their export to European Counties after Customs Union agreement. Furthermore, 51% (35 firms) of owners or representatives of the firms answered that import increased after CU, but 49% (29 firms) disagreed. It can be concluded that import increased after CU agreement. As a result of these two graphs, it can be concluded that trade volume between Turkey and EU increased after CU.

One of the main problems of entering CU is the effect of the agreement on small and medium-sized enterprises. It is believed that the agreement has effected these kinds of firms substantially. In order to support these firms, EU grants them with funds to cover some of their trade-related expenses. Survey results indicated that 23% (16 firms) received financial/compensation after Turkey signing a CU agreement with the European Union and 77%
(49 firms) did not receive any financial assistance or funds.

Conclusions

EU-Turkey relationship has been an important subject matter of the EU member countries for many years. A substantial amount of research has been conducted to understand the importance of EU membership for Turkey as well as the benefits of Turkey joining the EU for 27 member state. As the EU membership is the final aim of Turkey, the country must comply with the strict economic and political requirements of the EU. In this endeavor, customs union was one of the most criteria among the requirements for full membership with the European Union.

In the research conducted, it is observed that 16% of respondents are pessimistic toward customs union. The respondents who approach to customs union in an optimistic manner accounted by 14%. The ones who take an opportunistic approach to customs union is 14% and cooperation seekers are 10%. In the light of these survey results, we can conclude that Turkish firms, in general, are eager to support Turkish customs union membership. Some respondents also maintained that becoming a member of CU before full membership was a big mistake. A lot more needs to be done in the future to overcome the negative feelings prevailing both among Turkish company managers and the public as well as within the European Union member countries. This study concluded that Turkish business leaders portray positive attitudes toward customs union, even though some of them lose money in their trading relationship with the EU member countries. But, they look to the future with much anticipation and they are in the opinion that a full EU member Turkey will create tremendous growth opportunities for them.

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Assessment of the Lebanese Real Estate Market: A Content Analysis Approach

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Karim Ghasham, Lebanese American University, Lebanon
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The purpose of this study is to assess the real estate market in Lebanon. The study was conducted by a group of MBA students at the Lebanese American University. A content analysis of the classified advertisements of the Lebanese Real Estate was conducted. Results identified four major elements that affect the Lebanese Real Estate market: Advertisements ($R^2=0.79$), Season of the advertisements ($R^2=0.74$), Location of the advertisement ($R^2=0.59$), and Area of the advertisement ($R^2=0.09$). The variable, advertisements, was most affected by the other variables. A recursive system test was conducted to show the relationship between advertisements, and the rest of the variables. ($P_{43}=0.63$)

Introduction

The purpose of this research is to report about the real estate market in Lebanon. Lebanon has been experiencing severe political instability for the past couple of years. The instability has reached a dead-end political situation, an economic stagnation, a disastrous touristic season (Ramco Real Estate). It all began with the assassination of late prime minister Rafic Al-Hariri. The instability was followed by a war in July 2006, inter community violence, strikes, and sit-ins. Similarly, a war struck out between the Lebanese army and Fateh Al Islam, a terrorist group in Nahr El Bared took place in the summer of 2007. Such a situation has not only lead tourists to avoid Lebanon, but has also pushed the Lebanese themselves to escape and leave the country in search of safety and better quality of life. Most departing Lebanese have gone to Europe, the U.K. or the oil rich regions of the Middle East. The exodus of the highly skilled Lebanese became a positive aspect when it came to investments or real estate. (Batbiche, H., 2006)

Currently, the real-estate market in Lebanon is a mature sector that is barely affected by the political situation occurring in the country. “The market has seen resumption in real estate sales transactions in Beirut at the same prices negotiated before July war. This indicates that despite the long term effects of the war, confidence investor’s in the local real estate has not shaken.” said Raja Mokarem of Ramco Real Estate Brokers and Consultant to Lebanese Opportunities, a local investment journal. Some brokers still have confidence in the Lebanese real-estate market and feel that the rich Gulf Arab investors and the Lebanese working and living abroad will continue to upwardly drive market prices.

There is a growing demand for real estate in Lebanon. Most investments are taking place in land, residential and/or commercial developments, which became a major reason for the price increase. Since the assassination of Rafic Al-Hariri and up to present time, apartment prices have gone up by an average of 20-30%, and it has become increasingly difficult to find a new apartment in Beirut even for the price of $200,000 while some years ago, such an amount would have been enough for a middle class couple to purchase a decent flat. Today, however, this same couple must pay about $400,000-$800,000 to purchase the same apartment. Moreover, land prices have doubled where the land price at the sea front has increased from $3,000/m2 to $4,000/m2. While some buyers are looking to snatch up properties at bargain prices, few sellers are willing to lower their prices even though brokers advice a 10% reduction in the asking price in order to increase sales. (Raja Makarem, 2007)

A major reason behind the growth in the real estate sector is the increased interest shown by the Lebanese expatriates and investors from the oil rich Arab countries. According to Lebanese Opportunities in 2005, the government issued 7,499 construction permits, compared to 7,232 permits in 2003, resulting in a 5% increase. According to Nabil Sawabini, chairman and CEO of Mena
Capital, the annual real estate transactions have increased in value by 88% from 2001 to 2005. In addition to high interest of the Gulf nationals in the real estate in Lebanon, the increasing wealth of the Lebanese expatriates has a great impact on the real estate market. Moreover, Lebanon’s climate attracts Gulf nationals to buy second summer homes in the Lebanese mountains. Lebanese living abroad are also looking to buy homes in their villages and/or second homes in the city of Beirut.

According to Lebanon Opportunities (2006), of the 160 new building permits for private residence in Mount Lebanon, only 95 permits are for Gulf investors. Almost 72% of land purchases were in Mount Lebanon, mainly Baabda, Aley and Metn, and 95% of these purchases were made by Gulf investors. The amount of these investors has definitely decreased. Yet, Gulf buyers have always been a major source of demand for Lebanon's property. Clearly they are the main source of demand for large-size apartments (500-1500 m2) which is available at a price between $2 and $10 million. These clients are generally buying luxury seafront units. (Dana Chatila, 2006)

The number of Lebanese expatriates’ has been growing fast in the last few years. Their incomes and buying power have also increased significantly as the Gulf region entered into a global boom. There are, however, two categories of expatriates. The first category is the upper segment which may come to the market with a budget of one million USD, and is willing to buy at 2000-2500 USD per m2 in newly developed buildings. However, the mainstay of expatriate market is the category of salaried couples seeking apartments of 200-300 m2 with a budget of up to 500,000 USD. (Raja Makarem, 2007)

Moreover, local buyers remain a very important segment of the market. They generally consist of couples with children seeking apartments priced at 150,000-250,000 USD with sizes between 150 and 200 m2. This category is learning to limit their expectations regarding features such as view or calmness as they realize how difficult it has become to maintain a foothold in fast appreciating Beirut. In other words, such people want to be in Beirut, but they know very well that, with their budget, they have more limited choices.

To assess the real estate market in Lebanon, one must provide an overview of the business environment surrounding the topic. Since Lebanon has a market-based economy, we must have an understanding of Lebanon’s economy along the past years, up to our current situation.

**Literature Review**

**Lebanese Real-estate market**

As 2000 unfolds, all predictions for the Lebanese real estate market have been positive and upward. As indicated by surveys and interviews with leading authorities, investments in real estate are becoming closer to the peak of the investment cycle. Investment in real estate is not only growing, but also becoming much more diverse. Real estate markets now provide less risk, higher return, better supply/demand balance, and improved development prospects. (Badih Abu Abdallah, 2007)

**Real Estate in U.S.A., Europe, and Australia**

Concerning America's housing market, the past year has witnessed the largest slowdown in growth rate since 1975. The average price of a house went up by only 1.2% in the second quarter, the smallest gain since 1999. Average prices were still up by 10.1% since previous year. The number of unsold homes is likely to bring down prices. The housing futures contract traded on the Chicago Mercantile Exchange predicts a 5% decrease in the following year. European housing markets, especially Belgium, Denmark, France, Ireland, and Sweden, are now on top of the league. A noticeable change is arising as the German market now starts to wake up after more than a decade of declining prices.

Several economists have suggested that Australia and Britain are “the canaries in the coal mine”, giving out early warnings to America's real estate fate. In both countries, the annual growth rate in real estate, especially house prices, dropped down from 20% in 2003 to zero in the summer of 2006. However, house prices in both countries, now referred to as the "canaries", have started to rise again. Over the past year, Australia’s average prices have improved by 6.4%. This is partially due to a 35% increase in Perth, a company in Australia, at the expense of the commodity boom. Similarly, British home prices have witnessed an average increase of 6.6% than the previous year. It is thus claimed that housing markets in Australia and Britain have had a soft landing.

The impact of home prices' flattening is considered to be tougher on the Americans than on the British and the Australians. America's saving rate has sunk, while consumer spending has pitched as homeowners borrow against their capital gains, enhancing the impact on consumers. Britain's saving rate fell down more humbly, so that as prices flattened, the effect on consumer spending was less profound than that of the United States. In Australia, the slowdown in housing made a big dent in construction and consumer spending. However, it was veiled by the commodity boom and exports to China. The risk lies in the fact that the flattening of U.S. home prices could prove much more painful than it has ever been in Australia or Britain.

**Real Estate in the Middle East**

The governments in the Gulf are heavily focusing their interests on real estate projects. Entire Cities are being developed and large projects are to be done. And example
is the King Abdullah City will cost $26 billion and will be comprised of 592 million square feet of Greenfield will stretch 22 miles along Saudi Arabia’s western coastline. Another development is the $15 billion Blue City in Oman, which has been designed to accommodate 2 million tourists each year along with 250,000 permanent residents; other projects are the New Town and the Industrial Projects in Bahrain, which cost more than $2.2 billion and are being constructed on reclaimed land; not to mention Qatar’s $5 billion Lusail development, which will hold 200,000 inhabitants. Moreover, Kuwait is considering a new project: a 1,001-meter-tall Mubarak al-Kabir Tower. (Natalie Visele, 2007). We still haven’t mentioned the most outstanding country in the Gulf concerning real estate, Dubai, with projects valued at $200 billion. Dubai has four major projects that have been popular all around the world and have attracted the richest, most famous and powerful men in the world. The $9.5 billion land theme park is to be completed in 2010. Regarding the World and Palm Islands developments, these two land reclamation projects including hundreds of islands, will extend the United Arab Emirates’ beachfront by more than 160%. They are being developed by a variety of real estate consortia to construct a mixture of exclusive residential, leisure and commercial developments. The half-mile high Dubai Burj comes at the top of the list and is expected to be the world’s tallest and largest building. For it will contain a hotel, luxury apartments and a 12 million square feet shopping mall. Real estate is not far from the hotel development of tourist infrastructure. The boom in real-estate in the Middle East has greatly aided tourism to substantially boom as well. Christian Portman, the World Bank vice-president for the MENA region, said, “With rising oil prices contributing to surging liquidity, the efficiency with which the region can manage these resources and channel them to productive uses will depend critically upon the region’s financial sectors. It is thus particularly opportune that this report highlights the state of the region’s financial systems, to understand how they are poised to meet some of the region’s development objectives.”

**Methodology**

The study was conducted by a group of MBA students at the Lebanese American University. The students conducted a content analysis study of the classified advertisements of real state in Lebanon. Information generated from the study was obtained from three major daily published Lebanese newspapers, Al-Nahar, Al-Safir, Addiyyar, and one magazine monthly published Lebanon Opportunities. Additionally, personal interviews were conducted with Mr. Rajha Makarem, owner of Ramco, a local real estate firm, and Mr. Badih Bou Abdallah, representative of Coldwell Lebanon. This study was conducted to obtain information about major trends in the real estate market in Lebanon. The study analyses the Lebanese real estate market for the period between 2001 and 2007.

**Results**

**Building the recursive system**

This procedure aims toward a complete diagnosis of the effects of each of the independent variables on the dependent variables (Advertisements) and whether this effect is a direct effect or indirect one. It is a significant way, where some variables are dependent at times and independent at other times, until we reach the final most effected dependent.

The study examined the dependency of each of the variables on the others by undergoing regression statistics to figure out which of the dependents has the highest R, R^2, and ratio of the explained variation of the dependent variable with respect to the independent variable. Accordingly, the variables were arranged from highest to lowest scores. A correlation analysis between each of the highest and lowest score was conducted. Data was categorized into four groups:

- **Group one:** consists of the count of all the terminologies that refer to advertisements of real estate.
- **Group two:** refers to the count of all the terminologies that refer to the season of the advertisements of real estate.
- **Group three:** refers to the count of all the terminologies that refer to the location of the real estate.
- **Group four:** consists of the count of all the terminologies that refer to the area of the real estate.

<table>
<thead>
<tr>
<th>Year</th>
<th>Group One</th>
<th>Group Two</th>
<th>Group Three</th>
<th>Group Four</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>207</td>
<td>130</td>
<td>132</td>
<td>120</td>
</tr>
<tr>
<td>2002</td>
<td>195</td>
<td>170</td>
<td>120</td>
<td>157</td>
</tr>
<tr>
<td>2003</td>
<td>254</td>
<td>195</td>
<td>172</td>
<td>140</td>
</tr>
<tr>
<td>2004</td>
<td>302</td>
<td>248</td>
<td>150</td>
<td>135</td>
</tr>
<tr>
<td>2005</td>
<td>280</td>
<td>230</td>
<td>170</td>
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<tr>
<td>2006</td>
<td>225</td>
<td>110</td>
<td>130</td>
<td>216</td>
</tr>
<tr>
<td>2007</td>
<td>280</td>
<td>260</td>
<td>160</td>
<td>170</td>
</tr>
</tbody>
</table>
In 2001, 207 terminologies referred to advertisement of real estate (group one), 195 in 2002, 254 in 2003, 302 in 2004, 280 in 2005, 225 in 2006 and 280 in 2007. In 2001, 130 terminologies referred to the season of the ads of real estate (group two), 132 terminologies that refer to the location of the real estate (group three) and 120 terminologies that refer to the area of the real estate (group four).

Results of the regression model in Table 2 show that the dependent variable (group one), which represents the advertisements of real estate, has deviations that are 79% explained by the deviation in the independents variable (group two, three and four).

Table 2. Regression Statistics of Group 1 (Advertisements)

<table>
<thead>
<tr>
<th>Multiple R</th>
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</tr>
</thead>
<tbody>
<tr>
<td>R Square</td>
<td>0.795559</td>
</tr>
<tr>
<td>Adjusted R Square</td>
<td>0.591117</td>
</tr>
<tr>
<td>Standard Error</td>
<td>26.120669</td>
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<tr>
<td>Observations</td>
<td>7.000000</td>
</tr>
<tr>
<td>F</td>
<td>3.891375</td>
</tr>
<tr>
<td>Significance F</td>
<td>0.146921</td>
</tr>
</tbody>
</table>

Results of the regression model in Table 3 shows that the dependent variable (group two), has deviations that are 74% explained by the deviation of the independent variables (groups one, three and four).

Table 3. Regression Statistics of Group 2 (Season)

<table>
<thead>
<tr>
<th>Multiple R</th>
<th>0.861010</th>
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<tbody>
<tr>
<td>R Square</td>
<td>0.741338</td>
</tr>
<tr>
<td>Adjusted R Square</td>
<td>0.482677</td>
</tr>
<tr>
<td>Standard Error</td>
<td>41.800087</td>
</tr>
<tr>
<td>Observations</td>
<td>7</td>
</tr>
<tr>
<td>F</td>
<td>1.465152</td>
</tr>
<tr>
<td>Significance F</td>
<td>0.380592</td>
</tr>
</tbody>
</table>

Results of the regression model in table 4 show that the dependent variable (group three) has a 59% deviations that is explained by the independent variable (groups 1, 2 and 4).

Table 4. Regression Statistics of Group 3 (Location)

<table>
<thead>
<tr>
<th>Multiple R</th>
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<tbody>
<tr>
<td>R Square</td>
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</tr>
<tr>
<td>Adjusted R Square</td>
<td>0.188691</td>
</tr>
<tr>
<td>Standard Error</td>
<td>18.646820</td>
</tr>
<tr>
<td>Observations</td>
<td>7.000000</td>
</tr>
<tr>
<td>F</td>
<td>0.110603</td>
</tr>
<tr>
<td>Significance F</td>
<td>0.948270</td>
</tr>
</tbody>
</table>
Results of the regression model in table 5 shows the dependent variable (group four), has deviations that are less than 1% explained by the deviation of the independent variables (groups one, two and three).

Table 5. Regression Statistics of Group 4  (Area)

<p>| | |</p>
<table>
<thead>
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<tbody>
<tr>
<td>Multiple R</td>
<td>0.315576</td>
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<tr>
<td>R Square</td>
<td>0.099588</td>
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<tr>
<td>Adjusted R Square</td>
<td>-0.800824</td>
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<tr>
<td>Standard Error</td>
<td>49.784880</td>
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<tr>
<td>Observations</td>
<td>7.000000</td>
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<tr>
<td>F</td>
<td>2.866054</td>
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<tr>
<td>Significance F</td>
<td>0.205106</td>
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Table 6. Correlation between the first group and the remaining Groups

<table>
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<tr>
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<th>P4</th>
<th>P1</th>
<th>P2</th>
<th>P3</th>
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<tbody>
<tr>
<td>P4</td>
<td>1</td>
<td>0.1026086050</td>
<td>0.7678409950</td>
<td>0.8444954830</td>
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<tr>
<td>P1</td>
<td>0.1026086050</td>
<td>1</td>
<td>0.0898412260</td>
<td>-0.0712724530</td>
</tr>
<tr>
<td>P2</td>
<td>0.7678409950</td>
<td>0.0898412260</td>
<td>1</td>
<td>0.6815235630</td>
</tr>
<tr>
<td>P3</td>
<td>0.8444954830</td>
<td>-0.0712724530</td>
<td>0.6815235630</td>
<td>1</td>
</tr>
</tbody>
</table>

Table 7. Represents the internal force that affect the R equation

<table>
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<th>R Inverse</th>
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<tr>
<td>1.042596</td>
<td>-0.26948</td>
</tr>
<tr>
<td>-0.26948</td>
<td>1.936974</td>
</tr>
<tr>
<td>0.257962</td>
<td>-1.3393</td>
</tr>
<tr>
<td>-1.3393</td>
<td>1.93115</td>
</tr>
<tr>
<td>P Values</td>
<td></td>
</tr>
<tr>
<td>P41</td>
<td>0.1179129270</td>
</tr>
<tr>
<td>P42</td>
<td>0.3286051790</td>
</tr>
<tr>
<td>P43</td>
<td>0.6289472550</td>
</tr>
</tbody>
</table>

Further, the highest variable scores were eliminated the same procedure was repeated twice. Then Mmult and Minverse calculations for each of the results of the correlations were applied. Internal forces P43, P42, etc. were obtained. These Forces were then used to calculate the whole set of reaction between the variables.

By applying a calculation of Minverse to get the inverse of \( R \) (table colored in blue) and then MMult (multiplying the inverse of \( r \) with \( V \) (table in blue) for each of the results in the correlations table as shown above we can get the internal forces P43, P42......that constitute the Relations between the different variables. (R43,R42,R41) R41 = P41 + P42P21 + P43P31 + P43P32P21 = 0.1026 Where 0.1179 comes from the endogenous relation and -0.0153 Comes from the exogenous relation.

R41 represents the relation between advertisements and area where we found that the effect of the area on the number of ads through the years 2000 and 2007 is not large 0.102 according to the recursive system but what is significant is that this relation comes mainly from the direct effect (endogenous relation) of the area on the # of ads.

\[
R_{42} = P_{42} + P_{41}P_{21} + P_{43}P_{32} + P_{43}P_{31}P_{21} = 0.767
\]

Where 0.3286 comes from the endogenous relations and 0.439 comes from the exogenous relations.

R42 represents the relation between advertisements and location where we found that the effect of the location on the number of ads through the years 2000 and 2007, is large 0.767 according to the recursive system but what is significant is that this relation is divided between the direct effect of the location on the # of ads 0.328 and the indirect effect 0.439.

\[
R_{43} = P_{43} + P_{41}P_{31} + P_{42}P_{32} + P_{43}P_{32}P_{21} + P_{42}P_{31}P_{21} = 0.84
\]

Where 0.6289 comes from the endogenous relations and 0.2155 comes from the exogenous relation.

R43 represents the relation between advertisements and location where we found that the effect of the location on the number of ads through the years 2000 and 2007, is large 0.844 according to the recursive system but what is significant is that this relation is divided between the direct effect of the location on the # of ads 0.628 and the indirect effect 0.2155.
Discussion

Lebanon’s marketing-based economy is driven by services, banking and tourism sectors. The banking sector in Lebanon acts as a magnet for locals and foreign investors because there are no restrictions on foreign exchange and capital movement and most importantly, bank secrecy is strictly enforced. Another aspect that nourishes tourism and creates spillover to the banking sector is the lack of restrictions concerning foreign investment. As a result, people from all around the world are allowed to own property in Lebanon and create investments which consequently make them feel at home.

The real estate sector is one of the major components of the Lebanese economy. So for the last for couple of years, real estate has been considered among the top investment priorities of all people. A discussion about the importance of real estate and its advancement over the years is presented.

RAMCO, a leader in the Lebanese real estate market with a portfolio of more than 20 million dollars composed of lands, apartments and villas distributed all over the country. Mr. Makarem said that the trend in the Lebanese market concerning the real estate has been upwardly sloping since 1994. However, this increase is negatively affected, to a great extent, by the instable political and security situation, where the continuous Israeli attacks on Lebanon severely discourage investors.

At the same time, Mr. Makarem said that the overall performance of this sector was good and that we can distinguish between the three stages the real estate sector has passed through:

- The first stage is the period following the war from 1990 till 1994. In this period, the sector started to grow little by little, people started to regain confidence in the country, and lots of them wanted to return from aboard, thus increasing the market demand and giving the green light to contactors to aggressively buy lands to build apartments and satisfy the increasing demand.

- The second stage was from 1994 to 2005, where the Prime Minister Rafic Hariri launched the plane of “Rebuilding Lebanon”. According to Mr. Makarem, this stage was considered as the golden phase of the Lebanese real estate, where huge amounts of money, particularly from Gulf investors rushing to own properties in Lebanon, were injected in this sector.

- The third stage starts from 2005, when Prime Minister Hariri was assassinated, and continues till the present time. As Mr. Raja commented, this stage is the most critical and complicated phase in the real estate life cycle, where the growth continued in spite of all the instability of the political and security situation. This growth, however, only targeted certain areas in the country such as Beirut and its suburbs. As for the future, Mr. Raja stated that the political situation is the key player for the market. Therefore, we are facing two scenarios. The first is a boom, meant to happen for the first time if the political complex is resolved. This is due to the great amounts of money, particularly from the gulf region due to increase in oil prices, waiting to be invested in the real estate sector. The other scenario is a steep decline caused by either a war or an economical break down in the country. (Raja Makarem, 2007)
The Coldwell, which is another leading real estate firm in Lebanon, represented by Mr. Badih Abu Abdallah, considers the real estate sector as one of the treasures that Lebanon possesses. It attracts investors due to the beautiful mild weather and short distances. In his opinion, the trend in the Lebanese R.E. will continue to increase in the future. Even in the worse case scenario, this increase will be, on average, around 8% per year. After all, the country has been unstable for the past 25 years and this didn’t hinder growth. The Variety of land found in Lebanon, and the limited areas are all factors supporting this sector and making it more valuable. Moreover, the demand on real estate in Beirut and its suburbs is very high and is considered as the main reason for the growth in real estate.

The prices in the real estate sector were still increasing. According to Mr. Simman, the head of the mortgage publishing in the Addiyar news paper, this was due to the intervention of e-buying, where the internet revolution has reached its peak. This had caused people to shift away from the traditional news paper ads. These major categories in real estate (lands, buildings, and Villas) were depicted as different categories in order to determine important trends and where demand is concentrated.

The reason for this discrepancy can be explained by the shift towards online advertising. It is also due to the aggressive strategies implemented by the real estate firms. According to Mr. Badih Bou abdallah, Coldwell has employed more than 100 young people to work as real estate brokers and to conduct market research through site visiting and personal interviews with buyers and sellers in order to identify the needs and opportunities away from advertising and the traditional publishing of real estate. According to Mr. Bou Abdallah, this strategy is successful since these brokers as playing the role of intermediaries between the buyer and the seller and directly matching their needs. (Badih Abu Abdallah, 2007)

**Limitations**

- We were not able to link between the increase in prices and increase in ads, so we had to interview experts and conduct research and read many article in order for us to determine the trend of prices.
- The real trend was not represented only through ads, which drew a real image till end of 2003, but after that there was a decrease in the number of ads for real estate sector, while the price were going up. So this was explained later by tracing some interviews and conducting research analysis.

**Conclusion**

By adopting the content analysis strategy and following its steps, we were able to draw out a conclusion to our topic which is reasonable matter and can be repeated again. By applying the funnel method starting from the general economy in Lebanon, then targeting real estate sector as a whole and after that determining the main components of this sector and the key factors behind its growth, in addition to main locations that the investors are seeking (Beirut). All this was achieved by tracing the ads in several sources, and by locating them into categories and sub categories using the coding process. Our findings matched our research questions where we were able to determine that the trend of real estate in Lebanon is upward and the economical and political factories didn’t severely affect this area where prices are still increasing as well as demand. Moreover, we observed the effect of seasonality on real estate which is changing from season to season, except for Beirut; where demand is approximately the same all over the year. Based on the sources we were targeting and on the interviews that we conducted no one can deny that there is, undoubtedly, some risk linked to the current situation, but we consider this as a calculated risk. Real Estate in Lebanon remains a sure value.

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1987 – 2008